THE GROWING IMPORTANCE OF TRUSTEES OF 501(c)(3) ORGANIZATIONS

South Carolina Public and Independent College and University Trustees Conference

September 29, 2009

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IRS Good Governance Practices – Transparency and Accountability

- Mission – S.C. Code §33-31-801(b)
- Organizational Documents
- Governing Body
- Governance and Management Policies
  - Executive Compensation
  - Conflicts of Interest
  - Fundraising
  - Document Retention
  - Whistleblower
  - Investments
- Financial Statements and Form 990
- Document! Document! Document!
- Indemnification – S.C. Code §33-31-851

Documentation

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Focus on Board Members – Transparency and Personal Responsibility

- Executive Compensation
- Conflict of Interest
- Accounting for Investments
- Application of Contributions

Protection for Board Members

- Business Judgment Rule – S.C. Code §33-31-830(a)-(d)
- Common Sense

Attachments: Good Governance Practices for 501(c)(3) Organizations

Business Judgment Rule

MCNAIR

Good Governance Practices
For 501(c)(3) Organizations

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. Successful governing boards include individuals not only knowledgeable and passionate about the organization's programs, but also those with expertise in critical areas involving accounting, finance, compensation, and ethics.

Organizations with very small or very large governing boards may be problematic: Small boards generally do not represent a public interest and large boards may be less attentive to oversight duties. If an organization's governing board is very large, it may want to establish an executive committee with delegated responsibilities or establish advisory committees.

The Internal Revenue Service suggests that organizations review and consider the following to help ensure that directors understand their roles and responsibilities and actively promote good governance practices. While adopting a particular practice is not a requirement for exemption, we believe that an organization that adopts some or all of these practices is more likely to be successful in pursuing its exempt purposes and earning public support.

Mission Statement

Code of Ethics

Due Diligence

Duty of Loyalty

Transparency

Fundraising Policy

Financial Audits

Compensation Practices

Document Retention Policy

1. Mission Statement

A clearly articulated mission statement that is adopted by an organization's board of directors will explain and popularize the charity's purpose and serve as a guide to the organization's work. A well-written mission statement shows why the charity exists, what it hopes to accomplish, and what activities it will undertake, where, and for whom.

2. Code of Ethics and Whistleblower Policies

The public expects a charity to abide by ethical standards that promote the public good. The board of directors bears the ultimate responsibility for setting ethical standards and ensuring they permeate the organization and inform its practices. To that end, the board should consider adopting and regularly evaluating a code of ethics that describes behavior it wants to encourage and behavior it wants to discourage. The code of ethics should be a principal means of communicating to all personnel a strong culture of legal compliance and ethical integrity.

The board of directors should adopt an effective policy for handling employee complaints and establish procedures for employees to report in confidence suspected financial impropriety or misuse of the charity's resources. Such policies are sometimes referred to as *whistleblower* policies.

3. Due Diligence

The directors of a charity must exercise due diligence consistent with a duty of care that requires a director to act:

- In good faith;
- With the care an ordinarily prudent person in a like position would exercise under similar circumstances;
- In a manner the director reasonably believes to be in the charity's best interests.

Directors should see to it that policies and procedures are in place to help them meet their duty of care. Such policies and procedures should ensure that each director:

Is familiar with the charity's activities and knows whether those activities promote the charity's mission and achieve its goals;

Is fully informed about the charity's financial status; and

Has full and accurate information to make informed decisions.

4. Duty of Loyalty

The directors of a charity owe it a duty of loyalty. The duty of loyalty requires a director to act in the interest of the charity rather than in the personal interest of the director or some other person or organization. In particular, the duty of loyalty requires a director to avoid conflicts of interest that are detrimental to the charity. To that end, the board of directors should adopt and regularly evaluate an effective conflict of interest policy that:

> Requires directors and staff to act solely in the interests of the charity without regard to personal interests;
>
> Includes written procedures for determining whether a relationship, financial interest, or business affiliation results in a conflict of interest; and
>
> Prescribes a certain course of action in the event a conflict of interest is identified.

Directors and staff should be required to disclose annually in writing any known financial interest that the individual, or a member of the individual's family, has in any business entity that transacts with the charity. Instructions to Form 1023 contain a sample conflict of interest policy.

5. Transparency

By making full and accurate information about its mission, activities, and finances publicly available, a charity demonstrates transparency. The board of directors should adopt and monitor procedures to ensure that the charity's Form 990, annual reports, and financial statements are complete and accurate, are posted on the organization's public website, and are made available to the public upon request.

6. Fund raising Policy

Charitable fundraising is an important source of financial support for many charities. Success at fundraising requires care and honesty. The board of directors should adopt and monitor policies to ensure that fundraising solicitations meet federal and state law requirements and solicitation materials are accurate, truthful, and candid. Charities should keep their fundraising costs reasonable. In selecting paid fundraisers, a charity should use those that are registered with the state and that can provide good references. Performance of professional fundraisers should be continuously monitored.

7. Financial Audits

Directors must be good stewards of a charity's financial resources. A charity should operate in accordance with an annual budget approved by the board of directors. The board should ensure that financial resources are used to further charitable purpose by regularly receiving and reading up-to-date financial statements including Form 990, auditor's letters, and finance and audit committee reports.

If the charity has substantial assets or annual revenue, its board of directors should ensure that an independent auditor conduct an annual audit. The board can establish an independent audit committee to select an oversee the independent auditor. The auditing firm should be changed periodically (e.g., every five years) to ensure a fresh look at the financial statements.

For a charity with lesser assets or annual revenue, the board should ensure that an independent certified public accountant conduct an annual audit.

Substitute practices for very small organizations would include volunteers who would review financial information and practices. Trading volunteers between similarly situated organizations who would perform these tasks would also help maintain financial integrity without being too costly.

8. Compensation Practices

A successful charity pays no more than reasonable compensation for services rendered. Charities should generally not compensate persons for service on the board of directors except to reimburse direct expenses of such service. Director compensation should be allowed only when determined appropriate by a committee composed of persons who are not compensated by the charity and have no financial interest in the determination.

Charities may pay reasonable compensation for services provided by officers and staff. In determining reasonable compensation, a charity may wish to rely on the rebuttable presumption test of section 4958 of the Internal Revenue Code and Treasury Regulation section of 53.4958-6.

9. Document Retention Policy

An effective charity will adopt a written policy establishing standards for document integrity, retention, and destruction. The document retention policy should include guidelines for handling electronic files. The policy should cover backup procedures, archiving of documents, and regular check-ups of the reliability of the system. For more information see IRS Publication 4221, *Compliance Guide for 501(c)(3) Tax-Exempt Organizations,* available on the IRS website.

Code 1976 § 33-31-830

Code of Laws of South Carolina 1976 Annotated Currentness
Title 33. Corporations, Partnerships and Associations (Refs & Annos)
Chapter 31. South Carolina Nonprofit Corporation Act
Article 8. Directors and Officers
Subarticle C. Standards of Conduct
§ 33-31-830. General standards for directors.

(a) A director shall discharge his duties as a director, including his duties as a member of a committee:

(1) in good faith;

(2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and

(3) in a manner the director reasonably believes to be in the best interests of the corporation.

(b) In discharging his or her duties, a director is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by:

(1) one or more officers or employees of the corporation who the director reasonably believes is reliable and competent in the matters presented;

(2) legal counsel, public accountants, or other persons as to matters the director reasonably believes are within the person's professional or expert competence;

(3) a committee of the board of which the director is not a member, as to matters within its jurisdiction, if the director reasonably believes the committee merits confidence; or

(4) in the case of religious corporations, religious authorities and ministers, priests, rabbis, or other persons whose position or duties in the religious organization the director believes justify reliance and confidence and who the director believes is reliable and competent in the matters presented.

(c) A director is not acting in good faith if the director has knowledge concerning the matter in question that makes reliance otherwise permitted by subsection (b) unwarranted.

(d) A director is not liable to the corporation, a member, or any other person for any action taken or not taken as a director, if the director acted in compliance with this section.