

IRS releases governance guidelines for charitable organizations

The IRS recently released guidelines on “[Governance and Related Topics](#)” for 501(c)(3) organizations. These guidelines expand upon a preliminary staff discussion draft entitled “Guidance on Good Governance Practices” released in February 2007 and provide important commentary on the new governance-related questions in the [revised Form 990](#) released in December 2007.

The new guidelines make more explicit than ever the fact that the IRS has specific expectations as to the governance of public charities:

- An effective organization will have an “active and engaged board” that includes members who are independent of management and are “selected with the organization’s needs in mind (e.g., accounting, finance, compensation, and ethics).” The guidelines strongly imply that boards should be neither too large to permit effective decision-making nor too small to adequately serve the needs of the organization. They also encourage that meetings and actions be contemporaneously documented.
- Executive compensation should be “determined by persons who are knowledgeable in compensation matters and who have no financial interest in the determination.” Charities should use comparability data and should contemporaneously substantiate their compensation decisions. The IRS encourages charities to rely on the rebuttable presumption “safe harbor” in section 4958 of the Internal Revenue Code (the so-called “intermediate sanctions” provisions).
- An organization’s conflict of interest policy should contain a requirement that directors and staff act solely in the charity’s interest; provide an effective mechanism for disclosure of conflicts; and “prescribe a course of action in the event a conflict of interest is identified.”
- Charities should have written policies and procedures requiring them to evaluate their participation in joint ventures, for-profit entities, and “complicated and sophisticated financial products or investments.”
- Charities should adopt written policies “establishing standards for document integrity, retention and destruction.”
- Organizations should have “codes of ethics that describe behavior they want to encourage and behavior they want to discourage.”
- Whistleblower policies should be in effect to permit employees “to report in confidence any suspected financial impropriety or misuse of the charity’s assets.”
- The IRS states that even if audited financial statements are not required by state or other law, “a charity with substantial assets or revenue should consider obtaining an audit of its financial statements by an independent auditor.”
- Underlining the public disclosure rules for the Forms 1023, 990 and 990-T, the IRS states its belief that “by making full and accurate information about its mission, activities, finance, and governance publicly available, a charity encourages transparency and accountability to its constituents.”

While none of these topics is new, the IRS has moved beyond merely stating general principles (as in the February 2007 Guidance) and merely asking questions (as in the new 990) to explicitly stating its governance expectations of public charities. While the IRS is testing, and possibly exceeding, the limits of its authority as a revenue agency, management and boards of public charities should actively evaluate the risks of noncompliance with these increasingly clear IRS recommendations.

For help in evaluating your current management structure and in developing new policies and procedures, please talk to your Ropes & Gray lawyer or one of the undersigned.

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