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Towards 21st Century Governance: The Basics and Beyond

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Governance Today

- Traditionally:
  - State law duties of care, loyalty and obedience
  - A simpler IRS Form 990
- Now:
  - Activist attorneys general in several states
  - Robust IRS role
  - Increased legislative and executive branch interest
  - “Watchdog” organizations and social media

What Remains Constant: The Key Role of the Board

- The board of directors is the key governance body for all non-profits, responsible for:
  - Overseeing the organization's financial well-being
  - Setting strategic direction
  - Evaluating performance and fidelity to mission
  - Ensuring compliance with laws
  - Hiring and evaluating the CEO

Role of Directors vs. Management

- **The board** is responsible for **overall management** of the nonprofit.
- **Day-to-day management** duties are typically **delegated to officers and employees** charged with operating the organization under the board's supervision.
- **Directors** do not carry out day-to-day decision making, but are held to certain **fiduciary standards** in order to ensure that the organization is achieving its mission through its activities.

Legal Framework: State Law Fiduciary Duties

- Duty of Care
  - Prudent Person Standard
  - Business Judgment Rule
- Duty of Loyalty
  - Undivided loyalty standard
  - Disclosure and recusal
- Duty of Obedience
  - Fidelity to law and mission

Legal Framework: Federal Tax Law Issues Affecting Governance

- Adherence to tax-exempt mission
- Prohibition against private inurement and limitation on private benefit
- Excise taxes on excess benefit transactions and self-dealing

IRS Statements about Governance

- "Good governance is important to increase the likelihood that organizations will comply with the tax law, protect their charitable assets and, thereby, best serve their charitable beneficiaries."

  -- IRS Website

- "We believe there is a nexus between good governance and tax compliance. It's as simple as that. That belief underlies our work in this area."

  -- Steven T. Miller
  Commissioner, Tax Exempt & Government Entities

IRS Governance Initiatives

- "Good Governance Practices"
- Revised Form 990
- Governance Checksheets

IRS "Good Governance Practices"

- Establish and regularly review mission
- Maintain organizational documents
- Select knowledgeable and engaged governing body
- Implement certain governance and management policies
- Monitor financial statements and Form 990 reporting
- Ensure transparency and accountability

Revised Form 990: Governance, Management and Disclosure

- Part VI of the Form 990 has three sections concerning governance:
  - Section A: Governing Body and Management
  - Section B: Policies
  - Section C: Disclosure

Revised Form 990: Governance, Management and Disclosure

- Part VI requires disclosure of:
  - Number of “independent” directors
  - Family or business relationships among directors, officers and key employees and with the organization
  - Material diversions of assets
  - Whether board and committee actions are “contemporaneously documented”
  - Whether Form 990 was provided to governing body before it was filed and Form 990 review process
  - Whether organization has a conflicts policy, whistleblower policy or document retention policy

IRS Governance Checksheets for Public Charity Exams

- Questions track Form 990:
  - Written mission statement?
  - Comparability data used in compensation determinations?
  - Any family relationships or outside business relationships with other board members, officers, directors or key employees?
  - Controlled by a single or select few individuals?
  - Written conflict of interest policy?
  - Systems to ensure assets are properly used, consistent with the organization's mission?
  - Form 990 reviewed by the full board and/or a designated committee?

IRS Comments about Governance Practices and Tax Compliance

- Based on 1,300 exam checklists, the IRS found:
  - Organizations more likely to be compliant if
    - have a written mission statement,
    - always use comparability data for compensation decisions,
    - have procedures in place for the proper use of charitable assets, and
    - Form 990 was reviewed by the entire board of directors.
  - Less likely to be compliant if control concentrated in one individual, or in a small, select group of individuals
  - No correlation with tax compliance: conflict of interest policies, occasional use of comp data, or family and business relationships between directors, officers, etc.

Legislative Interest: U.S. Senate Finance Committee

- "The tax-exempt sector is so big that from time to time, certain practices draw public concern. My goal is to help improve accountability and good governance so tax-exempt groups maintain public confidence in their operations."

  -- Senator Chuck Grassley, U.S. Senate Finance Committee

- "This proliferation of sloppy, unethical, and criminal behavior is unacceptable. It has led to a crisis in confidence. It has hurt fund raising by legitimate charities. And it overshadows the good work done by the majority of civic-minded groups."

  -- Senator Max S. Baucus, U.S. Senate Finance Committee

Legislative Interest: Recent U.S. Congressional Hearings and Action

- July 25, 2012: Senate Finance Committee launches investigation of disabled veterans' charity over charitable solicitation practices
- July 11, 2012: Congressional Research Service releases report: "An Analysis of Chariable Giving and Donor Advised Funds"
- May 25 and July 25, 2012: House Ways and Means Oversight Subcommittee hearings on public charities:
  - focus on organizational and compliance issues, including increasing complexity of organizational structures, profit-generating activities giving rise to UBIT, whether the new Form 990 is increasing compliance, and whether charities are doing enough to justify tax-exempt status

Proposed New York "Non-Profit Revitalization Act"

- First introduced in NYS Legislature on May 15, 2012—has not yet been enacted
- Based on February 2012 report of the Leadership Committee for Nonprofit Revitalization convened by Attorney General Eric T. Schneiderman
- Stated purpose: To modernize New York law, reduce costly regulatory burdens on nonprofits, and enhance nonprofit governance, oversight, and accountability

Proposed New York "Non-Profit Revitalization Act"

- The Act's Governance provisions would mandate:
  - Processes for approving related party transactions
  - Conflicts of interest policies and filing with the AG's Office
  - Fair and reasonable compensation for all employees set outside the presence of the employee in question
  - Audit committees, charters and duties for New York charities required to register for solicitation and that have annual revenues over $500,000
  - Compensation committees, charters and duties for New York charities required to register for solicitation and that have annual revenues over $1,000,000
  - Whistleblower policies for all New York not-for-profits with 5+ employee and annual revenues over $1,000,000

N.Y. Executive Order on Compensation and Overhead

- Purpose: To prevent use of state funds to pay for excessive administrative costs and outsized compensation for senior executives, rather than devoting a greater proportion to providing direct care or services to their clients
- Applicability:
  - To "covered providers," namely non-profits (and for-profits) that
    - have received, pursuant to a contract with a state agency for providing program services, state funding or "state-authorized payments" averaging over $500,000 a year for the 2 prior years and during the reporting period year, and
    - receive at least 30% of their total annual "in-state revenues" from state funding or "state-authorized payments"
  - Effective January 1, 2013

Governor Cuomo's Executive Order On Compensation and Overhead

- Limits on Executive Compensation:
  - Prohibits spending over $199,000 in state funds or state-authorized payments to compensate a covered executive.
  - If organization chooses to pay more than $199,000 from all sources, organization will incur penalties if:
    - a) compensation is greater than the 75th percentile paid to comparable executives, as established by a compensation survey identified or recognized by the applicable state agency and the Director of the NYS Department of Budget, OR
    - b) compensation was not approved by board or equivalent, including at least two independent directors, and such review did not include assessment of comparability data,
  - Organization must be able to substantiate a) or b) above

Governor Cuomo's Executive Order On Compensation and Overhead

- Limits on Administrative Expenses:
  - No less than 75% of organization's operating expenses paid for with state funds or state-authorized payments shall be for **program services** rather than **administrative expenses**; i.e., administrative expenses limited to 25%
  - Increases to 85% by 2015; admin expenses limited to 15%
- Agency waivers are available in certain circumstances for both executive compensation and administrative expenses.

Watchdog Organizations and Social Media

- Charity Navigator, BBB Wise Giving Alliance, GiveWell, Charity Watch
- Guidestar now partnering with GreatNonprofits to allow the public to review charities
- Different standards utilized by different parties to assess a charity's governance and impact

NYPMIFA: Reviewing the Basics

- Enacted September 17, 2010
- Applicable to all New York Not-For-Profit Corporations
- NYPMIFA compliance milestones:
  - Donor notice regarding endowment funds
  - Solicitation requirement for endowment funds
  - Investment policy requirement
  - Assessment of independence of external agents
  - Documentation of investment and endowment spending decisions
  - Integrated process for investing, budgeting and endowment spending

NYPMIFA Factors

Investment	Endowment Spending
1) General economic conditions	1) General economic conditions
2) Possible effects of inflation/deflation	2) Possible effects of inflation/deflation
3) Expected total return of the portfolio	3) Expected total return of the portfolio
4) Other resources of the organization	4) Other resources of the organization
5) Expected tax consequences, if any, of investment decisions or strategies	5) The duration and preservation of the endowment fund
6) Role that each investment or course of action plays within the overall investment portfolio	6) The purposes of the institution and the endowment fund
7) Needs of the organization and of particular investment funds to make distributions and preserve capital	7) The investment policy of the organization
8) Special relationship or value, if any, of a particular asset to the organization's charitable purposes	8) Where appropriate, alternatives to expenditure of the endowment fund, giving due consideration to the effect on the organization

NYPMIFA Investment Policy

- Sets forth guidelines on investments and delegation of management and investment functions in accordance with NYPMIFA's prudence standards
- Should be adopted and maintained by entire Board
- Should cover all institutional funds, including cash, cash equivalents and real estate held for investment
- Does not include program-related assets, e.g., college's dormitories and facilities, museum's art collections

NYPMIFA

- Investment management decisions should be made in the context of the overall portfolio and within the overall risk management strategy of the organization and not in isolation
- Diversification is required unless the organization reasonably determines that its needs are better served without diversification. NYPMIFA requires that decisions not to diversify be reviewed at least annually

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