

NONPROFIT GOVERNANCE POLICIES AND PROCEDURES REVISITED: TRENDS, DEVELOPMENTS, AND MORE

TEXAS SOCIETY OF CPAS
NONPROFIT ORGANIZATIONS CONFERENCE
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FORM 990 AT A GLANCE

Core Form

11 Parts

Part 1 - Summary

Part II – Signature Block

Part III - Program Service Accomplishments

Part IV – Checklist of Required Schedules

Part V – IRS Filings and Tax Compliance

Part VI – Governance, Management and Disclosure

Part VII – Compensation

Part VIII – Statement of Revenue

Part IX – Statement of Functional Expenses

Part X – Balance Sheet

Part XI – Financial Statements and Reporting

FORM 990 AT A GLANCE

16 Schedules

- Schedule A – Public Charity Status
- Schedule B – Contributors
- Schedule C – Political and Lobbying Activity
- Schedule D – Supplemental Financial Statement Detail
- Schedule E – Schools
- Schedule F – Foreign Activities
- **Schedule G – Fundraising and Gaming**
- Schedule H – Hospitals
- Schedule I – Grants
- **Schedule J – Compensation**
- Schedule K – Tax-Exempt Bonds
- **Schedule L – Transactions with Interested Persons**
- Schedule M – Non-cash Contributions
- Schedule N – Termination or Significant Disposition of Assets
- Schedule O – Supplemental Information
- Schedule R – Related Organizations and Unrelated Partnerships

THE CURRENT VERSION OF FORM 990 ASKS ABOUT THREE POLICIES

- Conflict of Interest Policy
- Whistleblower Policy
- Document Retention and Destruction Policy

See Attachment 1 for relevant pages of Form 990-Part VI

Section B covers policies (Page 6 of the Return) – organization may answer “Yes” to the “do you have a policy” questions only if the policy was in place as of the end of the filing year.

CONFLICT OF INTEREST

- Common way to violate the duty of loyalty
- Interested transactions
 - An officer or director is “interested” under state law if he:
 - makes a personal profit from the transaction with the corporation;
 - buys or sells assets of the corporation;
 - transacts business in the officer’s or director’s capacity with a second corporation of which the officer or director has a significant financial interest; or
 - transacts corporate business in the officer’s or director’s capacity with a member of his family.
 - Not inherently unethical or a violation of law
 - Note: Loans to directors are a statutory violation

CONFLICT OF INTEREST

- Interested transactions between corporate fiduciaries and their corporations are presumed to be unfair on the part of the officer or director and fraudulent on the corporation, and are thus generally voidable. *General Dynamics v. Torres*, 915 S.W.2d 45, 49 (Tex. App.—El Paso 1995, writ denied).
- However, Texas law provides a limited “safe harbor” for interested transactions if:
 - material facts are disclosed; and
 - majority of the disinterested directors
 - authorize the transaction in good faith and exercise of ordinary care.

CONFLICT OF INTEREST

- Then, the transaction is not void or voidable solely because of the director's interest or the director's participation in the meeting at which the transaction is voted on. See Texas Business Organizations Code (TBOC) § 22.230.
- Further, the transaction will not be void or voidable if it is "fair" to the corporation when it is authorized, approved or ratified by the board. See TBOC § 22.230. This is a nebulous concept and should not be relied on for planning.

DRAFTING POINTS ARISING FROM STATE LAW CONSIDERATIONS

- Draft to encourage compliance with statutory safe harbors (e.g., TBOC § 22.230).
- Coordinate policy with provisions of organizational documents.
- Draft with state laws in mind (e.g., TBOC § 22.225 (prohibiting loans to directors)).

See Attachment 2 for sample conflict of interest policy

DRAFTING POINTS ARISING FROM FEDERAL TAX LAW CONSIDERATIONS

- Tailor the policy to the specific type of nonprofit entity in question as it is classified under the Internal Revenue Code (the “Code”).
 - Not all Section 501(c)(3) charities are subject to the same rules governing COI transactions.
 - Draft to account for the difference between private foundations and public charities.
 - Draft to account for the unique rules governing supporting organizations and donor-advised funds.
 - Not all tax-exempt *non-charities* are subject to the same rules governing COI transactions.
 - Draft to account for the application of the excess benefit transactions excise tax (Code Section 4958) to tax-exempt Section 501(c)(4) entities (e.g., social welfare organizations).

CONFLICT OF INTEREST POLICY

- What if the entire board is related (i.e. a family foundation)?
- Documentation is key – be sure to document the disclosure of the conflict, careful consideration of the transaction, and the methodology used to determine that the transaction would be fair to the corporation.
- It may be advisable (although often not practical) to have the board appoint a committee of disinterested, but trusted advisors to make recommendations to the board with respect to interested transactions (such as compensation for related board members, etc.) and then follow those recommendations.
- These committees cannot have board delegated powers unless at least a majority of the committee members consist of foundation board members (thus defeating the purpose of “disinterested”).

See Attachment 3 for sample conflict of interest policy for family foundations

IS THE COMPENSATION PAID TO DISQUALIFIED PERSONS REASONABLE?

- There should be a job description, employment contract, engagement letter or other agreement which fully describes the duties, hours and responsibilities of the disqualified person.
- All types of cash and non-cash compensation, including salary, fees, bonuses, severance payments, fringe benefits and deferred compensation, must be taken into account to determine total annual compensation.
- If commission or other types of revenue sharing (incentive pay) is paid, some sort of evidence that the rate is in line with industry standards should be maintained and recorded.

IS THE REASONABLENESS OF COMPENSATION PROPERLY DOCUMENTED?

- Comparable data, i.e. surveys, offers the disqualified person received from others, availability of others for the job, opinion of consultants.
- The compensation should be approved by non-disqualified persons (non-conflicted board members), when possible.
- Written records of meeting minutes for the meeting in which the compensation arrangement was approved should be kept, along with notations of the comparability data relied on, the attendees, votes, abstentions (conflict) and any related discussions or actions.
- All compensation must be reported on Part VIII of the Foundation's Form 990-PF, including taxable and non-taxable fringe benefits.

WHISTLEBLOWER POLICY

- Form 990, Part VI - Line 13, Does the organization have a written whistleblower policy?
- A whistleblower policy:
 - encourages staff to come forward with credible information on alleged illegal practices or violations of adopted policies of the organization;
 - specifies protection from retaliation; and
 - identifies staff, board members, and/or outside parties to whom such information can be reported.

WHISTLEBLOWER POLICY

- Whistleblower protection provisions of SOX apply to nonprofit corporations
- Even if the claims are without merit, the organization may not “discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment” if the employee reports suspected fraud
- SOX makes it a crime to knowingly and intentionally retaliate against such an employee
- Criminal sanctions include, for individuals, fines up to \$250,000 and/or imprisonment of up to 10 years, and for organizations, fines up to \$500,000

DOCUMENT RETENTION AND DESTRUCTION POLICY

- Part VI, Line 14 - Does the organization have a written document retention and destruction policy?
- A document retention and destruction policy identifies the record retention responsibilities of staff, board members, and outsiders for maintaining and documenting the storage and destruction of the organization's documents and records.

DOCUMENT RETENTION AND DESTRUCTION POLICY

- A document retention and destruction policy
 - should include guidelines for handling electronic files
 - should cover backup procedures, archiving of documents, and regular check-ups of the reliability of the system.
- The document preservation provisions of SOX apply to nonprofit corporations. SOX provides criminal penalties for a person who:
 - “knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or [any federal investigation or bankruptcy case], or in relation to or contemplation of any such matter or case....”

DOCUMENT RETENTION AND DESTRUCTION POLICY

- This crime carries a maximum sentence of 20 years. The statute extends criminal liability to the destruction of documents relating to any federal investigation – even low level executive or administrative inquiries or any bankruptcy case.
- The statute applies to “contemplated” investigations, imposing potential criminal liability even where corporate officers have no actual notice of the investigation.
- SOX includes a separate offense, also punishable by up to 20 years, for any person who alters or destroys documents or records with the intent to impair their use for “official proceedings,” even before a subpoena has been issued.

DOCUMENT RETENTION POLICIES DRAFTING CONSIDERATIONS

- Include all the different types of records that should be included as “documents.”
- Be clear on what documents need to be kept and for how long AND be clear on what documents need to be destroyed and when.
- There is no uniform law on records retention and destruction. There are regulations in various industries regarding certain documentation (healthcare, etc.).
- Common law is well-established that once pending claims/litigation exists, documents relevant to the litigation are subject to a “litigation hold” and should not be destroyed.
- Policies should include where and in what medium records are maintained.

SUMMARY- 990 POLICIES

- Conflict of interest, whistleblower and document retention and destruction policies, while not legally required, are prudent steps for any charitable organization with meaningful assets and activities.
- Answering “no” to the Form 990 “do you have a _____ policy” questions is inherently less desirable than answering “Yes”:

“In the future, the IRS likely will take responses to particular Part VI questions into account when determining which organizations are most at risk of not complying with the tax law.” Stephen Clarke, IRS tax law specialist and Revised Form 990 project manager, March 23, 2010.

OTHER POLICIES



Joint Venture Policy



Expense Reimbursement Policy



990 to the Board Policy



Policy on Chapters, Affiliates, and Branches



Executive Compensation Policy



Gift Acceptance Policy



Political Activity Policy



Code of Conduct

GIFT ACCEPTANCE POLICY

- There is not a question on the 990 or 990-PF asking about a gift acceptance policy, but it is good practice to have one. See Attachment 7 – Sample Gift Acceptance Policy
- Other gift acceptance policies available online:
 - Foundation Center:
<http://www.foundationcenter.org/getstarted/faqs/html/giftaccept.html> (not actual policies, but a list of resources where you can find one)
 - Nonprofit Risk Management Center:
<http://www.nonprofitrisk.org/tools/hallmarks/tools/1gift-acceptance-policies.doc>
 - Community Foundation of Greater Birmingham:
http://bestpractices.cof.org/files/44._Greater_Birmingham_Gift_Acceptance_Policies_2005.doc

WHY HAVE A GIFT ACCEPTANCE POLICY?

- Protect organization from unanticipated liabilities
- Enhance relationship between organization and (prospective) donors
 - Uniform expectations
 - Terms governing restricted gifts
 - Enhance likelihood that restricted gifts will be potentially deductible
- Preserve organization's tax exemption/good governance
 - Reduce risks of excise taxes
 - Duties of care, loyalty
 - Substantiation
- Set standard terms for restricted gifts
 - Incorporate into fundraising appeals and specific agreements
 - Use of donations if have changed circumstances

CONSIDERATIONS FOR A GIFT ACCEPTANCE POLICY

- Does the gift have conditions that unacceptably tie up the use of the property?
- Will the type of property tie up other assets of the organization, such as incurring expenses for holding and/or maintaining the property?
- Will gifts of real estate will be accepted, and if so, will they be conditioned upon an inspection and evaluation?
- Will acceptance of the gift hinder or promote the mission?
- The organization's directors and officers must exercise prudence in investing and managing the organization's assets
- It may or may not be prudent to accept particular gifts
 - Does acceptance create negative publicity for the organization?
- Need to weigh each gift versus the best interest of the organization as a whole.

ESSENTIAL ELEMENTS

- Types of property that will/will not be accepted
 - Absolute prohibition; who has discretion as to other gifts (approval process)
- Types of gift vehicles
- Whether to accept restricted gifts, and if so, what types
- Provisions unique to gifts of real estate, business interests, and other unusual gifts
- Type of acknowledgments of gifts, and when to provide to donors

ESSENTIAL ELEMENTS

- May want to include provisions requiring organization to notify public of the policy
 - Especially with broad fundraising
- Insiders should not benefit personally from fees related to gifts received and should not participate in any activity which could be deemed a conflict of interest.
- No finder's fee or other private benefit to anyone for gift development.

ESSENTIAL ELEMENTS

- Advise all prospective donors to seek their own legal/tax counsel in any and all aspects of the proposed gift (and if necessary, the organization should assist the donor in securing independent counsel).
- Donors often want to use the services of the organization's attorney and are willing to waive any conflicts of interest. This should be done only after careful consideration and explanation and documentation of all potential risks to the donor. A disclosure/waiver letter is imperative.

See Attachment 7 for sample Gift Acceptance Policy.

CONFIDENTIALITY POLICIES DRAFTING CONSIDERATIONS

- Definition of confidential information should be specific and clear (and practical)
- Include circumstances under which disclosure of what is generally considered confidential information is allowed and the person(s) who can approve that disclosure
- It is not unusual for a Confidentiality Policy to be drafted in conjunction with an Ethics Policy or Code of Ethics of a nonprofit. This combination provides the opportunity for the organization's values to be stated and then have a Confidentiality Policy that reflects many of those values.

WRITTEN POLICIES FOR LOCAL CHAPTERS, BRANCHES, OR AFFILIATES

- Does the organization have local chapters, branches, or affiliates?
- If “yes,” does the organization have written policies and procedures governing the activities of such chapters, affiliates, and branches to ensure their operations are consistent with those of the parent organization? (Examples: required provisions in chapter’s articles of organization or bylaws, manual provided to chapters, a constitution, or similar document).
- If “no” , explain in Schedule O.

WRITTEN JOINT VENTURE POLICY

- Did the organization invest in, contribute assets to, or participate in a joint venture with a taxable entity during the year?
- If “yes,” has the organization adopted a written policy or procedure requiring the organization to evaluate its participation in joint venture arrangements under applicable federal tax law, and taken steps to safeguard the organization’s exempt status with respect to such arrangements?

WRITTEN JOINT VENTURE POLICY

- What is the definition of “joint venture” for purposes of line 16?
- Joint venture or similar arrangement means any joint ownership or contractual arrangement through which there is an agreement to jointly undertake a specific business enterprise, investment, or exempt-purpose activity without regard to-
 - whether organization controls the venture;
 - structure of the venture; or
 - whether venture treated as partnership or association.
- Disregard ventures if two conditions are met: (i) 95% or more of venture’s income is passive; and (ii) primary purpose of organization’s participation is the production of income or appreciation of property.

WRITTEN JOINT VENTURE POLICY

- Safeguard organization's exempt status with respect to venture:
 - control over venture sufficient to ensure venture furthers the exempt purpose of organization;
 - require venture to give priority to exempt purposes over maximizing profits;
 - restrict activities that would jeopardize exempt status; and
 - all contracts entered into with organization be at arm's length or more favorable.

INVESTMENT POLICY STATEMENT

- What is the purpose/objective of the investment account(s)?
- What type of investment structure/asset allocation make sense based on objectives/constraints/risk tolerance?
- How will the charity monitor performance?
- What will be the roles of the Board? The Investment Committee? The outside professionals?
- What will be the process to review the policy for compliance and necessary adjustment?

See Attachment 9 for sample investment policy statements.

INVESTMENT POLICIES DRAFTING CONSIDERATIONS

- Do not be overly specific so as to effectively hamstring the investment committee and outside investment advisors.
- By the same token, the policy must establish clear lines and mandate that investments must stay within these lines.
- Be observant of applicable statutes, most significantly the Texas Uniform Prudent Management of Institutional Funds Act, found at Section 163 of the Texas Property Code ("TUPMIFA").

SETTING A SPENDING POLICY

- What are the objectives to be met? (rationales for endowment)
- What are the charity's funding needs?
- Consider smoothing by including use of rolling average for calculating value of endowment

DRAFTING TIPS COMMON TO ALL POLICIES

- Involve the Board (they're adopting it!)
- Use understandable language/define terms
- Coordinate terms with provisions of governing documents
- Don't try to be Nostradamus
- Don't create something you won't follow
- Create a system for annual review and update as necessary

WHY DO GOVERNANCE POLICIES MATTER?

- Assist in complying with state law fiduciary duties
- Assist in maintaining the organization's federal income tax exemption and in avoiding federal excise taxes
- Assist in positioning the entity favorably with the IRS
- Contribute to a climate of ethical conduct
- Assist in separating the wheat from the chaff in board service

The information set forth in this outline should not be considered legal advice, because every fact pattern is unique.

The information set forth herein is solely for purposes of discussion and to guide practitioners in their thinking regarding the issues addressed herein.

Non-lawyers are advised to consult an attorney before undertaking any issues addressed herein.