



# The Nonprofit Board: Financial & Legal Best Practices

Although the Sarbanes-Oxley Act took effect more than a decade ago, nonprofit board members may be feeling its financial and legal impacts now more than ever

by Marc Kellenberger

REMEMBER ENRON? FALLOUT from the company's corporate abuse and accounting fraud can still be felt in corporate America more than a decade later — namely through the passing of the Sarbanes-Oxley Act (SOX) by Congress, which aimed to rebuild public trust in the corporate sector.

While SOX is almost exclusively aimed at corporations, a number of the law's provisions have trickled down into the nonprofit boardroom. "SOX law has essentially led nonprofit boards, grant makers, state regulators and, ultimately, the Internal Revenue Service to re-examine the role of good governance and strong policies and procedures for nonprofits," says Ellis Carter, principal of the Carter Law Group, PC.

Today, those governance issues play an even greater role at tax time for the nonprofit. According to Colette Kamps, a certified public accountant and partner with Henry & Horne, LLP specializing in nonprofit services, the IRS Form 990 for nonprofits was completely revamped in 2008 as a direct result of SOX. It now includes a series of board governance policy questions that both Kamps and Carter say nonprofits

should pay close attention to. Answering, "No, we have no policy in place," not only illustrates a lack of best industry practice but, as Carter points out, "An unfavorable response on all those governance questions can make your nonprofit look like low-hanging fruit."

Proof of the low-hanging fruit theory, Carter says, can be seen in the recent uptick of IRS audits at nonprofits. "For the longest time, nonprofits almost assumed it was impossible to be audited by the IRS." That isn't the case any longer. "We are seeing the IRS develop tools that will look at governance responses on the 990 to identify audit targets," she said. "That's actually happening now."

As a result, Carter advises her nonprofit clients to focus on establishing the following governance policies, the first three of which are addressed directly on Form 990 in requesting filers to disclose whether a written policy is in place:

**Whistleblower Policy** — SOX imposes criminal liability on tax-exempt organizations for retaliation against whistleblowers. Carter's recommendation is to adopt a policy that provides a place to confidentially report illegal

conduct and procedures for handling complaints regarding suspected financial impropriety or misuse of nonprofit resources.

**Document Retention and Destruction Policy** — SOX imposes criminal liability on tax-exempt organizations for destruction of records with the intent to obstruct a federal investigation. Carter's advice is to adopt a policy that requires destruction of documents to cease, even if it is being performed on a set schedule, whenever the organization or its employees become aware of a federal investigation or bankruptcy case.

**Conflict of Interest Policy** — A Conflict of Interest Policy is a de facto IRS requirement for public charities in which forms 990 and 1023 ask whether an organization has a Conflict of Interest Policy; both forms require an explanation for those that do not. Also, Arizona law requires a Conflict of Interest Policy for nonprofit corporations with revenues in excess of \$10 million. Conflict of interest policies should, at a minimum, require conflicted members to disclose the conflict, recuse themselves from discussions and votes related to the conflict, and have the conflict decided by disinterested decision makers.

**Signature Authority Policy** — While Form 990 does not ask if this policy is in place, failure to have a signature authority policy (with progressive approvals based on the size of the financial commitment or length of the contract) can lead to organizational liability if a rogue officer, director or employee makes an unauthorized commitment or overcommits funds. If an officer's ability to spend or commit funds is not specifically limited by the board, it will likely be interpreted as unlimited.

Kamps points to another financial expectation of SOX, which some nonprofits have adopted voluntarily: the creation of independent audit committees. "The goal is to have an independent arm of the organization — the audit committee — that acts as a liaison between the board and auditors, and also between auditors and the managers of the organization," says Kamps. "If you don't have that independence, you lose your skepticism in an audit."

While audit committees are not required by Arizona law, their existence is considered a best practice. At the very least, says Kamps, nonprofits should consider having a finance



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committee responsible for communicating directly with the auditors and separately with managers and staff about the audit.

Both Carter and Kamps agree that true compliance with SOX for the nonprofit is both unnecessary and cost prohibitive for most Arizona nonprofits. However, says Carter, having the above policies in place can avoid the possible unwanted attention of the IRS. “Nonprofits,” she says, “should ultimately consider and apply the elements of SOX that make the most sense to their organization.” The following are critical questions for consideration by each nonprofit organization:

1. Is the organization trusted by its various constituencies?
2. Does the governance structure of the organization, both on paper and in practice, provide appropriate levels of oversight where needed and create checks and balances to prevent any one group from having too much unbridled power and authority?
3. Are the operations of the organization sufficiently transparent to all interested parties?
4. Does the organization operate with the highest level of integrity?
5. Does the organization have systems which will ensure that any self-dealing and excessive compensation or benefit to employees within the organization will be dealt with swiftly and decisively?
6. What governance changes can be made that will assist the organization in furthering its mission?

In the end, Kamps and Carter believe that SOX has created a necessary transparency in the nonprofit sector. “I think, as a result of Sarbanes-Oxley, board members today better understand their fiduciary responsibilities and better understand the importance of board governance,” says Kamps. And that, she and Carter both agree, can only be good for the nonprofit. ■

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