GOOD CORPORATE GOVERNANCE FOR NONPROFITS

What is corporate governance?
Corporate governance generally refers to the processes, oversight and decision-making that shape an organization’s management and operations. The governing body, which for nonprofits is usually the board of directors, and the policies and practices that shape the governing body’s decisions are integral parts of corporate governance.

Keep in mind that “good” corporate governance varies depending on an organization’s size, structure, mission, funding, etc. What is right for one organization might not be right for another organization. Both state law and the Internal Revenue Service recognize this and allow for some flexibility in corporate governance.

Why is good corporate governance important?
Because It Benefits Your Organization. First and foremost, good corporate governance enables your organization to operate more effectively and to maximize resources to achieve the organization’s mission.

Because Donors Care about Corporate Governance. Potential donors may evaluate the way the organization is governed to determine whether or not they will support the organization. If your organization has no formal policies in place, has difficulty making decisions, or cannot keeping track of its goals and funding, donors may be less likely to support the organization.

Because Aspects of Corporate Governance Are Mandated by State or Federal Law.
State Law: State law provides the foundation for corporate governance of nonprofits, addressing areas such as duties owed by directors to the organization and procedures for amending bylaws. Both the organization and the directors could be liable for failure to follow good corporate governance practices if this failure results in fraud, misuse of funds, etc.

Sarbanes-Oxley: Although much of the Federal law known as Sarbanes-Oxley does not apply to nonprofits, there are two important provisions that do. Nonprofits officers and directors, like those at other corporations, may face criminal liability for retaliation against whistleblowers who report federal offenses or for destroying records with the intent to obstruct a federal investigation.

Because the IRS Cares. Although the IRS does not mandate that the organization have certain policies in place, it is placing a greater emphasis on corporate governance as
part of its reviews. If the IRS is concerned about corporate governance, your organization should be concerned as well. Failure to follow good corporate governance practices could cause your organization to be subjected to greater scrutiny by the IRS and could ultimately lead to the organization’s loss of tax-exempt status.

**Why does the IRS care about corporate governance?**
The IRS believes that “a well-governed charity is more likely to obey the tax laws, safeguard charitable assets, and serve charitable interests than one with poor or lax governance.”

The IRS wants to make sure that 501(c)(3) organizations use their assets to further their charitable missions. Although an organization might avoid misusing charitable assets without the use of formal policies, the IRS believes that an organization with good corporate governance policies is in the best position to safeguard its assets. When properly implemented, these policies remind the organization’s directors, officers and staff members of the organization’s responsibility to serve its charitable mission and help them to properly address situations that could jeopardize that mission.

**What steps is the IRS taking to review corporate governance?**
In general, the Internal Revenue Code does not set forth detailed corporate governance requirements for 501(c)(3) organizations. The IRS has, however, begun to review corporate governance more thoroughly in connection with 501(c)(3) determinations and compliance review. The IRS asks specific questions about corporate governance in the initial application for tax-exempt status (Form 1023) and recently expanded the corporate governance section of the annual return of tax-exempt organizations (Form 990).

**What does the new Form 990 cover?**
The IRS has identified at least four broad topics that are covered in the governance section of the revised Form 990:

- **Who governs the organization?**
  - These questions ask for information such as the size of the governing body and how many of those directors are “independent”.

- **What policies and practices are in place?**
  - These questions ask whether the organization has adopted specific policies such as conflict of interest, whistleblower protection, document retention, and executive compensation policies.

- **Conflicts, Business and Family Relationships**
  - These questions attempt to detect potential conflicts and ask for information about the organization’s procedure for handling conflicts.

- **Transparency**
  - These questions assess the ways the organization makes information about it, including its Form 990, available to the public.
Will our organization lose its tax-exempt status if it does not put in place the policies suggested by the IRS?
No. The IRS does not require tax-exempt organizations to implement these policies. The IRS is only concerned about these policies to the extent that they encourage and result in good organizational practices. In other words, the IRS is not as concerned about an organization’s approval of a conflict of interest policy as it is concerned about the possibility that an organization has entered into a transaction involving a conflict of interest that results in a misuse of funds. Maintaining and complying with suggested policies merely minimizes the risk that an organization will misuse its charitable assets. However, if the organization does not have the suggested policies in place, the IRS might view this as a reason to subject the organization to further scrutiny.

What can our organization do to enhance good corporate governance?
The IRS emphasizes that there is no set formula for governance and that nonprofits should have flexibility in their organizational structures. There are some basic guidelines however, that the IRS encourages tax-exempt organizations to implement in order to increase transparency and accountability:

• **Mission:** Adopt a clear mission and have the board of directors regularly review it to ensure that the organization’s activities are guided by that mission. The board of directors must comply with the articles and bylaws, and must update the IRS on any changes to the organizing documents.

• **Governing Body:** A charity’s board of directors must be active, informed, independent, and engaged to ensure charity’s success and its compliance with applicable tax law requirements.

• **Conflicts of Interest:** Adopt and regularly evaluate a written conflict of interest policy that (1) requires directors and staff to act solely in the interests of the charity without regard for personal interests, (2) includes written procedures for determining whether conflict of interest exists, and (3) lays out what to do in the event a conflict of interest is identified.

• **Fundraising:** Ensure that fundraising solicitations meet federal and state law requirements and are accurate, truthful, and candid.

• **Governing Body Minutes and Records:** Contemporaneously document minutes of the governing body and authorized subcommittee meetings or actions taken. For this purpose, contemporaneous means the document must be prepared by the later of (1) the next meeting of the governing body or committee, or (2) 60 days after the date of the meeting and reviewed and approved by the governing body or committee within a reasonable time thereafter.

• **Corporate Policies:** Consider adopting the following written policies:
  1. **Document Retention and Destruction:** This policy establishes standards for document retention, integrity, and destruction and forbids destruction of any documents in the event of an investigation.
2. **Code of Ethics**: This policy sets out behavior that the board wants to encourage, as well as behavior that it wants to discourage, communicating a strong culture of legal compliance and ethical integrity.

3. **Whistleblower Policy**: This policy lays out procedures for handling employee complaints and procedures for employees to report in confidence any suspected financial impropriety or misuse of the charity’s resources.

- **Form 990 and Form 1023**: Provide the board of directors with copies of the Form 990 for review before it is filed and post a copy where publicly accessible, such as on the charity’s website. The Code requires a charity to make its Form 1023 exemption application, Form 990, and Form 990-T available for public inspection. Make sure your organization has a copy of its Form 1023 readily available.

- **Executive Compensation**: A charity may not pay more than reasonable compensation for services rendered. Have persons who are knowledgeable in compensation matters and who have no financial interest at stake determine compensation.

- **Investments**: Charities participating in major investments in joint ventures, for-profit entities, or financial products should adopt written evaluation procedures in order to help safeguard the organization’s assets and protect its exempt status.