

Importance of governance in the nonprofit sector





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About the Global Family Office Group

Foreword

Sound governance policies and practices are critical to building a successful organizational foundation, as they provide a solid underpinning for the organization. This is especially true for the nonprofit sector in which organizations operate for a collective, public or social benefit. Transparency and accountability using well documented policies and practices can often go a long way to instill public confidence and trust in a nonprofit. Since nonprofits are typically supported, at least in part, by governments, private foundations, public charities and by the generosity of donations from the public, it is essential that each of these stakeholders have that confidence and trust in the nonprofits with which they partner.

Policies and practices should be established for most areas of statutory compliance for nonprofits and each country is different in terms of legal compliance requirements. It is always recommended that legal and tax professionals proficient in the nonprofit sector review and opine on the policies established and approved by the board/trustees to ensure each policy addresses any specific regulatory requirements to which the nonprofit must adhere.

Over the years, nonprofit organizations have increased in size, diversity and complexity, each with its own unique culture. Policies and practices should reflect the nonprofit's culture while including the key components that align with industry leading practices.

Policies and practices that are documented, reviewed and updated on a periodic basis tend to be more effective and easier to administer. Not every practice followed by the organization requires documentation and review, as that would lead to an administrative nightmare. Some of the governance policies that the board/trustees should establish for the nonprofit include:

- Conflicts of interest
- Code of ethics
- Whistle blowing
- Investment policy statement
- Compensation
- Gift acceptance
- Document retention and destruction

This white paper is intended to give an overview of select governance policies and to cover some of the key components that should be included therein. While not an exhaustive list, this paper seeks to provide an informative guide to creating a solid underpinning for your nonprofit organization.

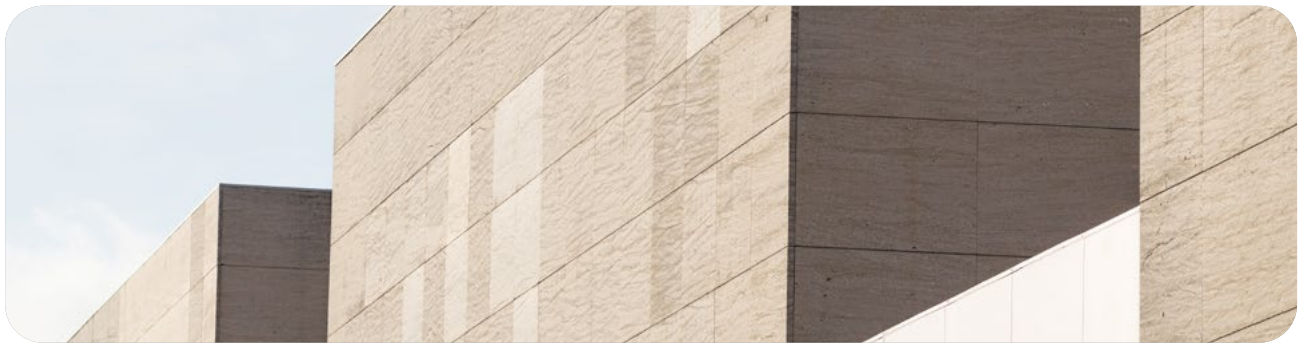


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Conflict-of-interest policy

A conflict of interest has been defined by the Internal Revenue Service as an instance where “the obligations of an individual member of a nonprofit, private foundation or public charity has personal financial interests that clash with the interests and/or obligations of their organization’s charitable purposes.”¹ In other words, an individual must act in the best interests of the nonprofit to the exclusion of their own or others’ personal interests. Conflicts of interest can have a negative effect on the internal and external operations of the nonprofit.

There may also be legal ramifications and reputational risk for the nonprofit resulting from an erosion of stakeholder trust and confidence, all of which may be hard to overcome. It is highly unlikely that any organization could completely avoid conflicts of interest. Therefore, board members, trustees, officers and employees should all be bound by the policy.



Key components of a conflict-of-interest policy

The conflict-of-interest policy is both proactive and reactive by nature. It typically requires those with a potential, perceived or actual conflict to disclose that fact. It then provides the steps for doing so and further actions to be taken.

Components to consider when drafting a conflict-of-interest policy include:

Definitions of common terms used when discussing conflicts are helpful for identifying the types of conflicts that may arise. For example, defining a “conflict of interest,” who is considered an “interested person” when a conflict arises, or what a “nonfinancial interest” is.

Annual disclosure statements are completed by board members/trustees to help identify potential conflicts. Information to disclose includes, but is

not limited to, information about board members/trustees, their immediate family members, positions held at other organizations, owned and controlled businesses, and relationships with other board members/trustees, officers or employees.

Outline the steps to report a potential, perceived or actual conflict, the procedures to determine if a conflict indeed exists, and once identified, next steps to be taken.

Documentation of the discussion and resolution of the conflict during board meetings should be included in the meeting minutes. If a board member or trustee has a conflict, whether potential, perceived or actual, they should be prohibited from voting on any associated matter.

Violations of the policy may also arise and the consequent steps need to be articulated.

¹ [Form 1023: Purpose of Conflict of Interest Policy | Internal Revenue Service \(irs.gov\)](#)

Code of ethics policy

The code of ethics policy is values-driven and is sometimes referred to as the statement of values. The purpose of adopting such a policy is to set out the values that guide ethical choices of conduct. Everyone in the organization – employees, volunteers, interns and board members/trustees – should be bound by the policy, as should those that the nonprofit does business with, such as vendors or major donors. Those within the nonprofit are all seen as representatives of the organization. This policy can therefore signal the nonprofit's commitment to ethical behavior for stakeholders outside of the organization, enhancing their confidence and trust in the organization.

In addition to providing basic guidelines of how to conduct oneself and business with others in a way that is ethical, this policy ensures there is accountability for that conduct, steps to take when violation occurs and the consequences for violation of the policy. Since each nonprofit has its own unique culture, each may have different values that are important to it.

Key components of a code of ethics policy

Some of the values that formulate the guidelines for the code of ethics policy are based on common principles of ethics, such as respect, integrity, honesty, responsibility, accountability, dignity, lawfulness and justice. Incorporating those values and other components when drafting a code of ethics policy include:

Defining the purpose and what is meant by ethics so that those bound by the policy have a clear understanding that it is not a matter of trust but rather a helpful guide when gray areas are encountered and where they are bound by a legal requirement.

Articulating the values important to your nonprofit to frame the guidelines. For example, respect may include treating people as you want to be treated, while honesty may include telling the truth and avoiding any wrongdoing to the best of your ability.

Setting out the guidelines based on the values determined to be important to the organization. Other organizational resources that may be helpful in various circumstances – as well as the steps to follow if action is needed – should be included.

For example:

Respect guidelines include treating everyone you interact with respectfully, perhaps also giving examples of breaches. This might include specifying that violence is strictly prohibited and will result in immediate termination. Likewise, harassment and sharing a link to the nonprofit's harassment policy provides an additional resource for people. Including the steps to follow if action is needed, e.g., reporting instances to HR, ensures there is a clear path to follow.

Lawfulness guidelines may apply differently for professional roles in the organization. For example, accountants may have their own legal requirements to comply with, and the policy could address the requisite knowledge expected for accountants. These guidelines may also specify required behaviors such as confidentiality and data protection, as well as prohibited behaviors such as bribery. Additional resources could include links to the nonprofit's data protection and cybersecurity policies. For next steps or additional guidance, the legal team or HR contact details might be given.

Whistleblower policy

While most of those working in the nonprofit sector always have the best interest of the nonprofit organization and its chosen cause in mind, there are no shortages of cases involving mismanagement of nonprofits. Adopting a whistleblower policy signals to internal and external stakeholders that the nonprofit wants to hear concerns and complaints about its practices. It shows that the nonprofit values transparency and accountability, which can help to bolster the trust and confidence of its external stakeholders. The policy may also be an effective tool to comply with local regulatory requirements.

The whistleblower policy should be communicated throughout the organization such that all are aware of the policy and its protections. It should be easily accessible internally and to the public.

Key components of a whistleblower policy

The whistleblower policy empowers employees at any level to speak up when they learn of a colleague's potential or actual harmful actions. It is meant to protect whistleblowers from retaliation, describe how problems are investigated, identify the internal or external parties to whom information can be reported and provide the path to resolution. Components to consider when drafting a whistleblower policy include:

Applicability of the policy should extend to everyone in the organization irrespective of their position, including volunteers, interns, employees, committees and board members/trustees.

Retaliation should spell out unacceptable responses to good-faith whistleblowing, including physical intimidation, ostracization in the workplace, micromanagement, any loss of pay or status and any other negative consequence for doing the right thing.



A mechanism for expressing concern should be clearly articulated and available to everyone in the organization with anonymity guaranteed. Reporting concerns directly to an email and/or telephone hotline, HR or legal can be adopted by the organization.

Resolution of concerns is the responsibility of the nonprofit, but investigation of concerns should not be. Instead, investigation ought to be handled by outside legal counsel.

Maliciously false allegations need to be addressed within the policy as well. This includes discouraging maliciously false statements, protecting personnel against such accusations and outlining the disciplinary consequences for perpetrators. It should be emphasized that incorrect concerns that are voiced in good faith will not attract sanction.



Investment policy statement

For nonprofits that accept donations to their endowments, have long-term investment funds, experience situational short-term capital needs, require financing and/or financial flexibility, the investment policy statement (IPS) provides the roadmap for the endowment's investing activities.

An IPS could be for everyone involved with the nonprofit. This includes – but is not limited to – the board/trustees, investment committee, employees, investment advisors, managers, beneficiaries and donors. The IPS seeks to provide transparent guidance on the philosophy and approach that will govern investment management in pursuit of the desired goals.

It may also serve to document a nonprofit's compliance with legal requirements of endowment asset management, if any. Since it documents the guidance and policy for prudent investment asset management, it provides the substantiation that those charged with the fiduciary responsibility of asset management followed the policy. This in effect provides a safeguard for those individuals against others second guessing their investment management decisions, especially in times of challenging market conditions.

In our white paper [Creating an investment policy](#), we outline the importance of spelling out investment policies, the roles and responsibilities of boards/trustees and/or the investment committee, and the components of the framework for helping to manage the nonprofit's resources efficaciously, make risk-weighted investment decisions and demonstrate that governance responsibilities are being met.

Compensation policy

For any organization, and especially in the nonprofit sector, attracting and retaining top talent are essential, especially to key leadership positions. The process for determining compensation of an executive director and other key employee roles for a nonprofit should be articulated in the compensation policy. In some jurisdictions, there are requirements that compensation for key employees of nonprofit organizations be “reasonable and not excessive” and in other jurisdictions, compensation for certain individuals associated with the nonprofit must be “reasonable and necessary to carry out the exempt purpose of the organization.”

The compensation policy can be used to document adherence to regional compliance requirements, help ensure that key employees of the nonprofit are compensated appropriately and contribute to transparency for both internal and external stakeholders, reinforcing their confidence and trust in the nonprofit.

Key components of a compensation policy

The role of the board/trustees is to hire, review and evaluate the executive leadership of the organization, as the executive director reports directly to the board/trustees. On a practical level, if the governing documents of the nonprofit allow, this could include considerations for use of a compensation committee to support the board/trustees. Components to consider when drafting a compensation policy include:

Applicability typically extends to officers, executives and key employees of the nonprofit.

Structure and elements of compensation should include all components of compensation and not just base salary. Bonuses, contributions to retirement accounts, insurance premiums paid by the organization, and housing and car allowances should be considered.

Data used for a comparative analysis requires in-depth research to determine competitiveness, reasonableness and appropriateness of compensation. Such research can be conducted in-house or can be outsourced to a compensation consultant and should compare leaders of nonprofits with similar responsibilities. Keep in mind that titles are not always an effective gauge of the actual role and responsibilities of a nonprofit leader.

Other comparisons to make when researching compensation may include the nonprofit’s mission, employee numbers, globality and endowment size. Additionally, some nonprofit organizations prepare compensation studies annually for purchase.

Decision making processes need to be set out, whether made by the board/trustees or through a compensation committee. The compensation policy should mandate that deliberations and approval decisions be documented either in board/trustee or committee meeting minutes or another formal document approved by the board/trustees.



Gift acceptance policy

Since nonprofits are typically financially supported by various stakeholders, it might appear inconceivable at first blush that any gift would be turned down. However, there are numerous instances where declining a gift may be the correct decision. For example, gifts may not align to a nonprofit's mission; the donor's reputation or source of wealth may be undesirable; there may be unacceptable strings attached; the nonprofit may have no experience with the format of the gift, e.g., real estate or digital assets.

Accepting gifts that are at odds with the nonprofit's mission or from questionable donors can be puzzling to employees, volunteers and board/trustees and easily become an internal distraction. If such gifts become known publicly, reputational damage may ensue, eroding the vital confidence and trust of external stakeholders.

When a nonprofit has no experience with a gift, especially illiquid assets, it may need to hire outside experts to help liquidate the gift. The internal time and financial resources required to do so may be more than the gift is worth. Maintaining discipline around acceptable gifts and steering clear of others can help avoid unnecessary risk, expense and liability.

Depending on the jurisdiction, some gifts may trigger compliance requirements. This could be as simple as a documented acknowledgement from the nonprofit to the donor describing the gift, the date of the donation, and indicating the goods or services received in exchange for the gift – and if none, stating this. Others may involve more stringent reporting to tax authorities. Some gifts, especially restrictive gifts, may be in violation of civil rights laws due to donor-stated conditions such as the gift only being used to benefit one race or gender.

Key components of a gift acceptance policy

The primary purpose of a gift acceptance policy is to guide staff and the board/trustees as to the types of gifts accepted. It is also helpful in managing donor expectations by helping staff to explain why they cannot accept certain gifts. A gift vetting committee could help support the board/trustees but also act as the primary resource to answer questions, scrutinize complex potential gifts and serve as the point of contact for legal engagement. Components to consider when drafting a gift acceptance policy include:

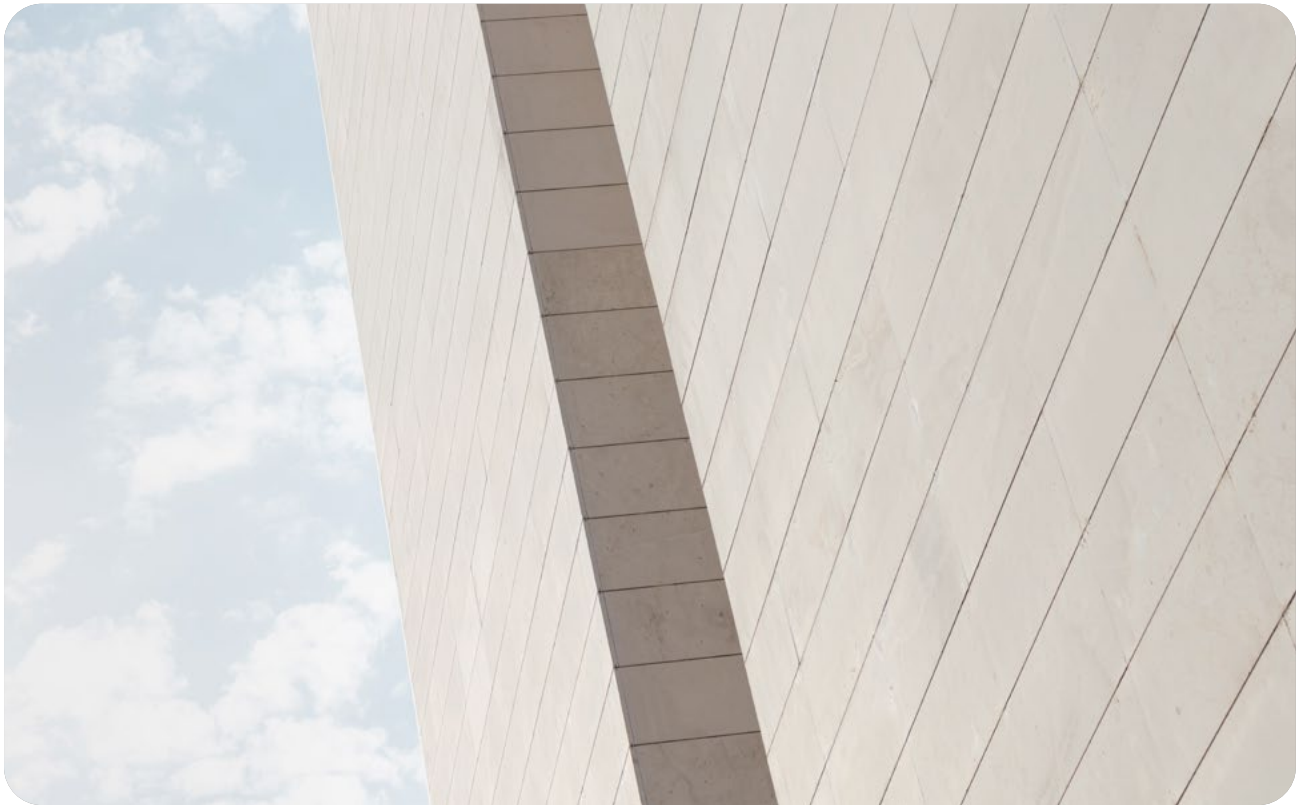
General guidelines can frame the issue of the alignment of gifts to the mission and purpose of the organization, extending to the reputation of prospective donors and/or their source of wealth.

Acceptable gifts should be listed along with any additional criteria that need to be considered for each type of non-cash gift. These may include the marketability of the gift, gift sale restrictions and additional carrying costs to hold the gift. The policy should also outline who is responsible for documentation and resolution and for additional considerations for the gift.

Tentatively acceptable and unacceptable gifts should also be listed along with the rationale for the caution or rejection. This can help staff in their discussions with prospective donors and provides the additional framework for those gifts that are subject to additional criteria. As noted, overly restrictive gifts should be vetted with legal counsel, as should other tentatively acceptable gifts such as those with naming rights or anonymity requirements. The aim is to ensure the nonprofit can comply with donor-stated restrictions. As with acceptable gifts, the policy should outline who is responsible for documentation and resolution and for additional considerations for the gift.

Approval process should identify those that are authorized to approve each type of gift and steps required in the gift acceptance process, including how to contact the authorized approver and how the approval or denial process is documented. Note that gifts such as cash, marketable securities and unrestricted bequests should be generally accepted with no approval process required. If a gift acceptance committee is involved, the policy should identify committee members, the types of gifts that must go through the committee, how to contact the committee and how often the committee meets to address proposed gifts. The committee can document approval or denial of the gift and their rationale via their meeting minutes.

Reporting requirements, if any, should be included within the policy and indicate the role(s) within the organization responsible for collecting the information required and to whom that information is given.



Document retention and destruction policy

An effective document retention and destruction policy will help ensure accurate financial statement and tax return preparation while safeguarding against improper disposal of documents. In this context, documents refer not only to physical documents but also to electronic documents and data stored on the cloud or on a server. In these cases, it is critical to have a back-up plan in place.

Determination of what is stored, how it is stored, retention period specifics and how physical and electronic documents are destroyed vary by country and by jurisdiction within countries. Data privacy regulations by jurisdiction play a critical role in development of this policy. The policy should prohibit the destruction of any document in anticipation of litigation.

Typically, documents such as general correspondence, duplicate deposit slips, bank reconciliations, bank statements, inventory records, employment applications and the like are retained for shorter periods of time as compared to documents such as formation documents, corporate resolutions, minutes, terminated employee personnel files, insurance policies, tax returns, real estate deeds, and trademark, patent and copyrights.



Key components of a document retention and destruction policy

The document retention and destruction policy provides easy-to-follow written rules and a point person to contact should questions arise. Components to consider when drafting the policy include:

Applicability typically extends to everyone in the organization, including volunteers, interns, employees, officers and directors.

How documents are stored can also help to control the accessibility of the documents or data. For example, access to databases that contain personal granting information should be limited to those within the development office. Documents or databases with sensitive personal information, such as payroll records, should not be accessible to everyone within the organization. Centralized document storage within networks, rather than on individual desktops, can help with version control of a document. Access to networks can also be controlled.

Record retention period provides the type of document and retention period start and end dates, enabling documents to be destroyed in accordance with the policy. As noted, it is critical to seek professional legal advice as each country and jurisdiction can differ.

Document destruction provides how documents are destroyed. For example, physical documents containing sensitive information are typically shredded, whereas general correspondence need not be. Consideration should also be given to deleting documents from individual computers, databases, networks and back-up storage. The policy should strictly prohibit any destruction of documents that may be pertinent to any ongoing or anticipated government investigation or proceedings or private litigation.

A point person to contact should questions arise can be helpful for the organization to identify, whether that person is the organization's general counsel or another senior leader who can engage outside legal counsel to resolve questions.



Closing thoughts

Well-run organizations – for-profit and nonprofit alike – typically have strong governance policies and practices, which provide a solid foundation and enable effective management of the organization. For the nonprofit sector that relies so heavily on the generosity of others, having well-documented, transparent policies sends the message to both internal and external stakeholders that it takes its mission seriously and strives for organizational excellence.

Whether your nonprofit is just starting out or is due a periodic review, policies provide the guidelines and structure necessary for the organization to grow and prosper.

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We offer clients comprehensive private banking and family office advisory services, institutional access to global opportunities and connections to a community of like-minded peers.

For more information, please contact your Private Banker or the group head in your region.

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Citi Private Bank [Philanthropic Advisory](#) partners with individuals, families and nonprofit organizations to help bring their legacies and missions to life by designing bespoke strategic development guidance, coupled with solid governance and programmatic frameworks that aim to create meaningful impact.

We guide clients through a range of considerations, including: strategic development, compliance and infrastructure, implementation, and monitoring and evaluation.

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