

## Issue At A Glance: Corporate Governance For Not-For-Profit Organizations

The House of Representatives finished its first 100 hours. There was a flurry of activity and a number of bills were passed. Most were the “low hanging fruit” that were non-controversial and received Republican support (although the Republicans did complain about being shut out of the process). It also is expected that the legislation will be received favorably in the Senate with modest changes. However, the change in control of Congress may affect a number of issues facing non profit organizations including the drive to place accounting restrictions on these entities.

By now, almost everyone has heard about the Sarbanes Oxley Act (better known as SOX). It was a reaction to the numerous corporate scandals in public companies. The Act placed a number of requirements on these public companies and resulted in increased oversight as well as additional disclosure requirements. While the Act resulted in substantially higher audit fees, it did place a lot of focus on good corporate governance.

Soon after the Act was enacted, a number of large charities also had accounting scandals. As a result, Senator Charles Grassley started to hold hearings on whether provisions, similar to those contained in SOX should be expanded to all tax-exempt entities. While the focus of the reforms was on charities, the thrust of the hearings was much broader and would have affected all not-for-profit organizations. With the Republicans losing the Senate, Senator Grassley is no longer chair of the Senate Finance Committee. It is unlikely, absent another scandal, that corporate governance for not-for-profit organizations will be a priority. However, some of the provisions of SOX will not, and should not, go away. Many board members of not for profit organizations have been exposed to the accounting rules in their own companies and are encouraging changes in the industry. Good governance is something that should be enforced in any case.

*Some of the nonprofit reform provisions that were discussed in the Senate Finance Committee would have required:*

- the exempt status of the entity to be reviewed every five years;
- tax returns and financial statements, for the last five years, to be disclosed via the entity’s web site;
- directors to attest to the performance of their duties and impose liability if not done; and,
- the establishment of a conflict of interest policy and procedures to protect whistle blowers.

The basic premise behind all of the proposals is the establishment of best practices. Several different categories should be reviewed by the Board in establishing best practices starting with the organization and operation of the Board itself. For the Board, best practices would require that it:

- establish policies and rules (including a Code of Conduct) and ensure they are followed;
- establish an audit committee;
- provide whistleblower protection;
- address disciplinary matters;
- ensure that accurate records are maintained;
- do long range planning;
- ensure that the structure and practices of the board provide for sound corporate governance;

The Board should be composed of directors and officers that have the trust and confidence of interested groups and will provide true leadership. In addition, it is imperative that the directors fully understand the duties and responsibilities of the position and that an orientation be provided. Good orientations begin with the recruitment and selection of directors with the overall interest of the organization in mind.

For many not for profit organizations, the board is a voluntary organization composed of individuals with an interest in the work of the entity. They must realize that they have a fiduciary duty to the organization. Part of these duties would require the board to:

- approve and monitor budgets;
- ensure proper use of the entity's assets;
- ensure standards of conduct are followed;
- establish and maintain a code of ethics and conflict of interest policy; and,
- support the organization in word and deed.

But how do board members become effective. First, the members must be educated. They must be aware of what is expected and what is going on both within the organization and in the industry as a whole. They need to identify and address emerging issues and be familiar with the major fiscal and legal policies addressing the organization. A board member should be proactive and be willing to seek the advice of outside experts when appropriate and more important support the board decisions once made.

Sarbanes Oxley requires many of these practices to be followed by public companies. The fact that Sarbanes Oxley does not apply to not for profits should not be a reason to ignore its more reasonable requirements. Although with the change in Congress, it is unlikely that the more onerous aspects of SOX will be expanded to not for profits, other agencies, both federal and state, may begin to move in that direction. Not for profit organizations need to be ready for any change.