

Nonprofit Board Governance and the New Form 990

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Nonprofit Board Governance and the New Form 990

- ◆ Nonprofit Board Governance – increasing in importance
- ◆ Topics:
 - ◆ What Should a Board Do? How does an effective board operate?
 - ◆ Who should sit on your board and how should your board be structured?
 - ◆ What are a director's fiduciary duties?
- ◆ The New IRS Form 990
 - ◆ What are the new requirements?



Nonprofit Board Governance – What Should a Board Do?



Nonprofit Board Governance

◆ What Should a Board Do?

The Board's actions are governed by:

- ◆ State Law
- ◆ Articles of Incorporation
- ◆ Bylaws
- ◆ IRS Recommended Policies and Best Practices



What Should a Board Do?

Adopt and Follow a Mission Statement

- ◆ Clearly articulated mission statement should be adopted by the board and include the following:
 - ◆ Why the charity exists
 - ◆ What it hopes to accomplish
 - ◆ What activities it will undertake (in line with its charitable purpose), where and for whom
- ◆ The Mission should guide organizational planning, board and staff decisions and volunteer initiatives
- ◆ The Mission statement should be reviewed every two to five years to ensure that it continues to be adequate, accurate and valid



What Should a Board Do?

Executive Director

- ◆ Select the Executive Director and set employment terms
- ◆ Support the Executive Director
- ◆ Review the Executive Director's performance



What Should a Board Do?

Provide Proper Financial Oversight

- ◆ Assist in developing the annual budget
- ◆ Review periodic financial statements, including comparison to budget and prior year
- ◆ Require an annual audit by an independent auditor
- ◆ Ensure adequate financial controls are in place
- ◆ Ensure cash management controls are in place
- ◆ Ensure the organization has adequate liability insurance
- ◆ Oversee investments
- ◆ Monitor reserve funds and endowments
- ◆ Formulate investment policy and strategy



What Should a Board Do?

Ensure Adequate Resources

- ◆ Fundraising!
- ◆ Board should be instrumental in the fundraising process
 - ◆ Using contact to raise funds
 - ◆ Making appropriate gifts
 - ◆ Assisting staff in donor cultivation and thanks
- ◆ Ensure short term and long term financial security of the organization



What Should a Board Do?

Ensure Legal and Ethical Integrity and Accountability

- ◆ Ensure the organization adheres to legal standards and ethical norms
 - ◆ Personnel policies
 - ◆ Conflict of Interest policy
 - ◆ Mission
 - ◆ Organizational documents
 - ◆ Independent audit
- ◆ Activities – Ensure that the organization
 - ◆ Follows applicable laws
 - ◆ Files required government reports
 - ◆ Adheres to organizational documents
 - ◆ Independent audit
 - ◆ Annual report



What Should a Board Do?

Ensure Effective Organizational Planning

- ◆ Strategic Plan
- ◆ Board members should be actively involved in the planning process
- ◆ The Board should review, revise and finally approve the strategic plan developed by staff
- ◆ Review progress at least annually and reassess the strategic plan as necessary



What Should a Board Do?

New Board Members and Board Performance

- ◆ Recruit and orient new Board members
- ◆ Board Governance Committee
 - ◆ Oversee the process of defining membership needs
 - ◆ Cultivate prospective nominees
 - ◆ Check credentials and performance on other boards
 - ◆ Recruit nominees
 - ◆ Oversee orientation
 - ◆ Draft statement of Board responsibilities
 - ◆ Design a program of Board self-assessment



What Should a Board Do?

Enhance the Organization's Public Standing

- ◆ Board members are ambassadors
- ◆ Education of community
- ◆ Talking points



What Should a Board Do?

Determine, Monitor and Strengthen the Organization's Programs and Services

- ◆ Determine programs consistent with mission
- ◆ Monitor effectiveness



Board Composition



Board Composition

“The Internal Revenue Service believes that governing boards should be composed of persons who are *informed and active* in overseeing a charity’s operations and finances. If a governing board tolerates a climate of secrecy or neglect, charitable assets are more likely to be used to advance an impermissible private interest...”

- ◆ Who should sit on your board?

Board should be composed of persons who are:

- ◆ Informed and active in overseeing a charity’s operations and finances
- ◆ With time to dedicate to the organization
- ◆ Knowledgeable and engaged
- ◆ Selected with the organization’s needs in mind (e.g. accounting, finance, compensation).
- ◆ Independent



Board Size

- ◆ Size is important.
- ◆ IRS believes that organizations with very small or very large boards may be problematic:
 - ◆ Small boards – do not generally represent a broad public interest
 - ◆ Large boards – unwieldy, difficult to manage and organize, and may be less attentive to oversight duties
- ◆ No right or wrong size – should be appropriate to ensure compliance with tax laws, safeguard assets and further corporate purposes.



Board and Advisory Committees

- ◆ Committees can have board delegated authority, or be advisory only
- ◆ Authority granted by majority of Board of Directors through board resolution or amendment to bylaws
 - ◆ Make sure scope of delegated authority is clear
 - ◆ Be cautious of apparent authority issues
- ◆ Typical committees:
 - ◆ **Executive Committee**: Often has the full authority of board to act generally or on specific matters
 - ◆ **Audit Committee**: Tasked with hiring auditors and review of financial statements
 - ◆ **Compensation Committee**: Tasked with establishing the compensation of officers
 - ◆ **Governance Committee**: Tasked with establishing governance procedures, finding director candidates, settling committee assignments and rotation of managers.
 - ◆ **Advisory Committees**: Do not wield the power of the board but are advisory only – study or review a particular issue and report findings back to the board. No corporate authority to take any action.



Fiduciary Duties



Fiduciary Duties

“A director shall perform the duties of a director...in **good faith**, in a manner such director believes to be in the **best interests of the corporation**, and with such **care**, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.” RCW 24.03.127

- ◆ 3 basic duties:
 - ◆ Good Faith
 - ◆ Duty of Care
 - ◆ Duty of Loyalty



Fiduciary Duties

- ◆ Good Faith
 - ◆ Honesty in purpose and honesty in fact. What was directors intent?
- ◆ Duty of Care
 - ◆ Stay informed
 - ◆ Show careful investigation
 - ◆ Show thoughtful consideration
- ◆ Duty of Loyalty
 - ◆ Act in best interest of corporation
 - ◆ Avoid conflict of interest and self-dealing



Consequences of Breaches of Fiduciary Duty

- ◆ Individual personal liability for directors
- ◆ Loss of an organization's tax exempt status
- ◆ Intermediate sanctions
- ◆ Loss of community goodwill



Director Protections

- ◆ Business Judgment Rule
- ◆ Indemnification in Organizational Documents
- ◆ Contractual Indemnification Rights
- ◆ D&O Insurance



Revised Form 990



Background on New Form 990

- ◆ Timeline of redesign
 - ◆ June 14, 2007 – draft Form 990 released
 - ◆ December 20, 2007 – final Form 990 released
 - ◆ April 7, 2008 – draft instructions released
 - ◆ August 19, 2008 – final instructions released
- ◆ Life Cycle for charities and other organizations
 - ◆ Educational tool developed by the IRS; see <http://www.irs.gov/charities/charitable/article/0,,id=122670,00.html>
 - ◆ Includes guidance “Governance and Related Topics – 501(c)(3) Organizations” – covers six topics (mission, organizational documents, governing body, governance and management policies, financial statements and Form 990 reporting, transparency and accountability).



Revised Form 990 – Filing Requirements

Tax Year	<u>Must</u> File Form <u>990</u>	<u>May</u> File Form <u>990-EZ</u>
2008	Gross receipts \geq \$1 million and/or total assets \geq \$2.5 million	Gross receipts $>$ \$25K and $<$ \$1 million and total assets $<$ \$2.5 million
2009	Gross receipts \geq \$500K and/or total assets \geq \$1.25 million	Gross receipts $>$ \$25K and $<$ \$500K and total assets $<$ \$1.25 million
2010	Gross receipts \geq \$200K and/or total assets \geq \$500K	Gross receipts $>$ \$50K and $<$ \$200K and total assets $<$ \$500K

- ◆ Organizations not required to file Form 990 or 990-EZ must file Form **990-N** (e-postcard).



Revised Form 990

- ◆ Parts of Form 990 that implicate board governance, management and oversight
 - ◆ Part VI – New section that includes questions on **board governance, policies** and **disclosure** practices.
 - ◆ Part XI – New section on **financial statements** and **audit committee/practices**



Part VI Governance, Management, and Disclosure (Sections A, B, and C request information about policies not required by the Internal Revenue Code.)

Section A. Governing Body and Management

For each "Yes" response to lines 2-7b below, and for a "No" response to lines 8 or 9b below, describe the circumstances, processes, or changes in Schedule O. See instructions.

	Yes	No
1a Enter the number of voting members of the governing body		
1b Enter the number of voting members that 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 organizational documents since the prior Form 990 was filed?		
5 Did the organization become aware during the year of a material diversion of the organization's assets?		
6 Does the organization have members or stockholders?		
7a Does the organization have members, stockholders, or other persons who may elect one or more members of the governing body?		
7b Are any decisions of the governing body subject to approval by members, stockholders, or other persons?		
8 Did the organization contemporaneously document the meetings held or written actions undertaken during the year by the following:		
a The governing body?		
b Each committee with authority to act on behalf of the governing body?		
9a Does the organization have local chapters, branches, or affiliates?		
b 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 organization?		
10 Was a copy of the Form 990 provided to the organization's governing body before it was filed? All organizations must describe in Schedule O the process, if any, the organization uses to review the Form 990		
11 Is there any officer, director or 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		

Section B. Policies

	Yes	No
12a Does the organization have a written conflict of interest policy? If "No," go to line 13		
b Are officers, directors or trustees, and key employees required to disclose annually interests that could give rise to conflicts?		
c Does the organization regularly and consistently monitor and enforce compliance with the policy? If "Yes," describe in Schedule O how this is done		
13 Does the organization have a written whistleblower policy?		
14 Does 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?		
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?		
b 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?		

Section C. Disclosure

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 Forms 1023 (or 1024 if applicable), 990, and 990-T (501(c)(3)s only) available for public inspection. Indicate how you make 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 makes its governing documents, conflict of interest policy, and financial statements available to the public.

20 State the name, physical address, and telephone number of the person who possesses the books and records of the organization: ▶.....



“Best Practices” – Governing Body and Management Procedures

- ◆ Policies, procedures and disclosures are *not required*
- ◆ Part VI, Section A includes the following questions:
 - ◆ Disclosure on the number of voting members that are independent
 - ◆ Whether an officer, director, trustee, or key employee (“ODTKE”) had a family or business relationship with another ODTKE
 - ◆ Whether the organization contemporaneously documented meetings held/written actions undertaken by the board and committees with authority to act on behalf of board
 - ◆ Whether a copy of the Form 990 was provided to the governing body before it was filed



Reporting on Independence of Board Members

- ◆ Form 990, Section VI, Line 1b – Requires disclosure of the number of independent voting board members
- ◆ “**Independent**” requires:
 - ◆ Not compensated as an **officer** or employee of organization or **related organization**;
 - ◆ Did not receive total **compensation** > \$10,000 as **independent contractor**, except reimbursement for expenses under **accountable plan** or **reasonable compensation** for services provided as board member; and
 - ◆ Neither member nor **family member** of member involved in transaction with organization or **related organization** reported on Schedule L



Reporting of Business and Family Relationships

- ◆ Form 990, Part VI, Line 2 - Must report if any **officers, directors, trustees, or key employees**, as reported in Part VII, Section A (“ODTKEs”), had a family relationship or business relationship with another ODTKE at any time during the tax year
 - ◆ **Family relationship** = virtually any family relationship, ranging from ancestors to spouses of great-grandchildren
 - ◆ **Business relationship** = (1) One employed by the other in a sole proprietorship or by an organization with which the other is an ODTKE or owns > 35%; (2) one transacting business with the other (> \$10K in the aggregate); or (3) Two persons each a director, officer, trustee, or >10% owner in same business or investment entity
 - ◆ **Privileged relationship exception**



“Reasonable Effort” Required for Reporting

- ◆ Organizations need only use “**reasonable effort**” to obtain necessary information to determine independence of members of the board and family or business relationships between two ODTKEs
 - ◆ “Reasonable effort” may be achieved with an **annual questionnaire** containing pertinent instructions and definitions
 - ◆ See Form 990 Instructions, Glossary
 - ◆ Follow-up with board members may be necessary



Additional Disclosures re: Business and Family Relationships

- ◆ Form 990, Part IV, Line 28
- ◆ Must report whether any person who is a current or former ODTKE:
 - ◆ Had a direct business relationship with the organization (other than as an officer, director, trustee, or employee), or an indirect business relationship through ownership of more than 35% in another entity
 - ◆ Had a family member who had a direct or indirect business relationship with the organization
 - ◆ Serves as an officer, director, trustee, key employee, partner, or member of an entity (or a shareholder of a professional corporation) doing business with the organization
- ◆ If answers to any of the above are yes, must complete Schedule L, Part IV



Minutes of Governing Body

- ◆ Form 990, Part VI, Line 8 – asks whether organization contemporaneously documents meetings held or written actions undertaken by the governing body and each committee with authority to act on behalf of the governing body
- ◆ Recommended practices:
 - ◆ Contemporaneously document meetings/actions undertaken
 - ◆ Record compliance matters (e.g., quorum, notice)
 - ◆ Record relevant information on oversight (e.g., documents provided, forum for questions)
 - ◆ Record votes and abstentions
 - ◆ Don't need to provide detail on who said what; just the action that was taken
 - ◆ Exercise caution with attorney-client communications and executive sessions



Form 990 Review

- ◆ Form 990, Part VI, Section A, Line 10 - asks whether a copy of the Form 990 was provided to the organization's governing body before it was filed
 - ◆ Requires organization to describe on Schedule O the process, if any, the organization uses to review the Form 990
- ◆ Prepare Form 990 early to ensure board/committee/management has the opportunity to review and comment
- ◆ Practices may differ widely on review process



“Best Practices” – Policies

- ◆ Policies referenced in Form 990, Part VI, Section B include:
 - ◆ Conflicts of Interest Policy
 - ◆ Whistleblower Policy
 - ◆ Document Retention and Destruction Policy
 - ◆ Policy/process for determining compensation of top management official, other officers and key employees by independent persons, using comparability data and contemporaneous substantiation of the deliberation and decision



Conflict of Interest Policy

- ◆ Form 990, Part VI, Line 12 – asks whether organization has written conflict of interest policy and whether and how it monitors and enforces compliance
 - ◆ If yes, requires description in Schedule O
- ◆ IRS places emphasis on Conflict of Interest Policy; should be adopted and enforced:
 - ◆ Should cover directors, officers, trustees and key employees and others with substantial influence
 - ◆ Require disclosure of potential conflicts and related material facts
 - ◆ Implement an annual disclosure process/form to determine whether a conflict exists



Conflict of Interest Policy (cont.)

- ◆ Conflict of Interest Policy components (cont.):
 - ◆ Include procedures for determining whether a relationship, financial interest, or business affiliation results in a conflict of interest
 - ◆ Prescribe a course of action when a conflict is identified
 - ◆ Require independent directors to review and approve transactions where a conflict exists
 - ◆ Require appropriate documentation of actions
 - ◆ Prudent to implement rebuttable presumption under excess benefit rules (e.g., conflicted person should leave the room and recuse him/herself)



Whistleblower Policy

- ◆ Form 990, Part VI, Line 5 - asks whether a material diversion of organization's assets occurred
- ◆ Form 990, Part VI, Line 13 – asks whether the organization has a written whistleblower policy
- ◆ Board should adopt Whistleblower Policy that includes procedures for reporting of illegal conduct (e.g., financial impropriety or misuse of charity resources), handling of complaints, anti-retaliation, and maintaining anonymity of whistleblower



Document Retention and Destruction Policy

- ◆ Form 990, Part VI, Line 14 – asks whether organization has a written document retention and destruction policy
- ◆ Policy should include guidelines on:
 - ◆ Mandatory document retention and periodic destruction
 - ◆ Handling electronic files
 - ◆ Backup procedures, archiving of documents, regular check-ups on reliability of the system
- ◆ Halt any destruction of documents if organization becomes aware of IRS, or other governmental investigation
- ◆ Ensure policy permeates throughout the whole organization



Executive Compensation

- ◆ Form 990, Part VI, Line 15 – asks whether compensation process for CEO, Exec Director, top management official, other officers or key employees includes a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision
- ◆ Establish Compensation Committee comprised of independent directors
- ◆ Adopt written Compensation Committee Charter authorizing committee to approve executive compensation and have full board approve CEO's compensation
- ◆ Adhere to Conflict of Interest Policy



Executive Compensation (cont.)

- ◆ Create Compensation Policy - must disclose process in Schedule O
 - ◆ Reasonable compensation for services rendered
 - ◆ Compensation not only just base salary, also incentives, benefits, executive benefits/perquisites, severance
- ◆ Prudent to implement procedures of rebuttable presumption test of I.R.C. § 4958 and Treas. Reg. § 53.4958-6
 - ◆ Compensation approved in advance by individuals w/out conflict of interest
 - ◆ Authorized body obtained comparability data prior to making determination
 - ◆ Authorized body adequately documented the basis for its determination concurrently w/ making the decision



Public Disclosure of Documents

- ◆ Form 990, Part VI, Section C
- ◆ Transparency and Accountability
- ◆ Requires narrative response on Schedule O as to whether, and how, the organization makes its governing documents, conflict of interest policy, and financial statements available to the public



Financial Reviews and Audits

- ◆ Recommended to establish audit committee comprised of independent members

- ◆ Form 990, Part XI, Line 2 - whether financial statements were compiled, reviewed, or audited by an independent accountant
 - ◆ If yes, asks whether organization has a committee that assumes responsibility for oversight of the audit, review, or compilation and selection of an independent accountant

- ◆ Size and level of assets or annual revenue will affect whether an independent auditor is necessary



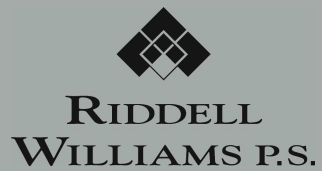
Other Policies and Procedures in Form 990

- ◆ Affiliate Policy – ensures consistency of operations among chapters, branches, or affiliates (Part VI, Line 9)
- ◆ Joint Venture Policy (Part VI, Line 16)
- ◆ Fundraising Policy (Schedule G)
- ◆ Gift Acceptance Policy (Schedule M)
- ◆ Policy on payments to or reimbursements for certain benefits to highly compensated employees for things like travel, club dues, etc. (Schedule J)
- ◆ Procedure for monitoring domestic and foreign grants (Schedules I and F)



Impact of Revised Form 990

- ◆ Organizations should consider whether to adopt the policies and procedures referenced in the new Form 990; consider and document decision not to adopt policies
- ◆ Administrative task of tracking board members and business and family relationships to one another and across related organizations
- ◆ Increased attention to board procedures and documentation



Questions?

Please contact us any time with additional questions.

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