BoardLink

Your connection to effective bar governance

BoardLink – Your Connection to Effective Bar Governance
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For the Good of the Order

When you decided to serve on your bar's board, you probably didn't expect that service would involve reading articles about the IRS Form 990. In case you're not familiar with it, that's the annual reporting return that most federally tax-exempt organizations must file. Since we continue to receive many questions from board members about the 990, we thought an issue of BoardLink focused on the topic was in order.

There are a few different issues relating to the 990 that we'll address. As a starting point, be sure your organization knows what and when to file. Check out this link. Last June, the IRS released a list of more than 275,000 nonprofits that had their tax-exempt status automatically revoked due to failure to file annual returns for three consecutive years. Bar associations were among them.

Many of our organizations have annual audits or reviews and receive valuable help from accounting firms in preparing the 990. Still, the 990 isn't something our boards can delegate completely. But what, exactly, is a board's role? In this issue of BoardLink, we are delighted to share articles that address this question. Emily Chan and Gene Takagi, nonprofit attorneys with the NEO Law Group in San Francisco, are the authors of "What Board Members Should Know about Reviewing a Form 990." The IRS also has an interest in our organizations' adoption and enforcement of certain governance policies, such as conflict of interest. Ms. Chan provides guidance on how to approach this issue, too, in her article "Form 990 Policies – Is it better to check 'yes' or 'no'?"

Every organization's Form 990 is an important public document. Let's be sure we're carrying out our fiduciary duties by giving it the attention it deserves. I hope you'll find these articles informative.

Sincerely,

William R. Bay
Chair, ABA Standing Committee on Bar Activities and Services

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This Quarter's Main Motion

What Board Members Should Know About Reviewing a Form 990

By Emily Chan and Gene Takagi, NEO Law Group

The redesigned Form 990 (the IRS annual information return for certain exempt organizations) released in 2008, marked a new era of increased IRS inquiry into governance-related matters of exempt organizations. Although almost four years have passed since the Form 990 underwent this major facelift, two questions continue to pose challenges and raise uncertainties for many organizations and their boards of directors:

1. Has the organization provided a complete copy of this Form 990 to all members of its governing body before filing the form?
2. Describe in Schedule O the process, if any, used by the organization to review this Form 990.

While federal tax law neither mandates nor provides instructions regarding the board's duty to receive a Form 990 or to have a Form 990 review policy, disclosures on the Form 990 indicating that board members do not receive the Form 990 before filing and/or do not review the form at any time may be perceived as a significant weakness of the organization. With today's increased demands for transparency and accountability in the nonprofit sector, exempt organizations and their boards cannot underestimate the value in proactively and properly addressing these questions.

Providing a copy to the board prior to filing

The Form 990 first asks if a copy of the final version of the Form 990 was provided to each board member before it was filed. While an affirmative response may not provide much assurance that the board is active in its oversight (as this question does not ask whether any board member who received a copy actually reviewed the form either before or after filing), a negative response may be perceived as an indicator of weak board oversight. Thus, although board members may fear that a requirement for the board to receive the final Form 990 prior to filing may result in increased personal exposure (especially if the form contains a misrepresentation or evidences the organization's failure to comply with applicable laws), they should be more concerned about the potential claims or appearance of poor governance associated with choosing to forgo the receipt of this critically important and widely available public document.

Developing a Form 990 Review Policy

The Form 990 next asks for a description of the process, if any, the organization uses to review its Form 990. Given the increasing importance of the Form 990 to authorities, stakeholders and media, organizations are strongly encouraged to develop a policy to help ensure the Form 990 becomes an asset, not a hindrance, to the organization.

Initially, the board should identify areas that deserve extra scrutiny such as those related to the organization's mission and significant activities, financial health, executive compensation, insider transactions, types of expenses (e.g., administrative, fundraising, programmatic), unrelated business activity, relationships among board members and officers, and lobbying and electioneering activity.

Next, the board should strategically identify the various individuals or groups who will be responsible for reviewing the Form 990. While all board members may want to generally review the organization's Form 990, in part as evidence of meeting their fiduciary duty of care, it may be advantageous to have a more manageable-sized board committee tasked with a critical review. Such committee, if carefully chosen and sufficiently prepared, may provide important feedback in the final preparation of the Form 990 and relay pertinent information back to the full board. It's not uncommon for boards to delegate these duties to the audit committee. But since its 2008 redesign, the Form 990 has become much more than a financial report. Accordingly, the extensive narratives, particularly of program service accomplishments and changes in activities, are some of the key areas that should be reviewed by those individuals who are most familiar with the organization's programs and/or have experience with fundraising, marketing, and public relations.

Finally, boards should take note the Form 990 can easily be scrutinized by third parties, and criticism can spread quickly regardless of its validity. Therefore, it may be helpful to charge one or more persons on the reviewing body to look specifically for weak points in the Form 990 prior to filing. Such weak points may be mitigated by, among other things, providing additional context or an explanation of the steps the organization has since taken to address those weaknesses.

Although the Form 990 can be intimidating at first blush, its coverage of financials, programmatic achievements, executive compensation, and governance policies should be familiar territory for a board. Organizations that engage and educate their board members about the Form 990 will benefit from more constructive feedback that in turn results in a public document that best reflects the organization and its values.

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What percentage of bars have adopted the governance policies mentioned on the IRS Form 990? According to the 2011 Membership, Administration and Finance Survey:

Conflict of Interest Policy	80%
Document Retention and Destruction Policy	68%
Whistleblower Policy	59%

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Form 990 Policies – Is it better to check "yes" or "no"?

By Emily Chan, NEO Law Group

Reprinted with permission. This is an updated version of the article published on the Nonprofit Law Blog on March 31, 2011.

The questions regarding certain governance policies referenced by the revised Form 990 have caused quite a stir since the revised Form 990 was released. Scattered throughout the Form 990 (2011) are governance questions which may be influenced by the presence or lack of policies, such as:

- Conflict of Interest Policy (Part VI, Section B)
- Executive compensation approval process (Part VI, Section B)
- Document Retention and Destruction Policy (Part VI, Section B)

- Gift Acceptance Policy (Schedule M)
- Meeting minutes document practices (Part VI, Section A)
- Review process of Form 990 by the Board of Directors (Part VI, Section B)
- Whistleblower Policy (Part VI, Section B)
- Joint Venture Policy, if applicable (Part VI, Section B)
- Policies regarding chapters, affiliates, and branches, if applicable (Part VI, Section B)

An organization can only check yes to having a policy if its board of directors (or a committee of the governing body, if the governing body delegated authority to that committee to adopt the policy) has adopted the policy by the end of its tax year and the policy is applied to the organization as a whole. (2011 Form 990 Instructions). What does this mean for organizations if they didn't have such policies (i.e., does it lead to penalties or increased scrutiny from the IRS)?

The answer is, not surprisingly, it depends. The IRS explains in the 2011 instructions to Form 990 that the policies and procedures requested in Part VI, Section B are generally not required under the Internal Revenue Code. However, the IRS goes on to state that "the IRS considers such policies and procedures to generally improve tax compliance. The absence of appropriate policies and procedures can lead to opportunities for excess benefit transactions, inurement, operations for non-exempt purposes, or other activities inconsistent with exempt status." Therefore, it likely will be a "bad fact" for an organization facing an IRS audit to lack such policies (or efforts to adopt such policies) and might actually contribute to an IRS decision to examine or audit an organization in the first place (see, e.g., IRS Governance Checklist, Part 5 – Conflict of Interest and Part 7 – Document Retention). From a practical standpoint, regardless of potential penalties in the future, such policies are encouraged because they provide helpful and, in some cases, critical guidance for better management of an organization.

"Yes," we have a policy!

Having a policy that has been adopted by the board can indicate good governance, assuming certain other conditions have also been met in implementing and enforcing this policy. The value of a policy in promoting good governance depends on more than simply having a document titled "______ Policy." Policies, like an organization's bylaws, are living documents that should be reviewed and revised throughout the organization's life cycle. Questions to ask include:

- Where did the policy come from? Is this a wholesale adoption of another organization's policy? Has it been vetted for legal compliance?
- When was the last time the policy was reviewed? Have the laws changed since then? Has the organization changed since then?
- Does the organization currently have the capacity – staff, financial resources, or otherwise – to adhere to the policy?
- Do the appropriate parties have and understand the policy (e.g., officers and directors understand and have signed a conflict of interest policy)?
- Is there anything we don't understand about a certain policy? Should we seek assistance (e.g., counsel) for further clarification?
- In practice, are we actually turning to these policies for guidance (e.g., referring to a gift acceptance policy when accepting major gifts)?
- What past governance issues have occurred and did these policies actually help in these situations? Does the policy need to be further altered or fine-tuned to fit the organization's needs?

(Note: Changes to policies are not required to be reported to the IRS unless such polices or procedures are contained within the organizing documents or bylaws and regarding certain subject matter such as conflicts of interests. See 2011 Form 990 Instructions.).

Bottom line: Read, understand, and follow your policy. Review, revise as necessary, and repeat.

"No," we don't.

Being able to report "yes" to having a policy probably feels better than having to mark "no," but organizations without these encouraged policies should not rush to adopt a policy just to join the "yes" group. Some organizations may fear that marking "no" on the publicly available Form 990 annual return will reflect poorly on the organization. However, the benefit of appearing to have good governance is severely undercut when an organization is not exercising good governance in practice. Furthermore, if an organization says "yes" to having adopted a particular policy, the public and the authorities such as the IRS will understandably expect the organization to follow it.

This is not to say these policies should be put on the back burner indefinitely. This is only to emphasize developing such policies takes time. Given that the revised Form 990 first went into effect for the 2008 tax year, organizations should be taking steps to join the "yes" group even if they currently have to mark "no" to having such policies on this tax year's Form 990. Thoughtful considerations about how to get to "yes" can include questions such as:

- Which policies have a higher priority based on the circumstances of the organization? For example, an organization that frequently accepts non-cash gifts may have a more pressing urgency to adopt a useful gift acceptance policy as opposed to an organization that hardly, if ever, accepts donations from the public.
- What are anticipated governance issues or past governance issues that these policies should address?
- What kind of capacity limitations – staff, financial resources, or otherwise – should we be mindful of in drafting and adopting a new policy?
- What is the projected timeline for drafting such policy and presenting it to the board?
- If anticipating a prolonged delay (due to resources, time, etc.) before formally adopting such policies, what problems might this cause and what can the organization do to help mitigate these risks?
- Is the organization prepared to explain to the IRS, its constituents, or others why it currently does not have a certain policy and articulate its action plan moving forward to adopt one?

Additionally, it is important to note an organization lacking the recommended policies is not without any recourse on the Form 990. For example, Schedule O (2011) allows for supplemental narratives to further explain the policies or processes used at the organization to address these governance concerns.

Bottom line: It is worse to adopt a policy that will not be followed or one that causes more problems than benefits than having to say "no" while in the process of developing a thoughtful governance policy.

Are we focusing on the bigger picture?

The question is really less about whether to check "yes" or "no" and more about what purposes these policies serve for the organization and whether steps are being taken to adopt these encouraged governance policies in an appropriate way for the organization. The Form 990 can be a marketing tool, but it's not just about being a good marketer. It's about being a good organization in practice as well.

Tales from the Boardroom

Tales from the Boardroom case studies are fictional examples created by the editor to illustrate common governance challenges.

Our scenario:
The Local Bar Association is about to make a major investment in some new membership management software. The executive director has outlined the pros and cons of three different packages, and is prepared to make a recommendation to the board at today's board meeting.

During the meeting, a board member mentions the bar's conflict of interest policy, discloses that a co-owner of one of the software companies is a family member and that she should probably abstain from the discussion. The president waives his hand. "It's fine. You have important insight in the technology arena. We'd like your input." The remaining board members are silent, and the board member remains in the room for the discussion and participates in the vote.

What's the problem?
According to BoardSource:

"Board service in the nonprofit sector carries with it important ethical obligations. Nonprofits serve the broad public good, and when board members fail to exercise reasonable care in their oversight of the organization they are not living up to their public trust. In addition, board members have a legal responsibility to assure the prudent management of an organization's resources. In fact, they may be held liable for the organization's actions. A 1974 court decision known as the "Sibley Hospital case" set a precedent by confirming that board members can be held legally liable for conflict of interest because it constitutes a breach of their fiduciary responsibility." ("Why must we be concerned about conflicts of interest?" BoardSource Knowledge Center Q&As)

And, if we learned nothing else from Emily Chan's article "Form 990 Policies – Is it better to check 'yes' or 'no'?", we should know that it can be more damaging to have a conflict of interest policy and ignore it than not to have one at all. It's the entire board's responsibility to ensure that policies are observed and enforced.

Sample bar policies can be found on the Division for Bar Services Form 990 Resource Page.

Write me at jennifer.lewin@americanbar.org with your bar's good practices and suggestions. We'll share them in the next issue.

This Quarter's Best Board Practice
An Annual Board Calendar is a great way to communicate recurring processes in which the board will be involved. It's also a great way to highlight events at which the organization would like board participation.

Sample Board Operations Calendar (Carter McNamara)

Other Board Resources

ABA Division for Bar Services Form 990 Resource Page, including sample policies
http://www.americanbar.org/groups/bar_services/resources/990.html

IRS Form 990 Resources http://www.irs.gov/formspubs/article/0,,id=239316,00.html

- Automatic Revocation of Exemption List http://www.irs.gov/charities/article/0,,id=239696,00.html
- How to get an organization's tax-exempt status reinstated http://www.irs.gov/charities/article/0,,id=240101,00.html
- Online courses provided by the IRS at http://www.stayexempt.irs.gov/

National Council of Nonprofits' Resource Page on IRS Form 990 Governance Guidance
http://www.councilofnonprofits.org/resources/resources-topic/boards-governance/irs-form-990-governance-guidance

Conflicts of Interest

- "Duty of Loyalty – Part 1" (Nonprofit Law Blog) (http://www.nonprofitlawblog.com/home/2006/06/duty_of_loyalty.html)

Executive Compensation

- "Compensation Strategies and Best Practices – Part 1" (Nonprofit Law Blog) (http://www.nonprofitlawblog.com/home/2010/10/compensation-strategies-and-best-practices-for-nonprofit-organizations-part-one.html)
- "Compensation Strategies and Best Practices – Part 2" (Nonprofit Law Blog) (http://www.nonprofitlawblog.com/home/2010/10/compensation-strategies-and-best-practices-for-nonprofit-organizations-part-two.html

Document Retention and Destruction

- "Creating a Technology Team/Advisory Committee" (Nonprofit Law Blog) (http://www.nonprofitlawblog.com/home/2009/08/creating-a-technology-teamadvisory-committee.html)

Gift Acceptance

- "Gift Acceptance Policies" (Nonprofit Law Blog) (http://www.nonprofitlawblog.com/home/2009/01/gift-acceptance-policies.html
- "Donation Policy – Controversial Donations" (Nonprofit Law Blog) (http://www.nonprofitlawblog.com/home/2009/04/donation-policy-controversial-donations.html)

Meeting Minutes Documentation Practices

- "Board Meeting Minutes Part 1" (Nonprofit Law Blog) (http://www.nonprofitlawblog.com/home/2011/02/board-meeting-minutes.html)
- "Board Meeting Minutes Part 2" (Nonprofit Law Blog) (http://www.nonprofitlawblog.com/home/2011/02/board-meeting-minutes-part-ii.html)

Sample policies are also available on the Public Counsel website, "Form 990 Policy Series."

Your Feedback

Click here to tell us what you think about this edition of *BoardLink*.