

Nonprofit Governance: What Every Compliance Officer Should Know

Heidi Neff Christianson
Shareholder, Nilan Johnson Lewis
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1. Introduction: The Compliance Officer and the Board. Much has been written about what the Board of a health care provider must know about Compliance and the Compliance program. The continued expansion of health care regulatory enforcement and compliance activities and heightened attention being given to the responsibilities of directors of health care organizations make directors keenly aware of what Compliance Officers do, and the importance of the Compliance Officer's work to them. This presentation is intended to give Compliance Officers a background understanding of the role of the Board of Directors in governance of a nonprofit provider of health care.
2. Nonprofit versus Tax Exempt. There is an important distinction between "nonprofit" and "tax exempt." Nonprofit refers to the chapter of state law under which the organization was formed. A nonprofit organization cannot pay dividends to shareholders or insiders (though it can pay reasonable compensation for services necessary to the nonprofit). Tax exempt refers to the section in the Internal Revenue Code under which the organization has applied for and received federal tax exemption. There are more than 20 different types of federal tax exemption. Nonprofit hospitals are generally tax exempt under Internal Revenue Code Section 501(c)(3), which is a unique designation – the only type of federal tax exemption that allows both exemption from payment of federal income taxes, and the ability to receive tax deductible contributions. New Internal Revenue Code Section 501(r) adds additional requirements for hospitals to maintain tax exemption. Federal tax exemption does not control sales or property tax exemption, which are determined at the state and county level, respectively.
3. Nonprofit Director Fiduciary Duties. The fiduciary duties of nonprofit directors reflect the expectation of corporate stakeholders (patients, regulators, employees, the public) regarding oversight of corporate affairs. Board members of nonprofit and for-profit corporations alike have three fiduciary duties- the duty of care, loyalty and obedience to the law. For profit corporations are most likely to see enforcement actions against their Board of Directors via shareholders. Nonprofit corporations are most likely to see enforcement actions against their Board of Directors by the state's Attorney General.
4. The Duty of Care. The duty of care requires that directors do the following.
 - Directors must **actively participate** in meetings, and committee meetings

- Boards may establish **committees** subject to control of the Board
- **Decisions** of the board should be documented
- Directors should have general knowledge of **books and records**
- Directors should assure accurate recordkeeping via **internal and external audit**
- Directors should protect, preserve, invest and manage **charitable assets**
- Directors should ensure adequate **resources** exist to achieve mission
- Directors should **investigate** warnings or reports
- Directors should engage in **self evaluation**

The duty to act with “care” means that the Board member will act in good faith, with the care an ordinarily prudent person would exercise under similar circumstances.

A. Reasonable Inquiry. Embedded within the duty of care is the concept of reasonable inquiry. Directors are required to make the inquiries and obtain the education that is reasonably necessary to satisfy their duty of care. The reasonable inquiry test basically asks whether the director conducted the appropriate level of due diligence to allow him or her to make an informed decision. The duty for the Board of Directors to oversee the compliance plan comes from the director’s fiduciary duty of “care”.

B. Right to Rely. Of course, crucial to the oversight function is the fundamental principle that a director is entitled to rely, in good faith, on officers and employees as well as corporate professional experts/advisors. A director, however, may be viewed as not acting in good faith if she is aware of facts suggesting that such reliance is unreasonable.

C. Legal Counsel and Compliance Officer. A recent report of the American Bar Association Task Force on Corporate Responsibility (ABA Task Force) suggests that a prudent corporate governance program should utilize the legal counsel to assist in the design and maintenance of the corporation’s procedures for promoting legal compliance. In many health care organizations, the Compliance Officer has primary responsibility for the development, coordination, and monitoring of the compliance and ethics program. However, the legal counsel can serve as a critically important program resource. For example, the legal counsel can provide insights into government regulations, and the potential legal consequences of a proposed course of action. The Board’s oversight function is enhanced if it understands the complementary roles of the legal counsel and the Compliance Officer in their support of the Board’s oversight responsibilities.

The Office of Inspector General and the U.S. Sentencing Commission recommend that Compliance Officers have direct access to the Board of Directors and Chief Executive Officer. Some have expressed concern that a reporting line through other senior manager may interject operational concerns into compliance reviews and financial analyses performed by the Compliance Officer. In many organizations, however, a number of practical and operational reasons may support a Compliance Officer reporting directly to a high-level manager. Either way, it is important that the Compliance Officer still have the regular opportunity to meet with the Board.

5. Duty of Loyalty. The Duty of Loyalty means that the director must put the organization's interests before his or her own interests.

A. Conflicts of Interest. Under certain circumstances, a contract or transaction between a nonprofit and an insider (director, officer, key employee or family or business owned by them) is acceptable. However, if the transaction is challenged, the director will have the burden of establishing that the contract or transaction was fair and reasonable to the nonprofit, that there was full disclosure of the conflict and that the contract or transaction was approved by members of the board without a conflict in good faith. Boards should establish a written conflicts policy. The policy should include annual disclosure of the insider's transactions with the nonprofit and his or her relationships with other entities that may do or seek to do business with the nonprofit. The Board should annually review the disclosures. Conflicts should be called out and observed whenever they arise at a board meeting.

B. Loans and Corporate Opportunity. The nonprofit corporation act provides that a nonprofit may not lend money (or guarantee an obligation of) a director, officer or employee unless the loan or guarantee may reasonably be expected, in the judgment of the entire board, to benefit the corporation. Additionally, directors of business organizations are under a fiduciary obligation not to divert a corporate business opportunity for their personal gain. A nonprofit director is also subject to this duty. This duty means that a director may not engage in or benefit from a business opportunity that is available to and suitable for the nonprofit, unless the nonprofit decides not to engage in the business opportunity and conflicts of interest procedures are followed.

C. Gifts from Vendors. Health care nonprofits should have a policy related to the acceptance by directors, officers and employees of gifts from vendors. The policy is intended to (1) protect the nonprofit from claims of inducement and (2) ensure that the nonprofit uses its assets wisely. The policy should both require disclosure and forbid acceptance of most types of gifts from vendors. Questions related to the policy should be directed to Compliance Officer. Concerns should be able to be reported via a compliance hotline, when necessary.

6. Duty of Obedience. The duty of obedience to the law requires the Board to understand and follow the organization's governing documents (Articles of Incorporation and Bylaws) and Policies. The duty of obedience suggests that new Directors should be given a Board orientation and assessment, so that they understand these documents and policies. In general the duty of obedience requires the following.

- Directors should be **familiar with state and federal laws**, employment, sales and property taxes, IRS regulations that impact tax exemption.
- Directors should act to **protect state and federal tax exemption**.
- Directors should ensure required filings are done to **ensure transparency**.
- Directors should be familiar with and follow **governing documents**.
- Where appropriate, directors should **obtain outside help** to comply with the law.

A. Chief Executive Assessment and Compensation. The Board or a Committee must regularly assess the chief executive's performance against goals and other relevant criteria. The Board obtains and reviews compensation data for comparable positions to determine whether the chief executive's compensation is reasonable. Only individuals free of a conflict of interest in the compensation decision participate in the discussion. The compensation deliberations are documented in meeting minutes.

B. Federal IRS Form 990 Review. The IRS form 990 is the annual tax filing made by all tax exempt organizations. It is the most widely accessed information regarding a tax exempt organization's activities conducted in support of its mission and tax exemption. All IRS forms 990 filed can be found at www.guidestar.org. The Board of Directors should conduct a timely review of the complete IRS Form 990 and all attachments. The final 990 must be provided to all Board members prior to filing. It is acceptable for the review to follow the actual filing, (e.g. at the next Board meeting). **Part VI and Schedule H** of the IRS Form 990 are critical to Board members.

C. Whistleblower Policy. Every nonprofit should have a policy and communicate procedures for reporting and investigation of complaints about perceived or possible illegalities, questionable practices or policy violations. The policy should provide for **confidentiality and protection from retaliation** by the organization.

D. Document Retention Policy. Every nonprofit should have a policy with respect to the retention and destruction of key documents. The policy should **prohibit the destruction** of documents placed under a **legal hold** by a person named in the policy as being responsible for legal holds when documents might be relevant to a government investigation or litigation.

7. Governance Check Sheet. The governance check sheet is a two-page document (IRS Form 14114) that is used by IRS exempt organizations Revenue Agents in their examinations of hospitals and other public charities recognized as income tax exempt under Internal Revenue Code § 501(c)(3). The Check Sheet provides questions to be considered by the agent with respect to six different aspects of the organization's corporate governance structure: (a) "Governing Body and Governance Topics"; (b) "Compensation"; (c) "Organizational Control"; (d) "Conflict of Interest"; (e) "Financial Oversight"; and (f) "Document Retention." The bottom line is that the IRS is monitoring nonprofit governance. Compliance Officers are well advised to be familiar with the Governance Check Sheet.