



READY REFERENCE PAGE

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Top Ten Policies and Practices for Nonprofit Organizations

*Increased emphasis on transparency and accountability
requires more formal attention to governance and administration*

The emphasis since the enactment of Sarbanes-Oxley on governance practices of all nonprofits organizations, and the specific questions on the revised Form 990 about conflict of interest, whistle blower, document retention and compensation setting policies and procedures of 501(c)(3) public charities have spurred renewed interest in written policies. The following are policies and practices that 501(c)(3)s and other nonprofits may want to consider.

Conflict of interest policy. Most nonprofits have a conflict of interest policy that helps to enforce nonprofit directors' duty of loyalty under state law. The revised Form 990 asks (a) whether the organization has a written policy, (b) whether officers, directors and key employees are required to disclose annually interests that could give rise to conflicts, and (c) for a description of how the organization regularly and consistently monitors and enforces the policy. Most organizations have adopted policies that enable them to give "good" answers to the Form 990 questions. The essence of most conflict policies is a disclosure procedure, where the director, officer or employee of the organization reports as to whether he or she, or any related individual or entity, has a financial interest in any vendor of goods or services to, or recipient of goods or services from, the organization. If such an interest exists, the interested party does not participate in the decision to purchase or provide the goods or services, and might be asked to leave the room during the discussion and decision. ([See Ready Reference Page: "Conflict of Interest Policies Help Avoid Problems"](#))

The revised Form 990, in addition to asking about the organization's conflicts policy, asks direct questions about financial transactions between the organization and directors, officers or key employees or related individuals and entities, but it is much more detailed in its inquiries than are most conflict of interest policies. The form also asks about personal and financial relationships between directors, officer and key employees of the organization. Most organizations distribute a separate questionnaire in order to answer the direct Form 990 questions.

Code of ethics/whistleblower policies. One of the two narrow provisions of Sarbanes-Oxley that applies directly to nonprofits creates penalties for retaliating against whistleblowers during a federal investigation. The revised Form 990 asks if the organization has a whistleblower policy, and this question has spurred nonprofits to adopt a written policy. Some organizations do this by adopting a code of ethical conduct that encourages directors, officers and employees to report unethical or illegal conduct of any type, and provides that there will be no retaliation for reporting pursuant to the policy.

Document retention. Sarbanes-Oxley prohibits the destruction of documents that may be material to a federal investigation. This provision applies to nonprofit as well as for-profit organizations. The revised Form 990 asks whether the organization has a document retention policy, and most organizations that did not previously have a written policy are adopting them. Some statutes require certain types of records to be kept for a stated period. For the most part, however, the periods for which documents are to be retained are based on the statute of limitations for a lawsuit. For example, because the IRS has six years after the filing of a return to bring a claim for taxes if there has been an underreporting of income

by 25% or more, most policies require retention of tax returns for 7 years. For records dealing with minors, it may be necessary to retain them until the statute of limitations would run after they reach the age of majority. And, of course, the policies state that no documents may be destroyed or altered where there is pending, threatened or reasonably foreseeable governmental investigation.

Compensation setting procedure. The revised Form 990 asks whether the organization is using a procedure for setting compensation in which an independent portion of the board is using comparables and making a determination based on those comparables that compensation for officers and key employees is reasonable. It also asks whether the determination that compensation is reasonable is put in writing contemporaneously. These three steps are taken from the regulations that provide 501(c)(3) public charities and 501(c)(4) organizations with a rebuttable presumption that compensation paid to an insider is reasonable or that amounts paid to purchase property from an insider do not exceed market value, but the Form 990 asks the question about the procedure of every organization filing the Form 990. (Of course, 501(c)(3) private foundations essentially cannot make purchases from insiders, other than purchases of services necessary for the foundation's operations.)

The regulations that contain the rebuttable presumption procedure are part of the excess benefit rules that apply to insiders of 501(c)(3) public charities and 501(c)(4) organizations. ([See Ready Reference Page: "Charities Must Avoid Excess Benefit Transactions"](#)) Under these rules, if the organization overpays an insider, the insider must repay the overpayment to the organization and pay an excise tax to the IRS equal to 25% of the overpayment. A manager of the organization who participates in the overpayment knowing that it is an excess benefit is subject to a tax equal to 10% of the excess up to a maximum of \$20,000. The severity of the overpayment taxes makes the rebuttable presumption very useful. Economic benefits provided to an insider but not treated as compensation (think spousal travel) are automatic excess benefits to the insider of a 501(c)(3) public charity or a 501(c)(4) organization.

The revised Form 990 asks questions about spousal travel, first class travel, social club dues, and other benefits that could contain a compensation element, of any filing organization that paid compensation greater than \$150,000 to any employee. Of course, such benefits provided to the insider of a 501(c)(3) private foundation but not treated as compensation are private inurement, and could cause the foundation to lose its exempt status.

Nonprofit organizations need to pay attention to all elements of compensation, be sure to treat them as compensation and be sure that the total compensation paid does not exceed what is reasonable. The procedures outlined in the rebuttable presumption regulations are very helpful, even for nonprofits not subject to the excess benefits rules of which the regulations are a part.

Charity care/debt collection. For several years Senator Charles Grassley (R-IA) and others have been questioning whether nonprofit hospitals provide sufficient charity care to justify their tax exemptions. News reports of nonprofit hospitals using commercial collections procedures have also generated questions. Perhaps as a result of the inquiries, the revised Form 990 and its Schedule H, which will be completed by 501(c)(3) hospitals beginning 2010, asks hospitals to quantify the amount of charity care they provide. Senator Grassley, mostly prior to the recent decline in the value of endowments, has also questioned whether the educational institutions with the largest endowments are providing sufficient charity care.

Many states have begun to look at the value of real estate and sales tax exemptions and some have made a specific level of charity care a requirement for state and local tax exemption. These discussions have prompted many nonprofit organizations that charge fees to think about the level of charity care they pro-

vide and to begin to document it. Even if the organization is not required to provide a stated level of charity care and does not wish to have a policy of providing a stated level of care, the board should know how it measures against norms being used by or applied to other organizations. A discussion at the board level about how collections will be handled is also appropriate.

Spending policy. Related to the issue of charity care, for organizations with permanently restricted investment assets, is the organization's spending policy. Private foundations are required to spend annually for charitable purposes an amount equal to 5% of the value of their net investment assets. They may choose to spend more, for example, in times when the value of their assets have fallen. Changes in the state laws governing true endowments (funds restricted by the donor to the expenditure of income only), permit flexibility in the amount that may be spent. ([See Ready Reference Page: "New UPMIFA Sets Rules for Management of Charitable Funds"](#)) This leaves the organization's governing board with choices to make about what the level of spending from the endowment will be. Even if the organization's funds are not donor restricted, the board needs to balance the current needs of the organization with anticipated future needs, and setting a spending policy gives the board an opportunity to consider those competing needs.

Investment policy. Every organization with investment assets should have an investment policy. The existence of the policy and procedures for its review provide the board or investment committee the opportunity for addressing how assets are invested and for thinking about what allocations should serve the organization best.

Gift acceptance. Even a simple gift acceptance policy can provide guidance for a development officer or board member when a prospective donor offers to gift an interest in real estate, a partnership or a limited liability company. The policy can be as simple as a statement that gifts other than cash and publicly traded stock are subject to an acceptance procedure. A policy may help the organization avoid offending potential donors by making it clear that the extra level of review is something that is a general practice and not directed at the specific situation.

Restricted gifts. A charitable organization is required to use restricted gifts for the purposes for which they are given. This requires the organization to be thoughtful in its solicitations, and once it has accepted a restricted gift, to be diligent in documenting its use of the gift. An accounting system that classifies restricted investment assets on their receipt and records expenditures attributed to those assets is necessary. Because of the administrative burden, the organization may only want to accept permanently restricted investments assets in excess of a stated level.

Joint ventures. The revised Form 990 asks any charity that has participated in a joint venture with a for profit entity during the year whether it has a written policy governing participation in such ventures. If an organization is entering into an arrangement which could be viewed as a sharing of profits with a for profit entity, it should become familiar with the IRS's views on joint ventures, and it may wish to adopt a policy about participation in such ventures. ([See Ready Reference Page: "IRS Says Charities Must Control Joint Ventures"](#))

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