

Governance & Best Practices February 12, 2013

Panel on the NonProfit Sector

So Who Is the Panel on the Nonprofit Sector?

- The Panel on the Nonprofit Section is an independent group of nonprofit leaders who have recommended actions to strengthen the governance, ethical conduct, and accountability of charitable organizations
- Formed by Independent Sector in October 2004 at the encouragement of the U.S. Senate Finance Committee, the Panel prepared recommendations for Congress the IRS and the nonprofit sector to improve the oversight and governance of charitable organizations and provided its Final Report in June 2005
- The Panel is comprised of 24 nonprofit and philanthropic leaders whose organizations encompass great diversity in location, mission, perspective, and scope of work
- The Panel has issued a supplemental report
- Pension Reform Act of 2006 implemented certain recommendations

Principals for Effective Practice

- Principals for Good Governance and Ethical Practice: A Guide for Charities and Foundations was issued by the Panel on the Nonprofit Sector Advisory Committee on Self-Regulation in 2007
- Contains thirty-three principles divided into 4 sections
- Website- www.nonprofitpanel.org

The Panel's Goal's

- Preserving the soundness and integrity of the NPE community must strike a careful balance between prudent legal mandates to ensure that organizations do not abuse the privilege of their exempt status, and well-informed self-governance and mutual awareness among nonprofit organizations

The Panels Conclusions

- NPEs have long embraced the need for standards of ethical practice that preserve and strengthen the public's confidence
- Many such systems in fact already exist, though none have applied to the entire range of American charitable organizations
- The principles set forth a comprehensive set of principles to inform the field

The Principles and Smaller NPEs

- In preparing the principles the Panel explained that while all organizations should be expected to operate ethically and serve as worthy stewards of the public and private resources entrusted to them it may not be possible or desirable for small organizations, given their limited human, technical, and financial resources, to demonstrate their ethical and accountable operation by complying with some of the more complex requirements appropriate for larger charitable organizations

The 33 Principles- Four Main Categories

1. Legal Compliance and Public Disclosure (The Board of Directors)
2. Effective Governance (The Governance Committee)
3. Strong Financial Oversight (The Finance, Investment and Audit Committees)
4. Responsible Fundraising (The Development Committee)

The Panel Recommends

- That an organization's board conduct a thorough discussion of the complete set of principles, and determine how the organization should apply each to its operations
- It is possible that after this review, the board may conclude certain principles do not apply to its organization
- The NPEs board develop a transparent process for communicating how the organization has addressed the principles, including the reasons that any of the principles are not relevant

Legal Compliance and Public Disclosure

1. A charitable organization must comply with all applicable federal, state and local laws and regulations including applicable international laws, regulations and conventions that are legally binding on the United States
2. A charitable organization should have a formally adopted, written code of ethics with which all of its directors or trustees, staff and volunteers are familiar and to which they adhere
3. A charitable organization should adopt and implement policies and procedures to ensure that all conflicts of interest, or the appearance thereof, within the organization and the board are appropriately managed through disclosure, recusal, or other means
4. A charitable organization should establish and implement policies and procedures that enable individuals to come forward (whistleblower) with information on illegal practices or violations of organizational policies
5. A charitable organization should establish and implement policies and procedures to protect and preserve the organization's important documents and business records
6. A charitable organization's board should ensure that the organization has adequate plans to protect its assets—its property, financial and human resources, programmatic content and materials, and its integrity and reputation—against damage or loss
7. A charitable organization should make information about its operations, including its governance, finances, programs, and activities, widely available to the public. Charitable organizations also should consider making information available on the methods they use to evaluate the outcomes of their work and sharing the results of those evaluations

8. A charitable organization must have a governing body that is responsible for reviewing and approving
 1. The organization's mission and strategic director
 2. Annual budget and key financial transactions
 3. Compensation practices and policies
 4. Fiscal and governance policies
9. The board of charitable organizations should meet regularly enough to conduct its business and fulfill its duties
10. The board of charitable organizations should establish its own size and structure and review these periodically
 1. The board should have enough members to allow for full deliberation and diversity of thinking on governance and other organizational matters
 2. Except for very small organizations, this generally means that the board should have at least five members
11. The board of a charitable organization should include members with the diverse background (including, but not limited to, ethnic, racial, and gender perspective), experience, and organizational and financial skills necessary to advance the organization's mission
12. A substantial majority of the board of a public charity, usually meaning at least two-thirds of the members, should be independent. Independent members should not:
 1. Be compensated by the organization as employees or independent contractors
 2. Have their compensation determined by individuals who are compensated by the organization
 3. Receive, directly or indirectly, material financial benefits from the organization
 4. Be related to anyone described above
13. The board should hire, oversee, and annually evaluate the performance of the chief executive officer of the organization, and should conduct such an evaluation prior to any change in that officer's compensation
14. The board of a charitable organization that has paid staff should ensure that the positions of chief staff officer, board chair, and board treasurer are held by separate individuals. Organizations without paid staff should ensure that the positions of board chair and treasurer are held by separate individuals
15. The board should establish an effective, systematic process for educating and communicating with board members to ensure that they are aware of their legal and ethical responsibilities, are knowledgeable about the programs and activities of the organization, and can carry out their oversight functions effectively
16. Board members should evaluate their performance as a group and as individuals no less frequently than every three years, and should have clear procedures for removing board members who are unable to fulfill their responsibilities
17. The board should establish clear policies and procedures setting the length of terms and the number of consecutive terms a board member may serve
18. The board should review organizational and governing instruments no less frequently than every five years

19. The board should establish and review regularly the organization's mission and goals and should evaluate, no less frequently than every five years, the organization's programs, goals and activities to be sure they advance its mission and make prudent use of its resources
20. Board members are generally expected to serve without compensation, other than reimbursement for expenses incurred to fulfill their board duties
21. A charitable organization must keep complete, current, and accurate financial records. Its board should receive and review timely reports of the organization's financial activities and should have a qualified, independent financial expert audit or review these statements annually in a manner appropriate to the organization's size and scale of operations

Strong Financial Oversight

22. The board of a charitable organization must institute policies and procedures to ensure that the organization manages and invests its funds responsibly, in accordance with all legal requirements. The full board should review and approve the organization's annual budget and should monitor actual performance against the budget
23. A charitable organization should not provide loans (or the equivalent) to directors, officers, or trustees
24. A charitable organization should:
 1. Spend a significant percentage of its annual budget on programs that pursue its mission
 2. The budget should also provide sufficient resources for effective administration of the organization
 3. And, if it solicits contributions, for appropriate fundraising activities
25. A charitable organization should establish clear, written policies for paying or reimbursing expenses incurred by anyone conducting business or traveling on behalf of the organization, including types of expenses that can be paid for or reimbursed and the documentation required
26. A charitable organization should neither pay for nor reimburse travel expenditures for spouses, dependents or others who are accompanying someone conducting business for the organization unless they, too, are conducting such business

Responsible Fundraising

27. Solicitation materials and other communications addressed to donors and the public must clearly identify the organization and to be accurate and truthful
28. Contributions must be used for purposes consistent with the donor's intent, whether as described in the relevant solicitation materials or as specifically directed by the donor
29. A charitable organization must provide donors with specific acknowledgements of charitable contributions, in accordance with IRS requirements, as well as information to facilitate the donor's compliance with tax law requirements

30. A charitable organization should adopt clear policies, based on its specific exempt purpose, to determine whether accepting a gift would compromise its ethics, financial circumstances, program focus or other interests
31. A charitable organization should provide appropriate training and supervision of the people soliciting funds on its behalf to ensure that they understand their responsibilities and applicable federal, state and local laws, and do not employ techniques that are coercive, intimidating, or intended to harass potential donors
32. A charitable organization should not compensate internal or external fundraisers based on a commission or a percentage of the amount raised
33. A charitable organization should respect the privacy of individual donors and, except where disclosure is required by law, should not sell or otherwise make available the names and contact information of its donors without providing them an opportunity at least once a year to opt out of the use of their names

The Panel Recommends

- Before proceeding let's ask the question that is on everyone's mind—what is the role of the NPE's CFO and the NPE's auditor related to these recommendations?
- Remember governance is not an accounting "thing"
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Pension Protection Act of 2006

- Pension Protection Act of 2006, signed by President Bush on August 17, 2006, contains a number of incentive and reform provisions that affect donations to and the operations of not-for-profit organizations
- Provides for disclosure to state officials of IRS actions relating to 501(c)(3) organizations
- Requires annual IRS notification for small organizations (gross receipts less than \$25,000)
- Requires 501(c)(3) organizations to make unrelated business income tax returns (990-T) available to the public
- Subjects donor advised funds to new requirements, including excise taxes imposed on donors, donor advisors and related persons who receive a benefit from a distribution from a donor advised fund
- Requires a controlling organization to disclose on its Form 990 any loans made to each controlled entity and any transfer of funds between the controlling entity and each controlled entity
- Imposes restrictions on appraisers and reduces thresholds for valuation penalties
- Limits charitable contribution deductions for certain easements and other items; and limits deductions of contributions of used clothing and household items to only items in good condition
- Increases the dollar limits on penalties for organization managers of public charities and social welfare organizations for participation excess benefit transactions

The IRS and Governance

- In light of these developments, we have removed the previously posted preliminary staff discussion draft entitled *Good Governance Practices for 501(c)(3) Organizations* from our website. Current IRS positions on nonprofit governance are best reflected in the reporting required by the revised Form 990, effective beginning with 2008 tax years, and the governance and related topics components included in the Life Cycle.
- You can find the Life Cycle and Form 990 information about governance and related topics through the following links:
- Life Cycle- For information about important governance topics to be considered over the life of the organization, see Governance and Related Topics- 501(c)(3) Organizations, covering the following six topics: Mission, organizational documents, governing body, governance and management policies, financial statements and Form 990 reporting, and transparency and accountability
- Form 990- As revised for tax year 2008, the IRS Form 990, *Return of Organization Exempt From Income Tax*, the annual information return filed by many charities, requires reporting organizations to answer questions about governance, management, and disclosure
- For example, see Part VI, *Governance, Management and Disclosure*, and Part XI, *Financial Statements and Reporting*
 - Tips and Frequently Asking Questions about Part VI, Form 990
 - Examination materials

Governance and Related Topics- 501(c)(3) Organizations

- The IRS remains committed to working with the sector and the states in the nonprofit governance area. States and nonprofit umbrella groups are other good sources for information about governance and related topics
- The Internal Revenue Service 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
- A charity that has clearly articulated purposes that describe its mission, a knowledgeable and committed governing body and management team, and sound management practices is more likely to operate effectively and consistent with tax law requirements
- And while the tax law generally does not mandate particular management structures, operational policies, or administrative practices, it is important that each charity be thoughtful about the governance practices that are most appropriate for that charity in assuring sound operations and compliance with the tax law
- As a measure of our interest in this area, we ask about an organization's governance, both when it applies for tax-exempt status and then annually as part of the information return that many charities are required to file with the Internal Revenue Service

- Some of the policies and practices we commend for your consideration are divided into the topics below. Although the discussion that follows is generally directed to public charities, private foundations and other exempt organizations should also consider these topics
- Depending on an organization's specific situation, some of the recommended policies and practices will be more appropriate than others
 - Mission
 - Organizational Documents
 - Governing Body
 - Governance and Management Policies
 - Financial Statements and Form 990 Reporting
 - Transparency and Accountability

The Revised 990 Part VI- Governance, Management, and Disclosure

- Section A- Governing Body and Management
- Section B- Policies
- Section C- Disclosures
- So lets have a discussion of the relationship of each of the 990 Part VI questions and good NPE governance
- Let's also discuss how the auditor and/or the NPE CFO can gain comfort that the questions have been answered appropriately by the NPE leader

Section A- Governing Body and Management

- 1a Enter the number of voting members of the governing body at the end of the tax year- If there are material differences in voting rights among members of the governing body, or if the governing body delegated broad authority to an executive committee or similar committee, explain in Schedule O
- 1b Enter the number of voting members included in line 1a, above, who are independent
- 2 Did any officer, director, trustee, or key employee have a family relationship or a business relationship with any other officer, director, trustee or key employee?
- 3 Did the organization delegate control over management duties customarily performed by or under the direct supervision of officers, directors, or trustees, or key employees to a management company or other person?
- 4 Did the organization make any significant changes to its governing documents since prior Form 990 was filed?
- 5 Did the organization become aware during the year of a significant diversion of the organization's assets?
- 6 Did the organization have members or stockholders?
- 7a Did the organization have members, stockholders, or other persons who had the power to elect or appoint one or more members of the governing body?
- 7b Are any governance decisions of the organization reserved to (or subject to approval by) members, stockholders, or persons other than the governing body?

- 8 Did the organization contemporaneously document the meetings held or written actions undertaken during the year by the following:
 - The governing body?
 - Each committee with authority to act on behalf of the governing body?
- 9 Is there any officer, director, trustee, or key employee listed in Part VII, Section A, who cannot be reached at the organization's mailing address? *If "yes", provide the names and addresses in Schedule O*
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Section B. Policies (This Section B requests information about policies not required by the Internal Revenue Code)

- 10a Did the organization have local chapters, branches, or affiliates?
- 10b If "yes", did the organization have written policies and procedures governing the activities of such chapters, affiliates, and branches to ensure their operations are consistent with the organization's exempt purposes?
- 11a Has the organization provided a complete copy of this Form 990 to all members of its governing body before filing the form?
- 11b Describe in Schedule O the process, if any, used by the organization to review this Form 990
- 12a Did the organization have a written conflict of interest policy? *If 'No', go to line 13*
- 12b Were officers, directors, or trustee, and key employees required to disclose annually interests that could give rise to conflicts?
- 12c Did the organization regularly and consistently monitor and enforce compliance with the policy? *If "Yes", describe in Schedule O how this was done*
- 13 Did the organization have a written whistleblower policy?
- 14 Did the organization have a written document retention and destruction policy?
- 15 Did the process for determining compensation of the following persons include a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision?
 - a The organization's CEO, Executive Director, or top management official
 - b Other officers or key employees of the organization
 - If "Yes" to line 15a or 15b, describe the process in Schedule O (see instructions)
- 16a Did the organization invest in, contribute assets to, or participate in a joint venture or similar arrangement with a taxable entity during the year?

Section C- Disclosure

- 16b If "Yes," did the organization follow a written policy or procedure requiring the organization to evaluate its participation in joint venture arrangements under applicable federal tax law, and take steps to safeguard the organization's exempt status with respect to such arrangements?
- 17 List the states with which a copy of this Form 990 is required to be filed
- 18 Section 6104 requires an organization to make its Form 1023 (or 1024 if applicable), 990, and 990-T (Section 501(c)(3)s only) available for public inspection. Indicate how you made these available. Check all that apply:

- Own website
 - Another's website
 - Upon request
- 19 Describe in Schedule O whether (and if so, how), the organization made its governing documents, conflict of interest policy, and financial statements available to the public during the tax year
 - 20 State the name, physical address, and telephone number of the person who possesses the books and records of the organization

