

**STRENGTHENING THE PARTNERSHIP:
EXECUTIVE PERFORMANCE, SUPERVISION,
EVALUATION AND COMPENSATION**

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YH ADVISORS
THE EXEMPT ORG EXPERTS

Presentation Overview

Transparency

Compensation

- Reasonable Compensation

Performance Evaluations

- Board Oversight & Supervision

Job Responsibilities

- Executive Director

Board Meetings

Policies & Procedures

- Conflict of Interest Policy
- Whistleblower Policy
- Reasonable Compensation Documentation Procedures



Transparency

Public Disclosure Rules (see Sec. 6104 of IRC)

- All 990s posted on www.guidestar.org
- General public disclosure rules
 - **Must make available without charge at principal office**
 - **No reason needs to be given to see Form 990**
 - **Need to provide back 3 years**

Relevant Parts of Form 990

- Part VI
 - **Policies**
 - Conflict of interest policy
 - Whistleblower policy
 - **Procedures**
 - Reasonable compensation documentation procedures
- Part VII
 - **Detailing of all insider compensation arrangements**
- Schedule J



Compensation

Reasonable compensation

- Valuation standard used to determine if there is an excess benefit in the exchange of a disqualified person's services for compensation
 - **All-inclusive, including all compensatory benefits received (other than nontaxable fringe benefits)**
- Initial contract exception
 - **Section 4958 does not apply to any fixed payment made to a person pursuant to an initial contract (binding written contract between public charity and a person who was not a disqualified person immediately prior to entering into the contract)**

Rebuttable presumption of reasonableness (shift burden of proof to the IRS)

- Transaction approved by independent members of governing body
 - **Independent connotes absence of conflict of interest**
 - Child of organization's Executive Director cannot serve on compensation committee deciding on the compensation for the Executive Director
- Before making decision, governing body relied upon comparability data
 - **Safe harbor for small organizations (gross receipts less than \$1 million)**
 - Comparability data includes compensation paid by three comparable entities (community/services)
- Governing body contemporaneously documents basis for making its determination



Compensation (cont'd)

Contemporaneous documentation (rebuttable presumption of reasonableness)

- Terms of the approved compensation and the date approved
- Members of the authorized body present during debate on the compensation amount and those who voted on it
- Comparability data obtained and relied upon and how such data was obtained
 - **Compensation paid by similarly situated organizations for functionally comparable positions**
 - **Availability of similar services in same geographic area**
 - **Current compensation surveys by independent firms**
 - **Insider's particular training, expertise, scope of duties**
 - **Actual offers from others competing for insider's services**
- Any actions by member of authorized body having a conflict of interest
- Documentation of the basis for the compensation determination before the later of the next Board meeting or 60 days after the final actions of the authorized body are taken



Compensation (cont'd)

Preparation of Reasonable Compensation Binder

- Satisfies documentation requirements of the intermediate sanctions rebuttable presumption set forth in Sec. 4958 of the Internal Revenue Code
 - **Provide enough documentation to shift the burden of proof to the Internal Revenue Service to claim that compensation being paid to an insider is unreasonable**
 - **Binder contains all necessary information to support that the total compensation paid to insider is reasonable (according to the payor tax-exempt organization)**



PROCEDURES – REASONABLE COMPENSATION (INSIDERS)

- ▶ The insiders of the organization are as follows:
 - Any member of the Board of Directors
 - Any Officer of the organization
 - Executive Director
 - Top financial person of the organization (e.g. Chief Financial Officer / Finance Director / Controller)
 - Any key employees (as defined by the Internal Revenue Service for purposes of completing Part VII of the Form 990)
 - Any family member for any of the aforementioned
- ▶ Definition of compensation - all-inclusive, including all compensatory benefits received (other than nontaxable fringe benefits); includes salaries, bonuses, taxable fringe benefits, retirement plan contributions, loan agreements, and deferred compensation amounts.
- ▶ Definition of reasonable compensation - amount of compensation a similar enterprise, whether taxable or tax-exempt, would pay for similar services under similar circumstances; reasonableness of compensation can be established by independent compensation surveys and actual written offers from similar institutions.
- ▶ When determining the annual compensation for any insider, the organization shall always undertake and satisfy all three prongs of the rebuttable presumption set forth in the Internal Revenue Code regarding intermediate sanctions (§4958).
 1. Compensation arrangement approved in advance by independent members of the organization's governing body (Board of Directors or a subcommittee thereof) that is composed of persons who do not have a conflict of interest with respect to the compensation arrangement.
 2. Before making the reasonable compensation determination, the governing body (or subcommittee thereof) relied upon comparability data (comparability data includes compensation paid by comparable and similarly situated entities) in deciding whether to approve the compensation.
 3. Governing body contemporaneously documents their basis for making its reasonable compensation determination, as follows:
 - a. Terms of the approved compensation and the date approved by the Board
 - b. Members of Board present during debate on the compensation amount and those who voted on it and how they voted on it
 - c. Description of the comparability data obtained and relied upon and how such data was obtained
 - d. Any actions by Board member having a conflict of interest (e.g. disclosure of the conflict of interest; recusal from the discussion)
 - e. Documentation of the basis for the compensation determination before the later of the next Board meeting or 60 days after the final actions of the authorized body are taken

- ▶ It is essential that the individuals whose compensation is being discussed not be present during such discussions.
- ▶ All identified payments of unreasonable compensation to an insider should be corrected (undoing of the unreasonable compensation to the extent possible) as soon as feasibly possible; for example, the insider should payback to the organization the unreasonable compensation amounts plus interest to put the organization in a financial position no worse than that in which it would be if the insider were dealing under the highest fiduciary standards.
- ▶ The reasonable compensation discussion should be undertaken by the Board at least annually; the reasonable compensation binder maintained for each insider should also be prepared, or at least updated, annually.
- ▶ The organization shall refrain, whenever possible, from paying contingent compensation to insiders and also avoid the payment of golden parachute payments to insiders.

Compensation (cont'd)

Board Negotiations with Executive Director re Salary

- Distinctive expertise
- Extensive experience with the applicable exempt organization
- Ability to undertake programmatic, administrative and fundraising work
- Scarcity of other viable candidates
- Retention factors
- Comparables



Performance Evaluations

Overview

- Undertaken annually at a minimum
- Administered during meeting with Board
- Everything should be written

Objectives

- More focus on goal setting than a report card

Process

- Develop performance measurements and standards
- Determine who should conduct the evaluation
 - **Generally should be a Committee of the Board**
- Gathering information for the annual performance evaluation
- Preparation of a self-evaluation
- Tabulating and reviewing evaluations from Board evaluators
- Presenting the evaluation
 - **Executive Committee?**
- Approval of evaluation by full Board



Performance Evaluations (cont'd)

Elements

- Financial
 - Preparation of monthly financial reports
 - Preparation of annual budgets
 - Presentation of audited financial statements to the Board
 - Oversight of the Form 990 preparation process
- Programmatic
 - Managing the exempt organization's program service activities
- Human Resources
 - Hiring staff
 - Supervising staff
 - Developing staff



Performance Evaluations (cont'd)

Elements (cont'd)

- Fundraising
 - **Developing and implementing a fundraising plan**
 - **Conducting public outreach activities**
 - **Public relations**
- Board Relationships
 - **Implementing Board policies and directives**
 - **Reporting the organization's activities to the Board**

Other Considerations

- 360 evaluations
- Interim or project evaluations



Job Responsibilities

Job Descriptions for the Executive Director

- Develop and maintain the exempt organization's program service activities
- Diversify the organization's funding base
- Develop and sustain the staff and volunteer resources essential to the pursuit of the organization's mission and program.
- Increase the understanding of, and support for, the organization's mission and program
- Develop and maintain organizational systems essential to sustaining the organization's financial management systems
- Assist the Board in the development of strategic plans, annual plans and fund-raising plans
- Development of business plans for the organization's program service activities



Job Responsibilities (cont'd)

Job Descriptions for the Executive Director (cont'd)

- Development, for approval by the Board , of a plan for communications with the organization's primary constituencies, stakeholders and audiences
- Direct supervision of all staff and volunteers
- Preparation of an annual budget
- Ensure that an annual financial and program audit, in compliance with Office of Management and Budget Circular A-133, is performed
- Prepare a report on the organization's financial condition for each meeting of the Board
- Provide a general report on the operations of the organization at each meeting of the Board
- Ensure operational compliance of the organization with all federal, state and local laws and regulations governing its activities



Board Meetings

Executive Director Attending Board Meetings

- Recommended that Executive Director not be voting member of the Board
 - **That being said, recommended that Executive Director attend all Board meetings**

Consent Agendas

- At every Board meeting, a number of items do not need any discussion or debate either because they are routine procedures or are already unanimous consent
- Consent agenda allows the Board to approve all these items together without discussion or individual motions
 - **Can free up anywhere from a few minutes to a half hour for more substantial discussion**
- Typical consent agenda items (routine, procedural decisions, and decisions that are likely to be noncontroversial)
 - **Approval of the minutes**
 - **Final approval of proposals or reports that the Board has been dealing with for some time and all members are familiar with the implications**
 - **Routine matters such as appointments to Committees**
 - **Staff appointments requiring Board confirmation**
 - **Reports provided for information only**
 - **Correspondence requiring no action**



Policies & Procedures

Conflict of Interest Policy

- All exempt organizations must have a conflict of interest policy
- Very important to identify, monitor and address conflicts

Whistleblower Policy

- Not necessary if organization does not have any employees
 - **Although it is still recommended**

Document Retention and Destruction Policy

- All exempt organizations should have a document retention and destruction policy

Reasonable Compensation Documentation Procedures

- Any exempt organizations compensating any insiders should maintain written reasonable compensation documentation procedures
 - **Reasonable compensation binder**



Appendix A: Sample Conflict of Interest Policy

Note: Items marked *Hospital insert – for hospitals that complete Schedule C* are intended to be adopted by hospitals.

Article I Purpose

The purpose of the conflict of interest policy is to protect this tax-exempt organization's (Organization) interest when it is contemplating entering into a transaction or arrangement that might benefit the private interest of an officer or director of the Organization or might result in a possible excess benefit transaction. This policy is intended to supplement but not replace any applicable state and federal laws governing conflict of interest applicable to nonprofit and charitable organizations.

Article II Definitions

1. Interested Person

Any director, principal officer, or member of a committee with governing board delegated powers, who has a direct or indirect financial interest, as defined below, is an interested person.

[Hospital Insert – for hospitals that complete Schedule C

If a person is an interested person with respect to any entity in the health care system of which the organization is a part, he or she is an interested person with respect to all entities in the health care system.]

2. Financial Interest

A person has a financial interest if the person has, directly or indirectly, through business, investment, or family:

- a. An ownership or investment interest in any entity with which the Organization has a transaction or arrangement,
- b. A compensation arrangement with the Organization or with any entity or individual with which the Organization has a transaction or arrangement, or
- c. A potential ownership or investment interest in, or compensation arrangement with, any entity or individual with which the Organization is negotiating a transaction or arrangement.

Compensation includes direct and indirect remuneration as well as gifts or favors that are not insubstantial.

A financial interest is not necessarily a conflict of interest. Under Article III, Section 2, a person who has a financial interest may have a conflict of interest only if the appropriate governing board or committee decides that a conflict of interest exists.

Article III Procedures

1. Duty to Disclose

In connection with any actual or possible conflict of interest, an interested person must disclose the existence of the financial interest and be given the opportunity to disclose all material facts to the directors and members of committees with governing board delegated powers considering the proposed transaction or arrangement.

2. Determining Whether a Conflict of Interest Exists

After disclosure of the financial interest and all material facts, and after any discussion with the interested person, he/she shall leave the governing board or committee meeting while the determination of a conflict of interest is discussed and voted upon. The remaining board or committee members shall decide if a conflict of interest exists.

3. Procedures for Addressing the Conflict of Interest

- a. An interested person may make a presentation at the governing board or committee meeting, but after the presentation, he/she shall leave the meeting during the discussion of, and the vote on, the transaction or arrangement involving the possible conflict of interest.
- b. The chairperson of the governing board or committee shall, if appropriate, appoint a disinterested person or committee to investigate alternatives to the proposed transaction or arrangement.
- c. After exercising due diligence, the governing board or committee shall determine whether the Organization can obtain with reasonable efforts a more advantageous transaction or arrangement from a person or entity that would not give rise to a conflict of interest.
- d. If a more advantageous transaction or arrangement is not reasonably possible under circumstances not producing a conflict of interest, the governing board or committee shall determine by a majority vote of the disinterested directors whether the transaction or arrangement is in the Organization's best interest, for its own benefit, and whether it is fair and reasonable. In conformity with the above determination it shall make its decision as to whether to enter into the transaction or arrangement.

4. Violations of the Conflicts of Interest Policy

- a.** If the governing board or committee has reasonable cause to believe a member has failed to disclose actual or possible conflicts of interest, it shall inform the member of the basis for such belief and afford the member an opportunity to explain the alleged failure to disclose.
- b.** If, after hearing the member's response and after making further investigation as warranted by the circumstances, the governing board or committee determines the member has failed to disclose an actual or possible conflict of interest, it shall take appropriate disciplinary and corrective action.

Article IV **Records of Proceedings**

The minutes of the governing board and all committees with board delegated powers shall contain:

- a.** The names of the persons who disclosed or otherwise were found to have a financial interest in connection with an actual or possible conflict of interest, the nature of the financial interest, any action taken to determine whether a conflict of interest was present, and the governing board's or committee's decision as to whether a conflict of interest in fact existed.
- b.** The names of the persons who were present for discussions and votes relating to the transaction or arrangement, the content of the discussion, including any alternatives to the proposed transaction or arrangement, and a record of any votes taken in connection with the proceedings.

Article V **Compensation**

- a.** A voting member of the governing board who receives compensation, directly or indirectly, from the Organization for services is precluded from voting on matters pertaining to that member's compensation.
- b.** A voting member of any committee whose jurisdiction includes compensation matters and who receives compensation, directly or indirectly, from the Organization for services is precluded from voting on matters pertaining to that member's compensation.
- c.** No voting member of the governing board or any committee whose jurisdiction includes compensation matters and who receives compensation, directly or indirectly, from the Organization, either individually or collectively, is prohibited from providing information to any committee regarding compensation.

[Hospital Insert – for hospitals that complete Schedule C

- d.** Physicians who receive compensation from the Organization, whether directly or indirectly or as employees or independent contractors, are precluded from membership on any committee whose jurisdiction includes compensation matters. No physician, either individually or collectively, is prohibited from providing information to any committee regarding physician compensation.]

Article VI **Annual Statements**

Each director, principal officer and member of a committee with governing board delegated powers shall annually sign a statement which affirms such person:

- a.** Has received a copy of the conflicts of interest policy,
- b.** Has read and understands the policy,
- c.** Has agreed to comply with the policy, and
- d.** Understands the Organization is charitable and in order to maintain its federal tax exemption it must engage primarily in activities which accomplish one or more of its tax-exempt purposes.

Article VII **Periodic Reviews**

To ensure the Organization operates in a manner consistent with charitable purposes and does not engage in activities that could jeopardize its tax-exempt status, periodic reviews shall be conducted. The periodic reviews shall, at a minimum, include the following subjects:

- a.** Whether compensation arrangements and benefits are reasonable, based on competent survey information, and the result of arm's length bargaining.
- b.** Whether partnerships, joint ventures, and arrangements with management organizations conform to the Organization's written policies, are properly recorded, reflect reasonable investment or payments for goods and services, further charitable purposes and do not result in inurement, impermissible private benefit or in an excess benefit transaction.

Article VIII **Use of Outside Experts**

When conducting the periodic reviews as provided for in Article VII, the Organization may, but need not, use outside advisors. If outside experts are used, their use shall not relieve the governing board of its responsibility for ensuring periodic reviews are conducted.

DC BAR PRO BONO PROGRAM

NONPROFIT GOVERNANCE

& THE REVISED IRS FORM 990

PROGRAM FIVE:

DEVELOPING A CULTURE OF TRANSPARENCY

APRIL 6, 2010

**The Joint Task Force of the Nonprofit and Unincorporated Organizations and
Exempt Organizations Committees of the State Bar of California**

Form 990 Policy Series

Document Retention and Destruction Memorandum

Whistleblower Memorandum

The two attached Memoranda were prepared by a Joint Task Force consisting of attorneys who are members of either the California State Bar Business Law Section's Nonprofit and Unincorporated Organizations Committee or the California State Bar Tax Section's Exempt Organizations Committee, or both. The consent of the Task Force to the use of the material for this program sponsored by the D.C. Bar is gratefully acknowledged.

The two memoranda that follow are part of a comprehensive *Form 990 Policy Series*, being finalized during 2010. The *Form 990 Policy Series* memoranda include form policies, but more importantly, include rationales and procedures for drafting and adopting appropriate policies responding to the new Form 990. While (as indicated in the "Note on the Scope of this Material" at the beginning of each memorandum) the Joint Task Force's *Form 990 Policy Series* addresses certain issues relevant only to nonprofit organizations organized under, or regulated by, California law, it is also intended as a helpful resource for the broader nonprofit community in addressing governance issues arising from the disclosure requirements of the new Form 990. It is anticipated that the entire *Form 990 Policy Series* will be available in due course for purchase from the California State Bar.

MEMORANDUM

From: The Joint Task Force of the Nonprofit and Unincorporated Organizations and Exempt Organizations Committees of the State Bar of California

Re: Document Retention and Destruction Policy – Form 990, Part VI, Section B, Line 14 (Form 990 Policy Series Memo #4)

Date: December 1, 2009

NOTE ON THE SCOPE OF THIS MATERIAL

This material is designed to provide general guidance about an aspect of nonprofit corporate governance in the specific and limited context of the disclosure requirements of the new IRS Form 990 (published by the IRS in 2008 and applicable to 990 filers based on a 2009-2011 filing year phase-in period depending on the size of the nonprofit). It is intended to provide some general guidance on the establishment of processes and/or policies to address a specific governance disclosure requirement of the Form. The subject matter of that requirement implicates a broad array of legal and practical issues ranging far beyond the immediate subject matter of the requirement itself. This material may address some of those issues but does NOT attempt to review them comprehensively and is NOT intended to be relied on for guidance on how they should be addressed in any specific situation.

Whether or not a nonprofit organization adopts a specific governance process or policy (or modifies an existing one), either in response to the disclosure requirements of the new IRS Form 990 or to change its governance practices for other reasons is a matter to be carefully considered by that organization, with input from its board and advisors and evaluation of its specific circumstances. The IRS has explicitly stated that adoption of the policies and practices about which the new Form 990 requires information is not mandatory, although the IRS has also indicated that it attaches significance to the manner in which all tax-exempt nonprofit organizations govern themselves. The inclusion of a sample policy in this material is not intended to suggest that the policy is appropriate for every nonprofit organization nor that, if a policy on that topic is determined to be appropriate, the formulation in the sample necessarily fits the needs of an individual nonprofit organization. A customized approach, with outside professional advice, is recommended. Accordingly, this material is intended as general information for legal practitioners advising nonprofit organizations as to their governance and does not constitute legal advice for any particular nonprofit organization.

Although the subject matter of this material may have relevance to nonprofit organizations that are not required to file informational tax returns with the IRS or are permitted to file on an IRS form other than Form 990, the focus of this material is 990 filers. While this material is meant to apply to Form 990 filers who are exempt under Section 501(c) of the Internal Revenue Code, certain portions of this material may be applicable only to Section 501(c)(3) organizations. In addition, although this material may be of assistance with respect to nonprofit organizations that are not subject to regulation under California law, there may be portions of this material that are relevant only to nonprofits organized under, or regulated (by reason of their California-related activities) by, California law and, except as specifically discussed in this material, the laws of other States are not addressed.

1. Summary

The new Form 990, at Part VI, Section B, Line 14, asks whether the organization has a written document retention and destruction policy. As stated in the new Form 990 Instructions: “A document retention and destruction policy identifies the record retention responsibilities of staff, volunteers, board members, and outsiders for maintaining and documenting the storage and destruction of the organization’s documents and records.” This Memorandum is intended to provide general guidance for the consideration and adoption of a policy responsive to the Form and Instructions.

2. Rationale for Adoption of the Policy

Historically, dating to the pre-electronic records era, a principal rationale for a Document Retention and Destruction Policy ("DRD Policy"), has been to save space and save money by destroying paper documents which were no longer needed or required for an organization. Paper storage took up a lot of space, either at the organization premises or at off-site storage facilities which charged for the service. Even with the dawn of the electronic records era, storage space and the cost of that space continued as an issue. Initially, records would be stored on magnetic cards or disks, which themselves also took up space, although not as much physical space as paper documents. At the same time, the electronic storage media themselves could become costly for an organization. Later, electronic records, including e-mails, were stored on servers maintained by the organization at its premises and/or off-site. As clients have indicated, this method of storage has also become costly, with the requirements of maintaining servers capable of storing vast amounts of data.

At the same time, another principal rationale for the DRD Policy was to ensure that the organization retained documents which could later be required for business or regulatory purposes. For example, maintaining tax documents in case of an audit or other investigation was a concern. Similarly, employment records were viewed as worthy of retention. Contract documents as well as those relating to ownership of organization assets also come into play in such a policy. Businesses in regulated industries may have other requirements.

In addition, document retention in case of litigation or governmental investigation became a consideration. In fact, particularly in light of developments in electronic (or e-) discovery, the proper maintenance and timely destruction of electronic (as well as paper) documents could save a great deal of money for an organization forced to search unwieldy and voluminous records in the face of discovery requests. At this time, compliance with law as it relates to litigation discovery and governmental investigations is another principal rationale for instituting and maintaining an appropriate DRD Policy and program.

3. Background of Requirements/Sources for the Policy

A. Specific Retention Period Requirements for Different Documents

State and federal laws with respect to statutes of limitation for particular lawsuits as well as specific requirements for retaining certain documents will largely determine the retention period for affected documents. At the same time, certain documents are of such importance to an organization that they should be permanently retained.

B. Sarbanes-Oxley Requirements

Section 802 (Criminal Penalties for Altering Documents) of the Sarbanes-Oxley Act ("SOX") added Section 1519 to the federal criminal code, which provides:

Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.

SOX Section 1102 (Tampering with a Record or Otherwise Impeding an Official Proceeding) added a new subsection (c) to Section 1512 of the federal criminal code, which states:

(c) Whoever corruptly— (1) alters, destroys, mutilates, or conceals a record, document, or other object, or attempts to do so, with the intent to impair the object's integrity or availability for use in an official proceeding; or (2) otherwise obstructs, influences, or impedes any official proceeding, or attempts to do so, shall be fined under this title or imprisoned not more than 20 years, or both.

In addition to possible criminal liability, civil liability may result from the wrongful destruction of evidence, or “spoliation.”

C. Federal Rules of Civil Procedure

Among other things, Federal Rule of Civil Procedure (“FRCP”) 26(a)(1) requires a party to voluntarily provide

a copy — or a description by category and location — of all documents, electronically stored information, and tangible things that the disclosing party has in its possession, custody, or control and may use to support its claims or defenses, unless the use would be solely for impeachment;

FRCP 26(b)(1) provides in pertinent part:

Parties may obtain discovery regarding any nonprivileged matter that is relevant to any party's claim or defense — including the existence, description, nature, custody, condition, and location of any documents or other tangible things and the identity and location of persons who know of any discoverable matter. For good cause, the court may order discovery of any matter relevant to the subject matter involved in the action. Relevant information need not be admissible at the trial if the discovery appears reasonably calculated to lead to the discovery of admissible evidence.

FRCP 37(e) states:

Absent exceptional circumstances, a court may not impose sanctions under these rules on a party for failing to provide electronically stored information lost as a result of the routine, good-faith operation of an electronic information system.

Note that “good faith” is an element of this defense. Negligence, willfulness or gross negligence in dealing with these matters will result in penalties.

D. Zubulake and Other Cases

In a series of five opinions involving an employment discrimination case (Zubulake I-V), the U.S. District Court for the Southern District of New York dealt with a number of issues relating to electronic discovery. In *Zubulake v. UBS Warburg, LLC*, 217 F.R.D. 309 (S.D.N.Y. 2003) (“Zubulake I”), the court dealt with the scope of electronic discovery and the issue of who should pay for it. **As indicated in Zubulake IV, an organization becomes subject to a duty to preserve (or halt the destruction of) records once litigation, an audit or a government investigation is reasonably anticipated.** *Zubulake v. UBS Warburg*, 220 F.R.D. 216 (S.D.N.Y. 2003).

At the same time, in order to comply with the preservation obligation, a company need not suspend the destruction of non-relevant records. Rather, parties should take steps to preserve the relevant information, what is sometimes known as a “litigation hold.” See *William T. Thompson Co. v. Gen. Nutrition Corp.*, 593 F. Supp. 1443, 1455 (C.D. Calif. 1984), where the court stated:

While a litigant is under no duty to keep or retain every document in its possession once a complaint is filed, it is under a duty to preserve what it knows, or reasonably should know, is relevant in the action, is reasonably calculated to lead to the discovery of admissible evidence, is reasonably likely to be requested during discovery and/or is the subject of a pending discovery request.

The holdings of these cases, as well as others like them, are relevant to the drafting and implementation of a DRD Policy. In that regard, taking into account such cases as well as the Federal Rules as they relate to electronic discovery, the DRD Policy should also establish standards for document integrity, including guidelines for handling electronic files, backup procedures, archiving of documents, and regular checkups of the reliability of the system.

E. Form 990 and Instructions

Part VI, Section B, Line 14 of the new Form 990 asks: “Does the organization have a written document retention and destruction policy?” The new Form 990 Instructions relating to this topic state:

A document retention and destruction policy identifies the record retention responsibilities of staff, volunteers, board members, and outsiders for maintaining and documenting the storage and destruction of the organization’s documents and

records. Answer “Yes” if the organization had these policies in place as of the last day of the organization’s tax year.

Certain federal or state laws may ... prohibit destruction of certain documents. For instance, while the federal Sarbanes-Oxley legislation generally does not pertain to tax-exempt organizations, it does impose criminal liability on tax-exempt as well as other organizations for ... destruction of records with the intent to obstruct a federal investigation. See 18 U.S.C. section... 1519. Also note that an organization is required to keep books and records relevant to its tax exemption and its filings with the IRS. ...

4. Considerations and Procedures for Implementation of the Policy

A. First, discuss with the client the ways in which documents are created or generated. With respect to each employee or organizational function, are documents created which can be easily segregated from others, so that, when it comes time to destroy (or retain) those documents, they can be easily culled from the others for disposition? For example, on an employee-by-employee basis, are e-mails and other documents of a significantly non-sensitive nature so that they might be deleted, even in the face of a litigation hold with respect to other, more sensitive, documents? While this discussion will not necessarily dictate the provisions of the DRD Policy, it may go a long way toward achieving a major purpose of the Policy -- to conserve resources (such as, money and space) -- by identifying document streams in a way which will allow the DRD Policy to routinely provide for destruction of documents. Ideally, the client will want to create and archive documents in a way that can readily identify and destroy documents with similar expirations.

B. Determine whether policies are already in place and, if so, whether they are worth retaining.

C. Determine how privacy laws will apply to documents and data from and with respect to employees and members or customers. The Policy and related procedures should provide or allow for complete compliance with such privacy laws. In addition, such procedures should be capable of audit and review on a regular basis.

D. Carefully think through the record retention responsibilities of staff, volunteers, board members, and outsiders for maintaining and documenting the storage and destruction of the organization’s documents and records. Although the IRS in its 990 instructions seems to imply that volunteers should have some responsibility, and, in fact, some special responsibility, with respect to such matters, the volunteers should have as little responsibility as possible. Anyone who is a volunteer (meaning that they are contributing their time, *gratis*) will think twice about continuing to volunteer if they are responsible for maintaining documents on their personal or business computers for some specified amount of time, for searching for documents on their computers and/or for destroying certain documents. These responsibilities should instead rest on management and staff.

Thus, the policies should be structured in such a way that the only (or primary) responsibility of volunteers with respect to documents would be to produce specifically identified documents upon request of management, if the volunteer still retained such documents. For example, the policy might provide that, after each project in which a volunteer has been involved, or each term which the volunteer has served, it would be the responsibility of the policy administrator to confirm whatever types of documents the volunteer retained and to request any such documents which such administrator felt would be necessary for retention by the organization (not by the volunteer). Other outsiders may include, without limitation, lawyers, accountants, bookkeepers, human resources providers, vendors and other service providers. Lawyers have their own special responsibilities with respect to documents. Depending upon the sensitivity of the documents involved with the particular vendor relationship, the organization's contract with the vendor could specify particular responsibilities of the vendor with respect to documentation. However, make no mistake about it, the primary responsibility with respect to document retention and destruction for an organization rests with management.

E. Ensure that the policy includes standards for document integrity, including guidelines for handling electronic files, backup procedures, archiving of documents, and regular checkups of the reliability of the system. However, by all means, only include requirements which management knows will be met within the capabilities of the organization. The worst thing that an organization can do is to adopt policies which it does not follow, since liability will then surely ensue.

F. Provide for one specific policy administrator (with assistants, if necessary) who will be responsible for administration of the policy. Such individual's responsibilities should include periodic review of the policies for current relevance and compliance. If that administrator is not the CEO, then the administrator should report to the CEO.

G. The policy must contain specific procedures for instituting a litigation hold where litigation, an audit or a government investigation is reasonably anticipated. As indicated above, this is an area where liability could be significant if proper procedures are not instituted and followed.

H. Once the policy is adopted, it should be explained to employees to the extent that they are able to assist in its compliance.

I. Again, it cannot be stressed enough, that the organization should only adopt policies which it is confident it can follow.

J. The DRD Policy should be carefully explained to and adopted by the Board of Directors. Prior to adoption, it should be determined where the policy should be placed in the organization's documentation. Alternatives may include, for example, in an employee manual, in the bylaws, in a board policies and procedures manual or as a stand-alone item. The manner in which the policy must or will be adopted – such as by the board of directors (recommended), by the members, or both – should also be determined. In every case, the policy must be disseminated to all affected constituencies such as, for

example, employees, directors, members and volunteers. Finally, the client should be cautioned that the organization should only adopt policies which it is confident it can follow. It could well be worse to adopt a policy which is not followed than to have no policy at all.

5. Sample Policy or Policies

DOCUMENT RETENTION AND DESTRUCTION POLICY

1. Policy and Purposes

This Policy represents the policy of _____ (the “organization”) with respect to the retention and destruction of documents and other records, both in hard copy and electronic media (which may merely be referred to as “documents” in this Policy). Purposes of the Policy include (a) retention and maintenance of documents necessary for the proper functioning of the organization as well as to comply with applicable legal requirements; (b) destruction of documents which no longer need to be retained; and (c) guidance for the Board of Directors, officers, staff and other constituencies with respect to their responsibilities concerning document retention and destruction. Notwithstanding the foregoing, the organization reserves the right to revise or revoke this Policy at any time.

2. Administration

2.1 Responsibilities of the Administrator. The organization’s _____ [CEO, President, Executive Vice President, Vice President for __, etc.] shall be the administrator (“Administrator”) in charge of the administration of this Policy. The Administrator’s responsibilities shall include supervising and coordinating the retention and destruction of documents pursuant to this Policy and particularly the Document Retention Schedule included below. The Administrator shall also be responsible for documenting the actions taken to maintain and/or destroy organization documents and retaining such documentation. The Administrator may also modify the Document Retention Schedule from time to time as necessary to comply with law and/or to include additional or revised document categories as may be appropriate to reflect organizational policies and procedures. The Administrator is also authorized to periodically review this Policy and Policy compliance with legal counsel and to report to the Board of Directors as to compliance. The Administrator may also appoint one or more assistants to assist in carrying out the Administrator’s responsibilities, with the Administrator, however, retaining ultimate responsibility for administration of this Policy.

2.2 Responsibilities of Constituencies. This Policy also relates to the responsibilities of board members, staff, volunteers and outsiders with respect to maintaining and documenting the storage and destruction of the organization’s documents. The Administrator shall report to the Board of Directors (the board members acting as a body), which maintains the ultimate direction of management. The

organization's staff shall be familiar with this Policy, shall act in accordance therewith, and shall assist the Administrator, as requested, in implementing it. The responsibility of volunteers with respect to this Policy shall be to produce specifically identified documents upon request of management, if the volunteer still retains such documents. In that regard, after each project in which a volunteer has been involved, or each term which the volunteer has served, it shall be the responsibility of the Administrator to confirm whatever types of documents the volunteer retained and to request any such documents which the Administrator feels will be necessary for retention by the organization (not by the volunteer). Outsiders may include vendors or other service providers. Depending upon the sensitivity of the documents involved with the particular outsider relationship, the organization, through the Administrator, shall share this Policy with the outsider, requesting compliance. In particular instances, the Administrator may require that the contract with the outsider specify the particular responsibilities of the outsider with respect to this Policy.

3. Suspension of Document Destruction; Compliance. The organization becomes subject to a duty to preserve (or halt the destruction of) documents once litigation, an audit or a government investigation is reasonably anticipated. Further, federal law imposes criminal liability (with fines and/or imprisonment for not more than 20 years) upon whomever "knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States ... or in relation to or contemplation of any such matter or case." Therefore, if the Administrator becomes aware that litigation, a governmental audit or a government investigation has been instituted, or is reasonably anticipated or contemplated, the Administrator shall immediately order a halt to all document destruction under this Policy, communicating the order to all affected constituencies in writing. The Administrator may thereafter amend or rescind the order only after conferring with legal counsel. If any board member or staff member becomes aware that litigation, a governmental audit or a government investigation has been instituted, or is reasonably anticipated or contemplated, with respect to the organization, and they are not sure whether the Administrator is aware of it, they shall make the Administrator aware of it. Failure to comply with this Policy, including, particularly, disobeying any destruction halt order, could result in possible civil or criminal sanctions. In addition, for staff, it could lead to disciplinary action including possible termination.

4. Electronic Documents; Document Integrity. Documents in electronic format shall be maintained just as hard copy or paper documents are, in accordance with the Document Retention Schedule. Due to the fact that the integrity of electronic documents, whether with respect to the ease of alteration or deletion, or otherwise, may come into question, the Administrator shall attempt to establish standards for document integrity, including guidelines for handling electronic files, backup procedures, archiving of documents, and regular checkups of the reliability of the system; provided, that such standards shall only be implemented to the extent that they are reasonably attainable considering the resources and other priorities of the organization.

5. Privacy. It shall be the responsibility of the Administrator, after consultation with counsel, to determine how privacy laws will apply to the organization's documents from and with respect to employees and other constituencies; to establish reasonable procedures for compliance with such privacy laws; and to allow for their audit and review on a regular basis.

6. Emergency Planning. Documents shall be stored in a safe and accessible manner. Documents which are necessary for the continued operation of the organization in the case of an emergency shall be regularly duplicated or backed up and maintained in an off-site location. The Administrator shall develop reasonable procedures for document retention in the case of an emergency.

7. Document Creation and Generation. The Administrator shall discuss with staff the ways in which documents are created or generated. With respect to each employee or organizational function, the Administrator shall attempt to determine whether documents are created which can be easily segregated from others, so that, when it comes time to destroy (or retain) those documents, they can be easily culled from the others for disposition. For example, on an employee-by-employee basis, are e-mails and other documents of a significantly non-sensitive nature so that they might be deleted, even in the face of a litigation hold with respect to other, more sensitive, documents? This dialogue may help in achieving a major purpose of the Policy -- to conserve resources -- by identifying document streams in a way that will allow the Policy to routinely provide for destruction of documents. Ideally, the organization will create and archive documents in a way that can readily identify and destroy documents with similar expirations.

8. Document Retention Schedule. [Periods are suggested but are not necessarily a substitute for counsel's own research and determination as to appropriate periods.]

<u>Document Type</u>	<u>Retention Period</u>
Accounting and Finance	
Accounts Payable	7 years
Accounts Receivable	7 years
Annual Financial Statements and Audit Reports	Permanent
Bank Statements, Reconciliations & Deposit Slips	7 years
Canceled Checks – routine	7 years
Canceled Checks – special, such as loan repayment	Permanent
Credit Card Receipts	3 years
Employee/Business Expense Reports/Documents	7 years
General Ledger	Permanent
Interim Financial Statements	7 years
Contributions/Gifts/Grants	
Contribution Records	Permanent
Documents Evidencing Terms of Gifts	Permanent
Grant Records	7 yrs after end of grant period

Corporate and Exemption

Articles of Incorporation and Amendments	Permanent
Bylaws and Amendments	Permanent
Minute Books, including Board & Committee Minutes	Permanent
Annual Reports to Attorney General & Secretary of State	Permanent
Other Corporate Filings	Permanent
IRS Exemption Application (Form 1023 or 1024)	Permanent
IRS Exemption Determination Letter	Permanent
State Exemption Application (if applicable)	Permanent
State Exemption Determination Letter (if applicable)	Permanent
Licenses and Permits	Permanent
Employer Identification (EIN) Designation	Permanent

Correspondence and Internal Memoranda

Hard copy correspondence and internal memoranda relating to a particular document otherwise addressed in this Schedule should be retained for the same period as the document to which they relate.

Hard copy correspondence and internal memoranda relating to routine matters with no lasting significance Two years

Correspondence and internal memoranda important to the organization or having lasting significance Permanent, subject to review

Electronic Mail (E-mail) to or from the organization

Electronic mail (e-mails) relating to a particular document otherwise addressed in this Schedule should be retained for the same period as the document to which they relate, but may be retained in hard copy form with the document to which they relate.

E-mails considered important to the organization or of lasting significance should be printed and stored in a central repository . Permanent, subject to review

E-mails not included in either of the above categories 12 months

Electronically Stored Documents

Electronically stored documents (e.g., in pdf, text or other electronic format) comprising or relating to a particular document otherwise addressed in this Schedule should be retained for the same period as the document which they comprise or to which they relate, but may be retained in hard copy form (unless the electronic aspect is of significance).

Electronically stored documents considered important to the organization or of lasting significance should be printed and stored in a central repository (unless the electronic aspect is of significance). Permanent, subject to review

Electronically stored documents not included in either of the above categories	Two years
Employment, Personnel and Pension	
Personnel Records	10 yrs after employment ends
Employee contracts	10 yrs after termination
Retirement and pension records	Permanent
Insurance	
Property, D&O, Workers' Compensation and General Liability Insurance Policies	Permanent
Insurance Claims Records	Permanent
Legal and Contracts	
Contracts, related correspondence and other supporting documentation	10 yrs after termination
Legal correspondence	Permanent
Management and Miscellaneous	
Strategic Plans	7 years after expiration
Disaster Recovery Plan	7 years after replacement
Policies and Procedures Manual	Current version with revision history
Property – Real, Personal and Intellectual	
Property deeds and purchase/sale agreements	Permanent
Property Tax	Permanent
Real Property Leases	Permanent
Personal Property Leases	10 years after termination
Trademarks, Copyrights and Patents	Permanent
Tax	
Tax exemption documents & correspondence	Permanent
IRS Rulings	Permanent
Annual information returns – federal & state	Permanent
Tax returns	Permanent

MEMORANDUM

From: The Joint Task Force of the Nonprofit and Unincorporated Organizations and Exempt Organizations Committees of the State Bar of California

**Re: Whistleblower Policy – Form 990, Part VI, Section B, Line 13
(Policy Series Memo #3)**

Date: December 1, 2009

NOTE ON THE SCOPE OF THIS MATERIAL

This material is designed to provide general guidance about an aspect of nonprofit corporate governance in the specific and limited context of the disclosure requirements of the new IRS Form 990 (published by the IRS in 2008 and applicable to 990 filers based on a 2009-2011 filing year phase-in period depending on the size of the nonprofit). It is intended to provide some general guidance on the establishment of processes and/or policies to address a specific governance disclosure requirement of the Form. The subject matter of that requirement implicates a broad array of legal and practical issues ranging far beyond the immediate subject matter of the requirement itself. This material may address some of those issues but does NOT attempt to review them comprehensively and is NOT intended to be relied on for guidance on how they should be addressed in any specific situation.

Whether or not a nonprofit organization adopts a specific governance process or policy (or modifies an existing one), either in response to the disclosure requirements of the new IRS Form 990 or to change its governance practices for other reasons is a matter to be carefully considered by that organization, with input from its board and advisors and evaluation of its specific circumstances. The IRS has explicitly stated that adoption of the policies and practices about which the new Form 990 requires information is not mandatory, although the IRS has also indicated that it attaches significance to the manner in which all tax-exempt nonprofit organizations govern themselves. The inclusion of a sample policy in this material is not intended to suggest that the policy is appropriate for every nonprofit organization nor that, if a policy on that topic is determined to be appropriate, the formulation in the sample necessarily fits the needs of an individual nonprofit organization. A customized approach, with outside professional advice, is recommended. Accordingly, this material is intended as general information for legal practitioners advising nonprofit organizations as to their governance and does not constitute legal advice for any particular nonprofit organization.

Although the subject matter of this material may have relevance to nonprofit organizations that are not required to file informational tax returns with the IRS or are permitted to file on an IRS form other than Form 990, the focus of this material is 990 filers. While this material is meant to apply to Form 990 filers who are exempt under Section 501(c) of the Internal Revenue Code, certain portions of this material may be applicable only to Section 501(c)(3) organizations. In addition, although this material may be of assistance with respect to nonprofit organizations that are not subject to regulation under California law, there may be portions of this material that are relevant only to nonprofits organized under, or regulated (by reason of their California-related activities) by, California law and, except as specifically discussed in this material, the laws of other States are not addressed.

1. Summary

The new Form 990 asks whether the organization has a written whistleblower policy. As stated in the new Form 990 Instructions: “A whistleblower policy encourages staff and volunteers to come forward with credible information on illegal practices or violations of adopted policies of the organization, specifies that the organization will

protect the individual from retaliation, and identifies those staff or board members or outside parties to whom such information can be reported.” This Memorandum is intended to provide general guidance for the consideration and adoption of a policy responsive to the Form and Instructions.

2. Rationale for Adoption of the Policy

As noted above, the new IRS Form 990 includes a section on corporate governance which asks, among other things, whether the organization has adopted a written whistleblower policy. Although nonprofit organizations are not required by the IRS to adopt a whistleblower policy in order to maintain tax-exempt status, the IRS signaled with the new Form 990 that having such a policy is encouraged as a good governance practice. The IRS instructions to the new Form 990 state that “Even though governance, management, and disclosure policies and procedures generally are not required under the Internal Revenue Code, the IRS considers such policies and procedures to generally improve tax compliance.” The adoption of a whistleblower policy can help to protect the nonprofit from monetary losses, employee fraud and damage to its reputation. When an employee or other constituent reports suspected impropriety to the corporation, rather than to outside agencies, the corporation may avoid loss or damage by stopping the improper practice right away, and may also give the corporation the opportunity to fix any errors or issues internally before a governmental investigation ensues. In addition, the adoption of a policy can demonstrate to the IRS (and to donors who read the Form 990 when making funding decisions) that the organization is committed to good governance and accountability practices.

Even prior to the revision of Form 990, nonprofit corporations were encouraged to adopt whistleblower protection policies as a result of the Sarbanes-Oxley Act enacted in 2002. While that Act largely relates to federal securities regulation, a provision for the protection of “whistleblowers” is more broadly applicable to all corporations, including nonprofit corporations (see Section 3.A. below). While the Sarbanes-Oxley Act does not require the adoption of a written whistleblower policy, the adoption of such a policy can help a corporation ensure that it will be in compliance with the requirements of Sarbanes-Oxley by notifying all of its employees that they must not retaliate, and can help a corporation prove its attempts to comply with the law if challenged.

In addition to any legal requirements, a nonprofit organization may also consider adopting a policy that protects whistleblowers because protecting whistleblowers can be an important component of an ethical and open work environment.

The Form 990 instructions state that a whistleblower policy should serve three purposes: (1) it should encourage staff and volunteers to come forward with credible information regarding illegal practices or violations of adopted policies of the organization; (2) the policy should explicitly state that the organization will protect the individual from retaliation for coming forward with the information; and (3) it should identify those staff, board members or outside parties to whom such information can be

reported. Thus, a corporation must adopt a policy that meets at least these three purposes in order to answer “yes” to Part VI, Section B, Line 13 of the Form 990.

3. Background of Requirements/Sources for the Policy

A. Sarbanes-Oxley Requirements

Section 1107 (Retaliation Against Informants) of the Sarbanes-Oxley Act (“SOX”) added Section 1513(e) to the federal criminal code, which provides:

(e) Whoever knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense, shall be fined under this title or imprisoned not more than 10 years, or both.

This prohibition on retaliation, which includes actions interfering with a person’s lawful employment or livelihood, extends beyond employees to include external parties, such as independent contractors. For example, if an independent contractor were to report a violation, the corporation would not be allowed to speak ill of him or her to others as retaliation. Civil and criminal sanctions may be imposed on a corporation and any individual within the corporation who is responsible for the retaliatory action.

Two other provisions of SOX govern the issue of whistleblowers in publicly traded corporations. Although these provisions are not applicable to nonprofit corporations, they provide guidance as to Congress’s viewpoint about implementation of a whistleblower policy.

Section 806 (Protection For Employees Of Publicly Traded Companies Who Provide Evidence Of Fraud) of SOX added section 1514A to the federal criminal code to extend protection to employees of publicly traded companies who report fraud to any federal regulatory or law enforcement agency, any member or committee of Congress, or any person with supervisory authority over the employee. Section 1514A provides that whistleblowers who provide information or assist in an investigation of violations of any federal law relating to fraud against shareholders or any Securities and Exchange Commission rule or regulation are protected from any form of retaliation by any officer, employee, contractor, subcontractor or agent of the company. Employees who are retaliated against will be “entitled to all relief necessary to make the employee whole,” including compensatory damages of back pay, reinstatement of proper position, and compensation for litigation costs, expert witness fees and attorney fees.

Section 301 (Public Company Audit Committees) of SOX amended section 10A of the Securities Exchange Act of 1934 to add a requirement that audit committees take a role in establishing procedures for whistleblowing and reducing corporate fraud. Section 301 requires audit committees to develop a reporting mechanism for the recording,

tracking and acting on information provided by employees anonymously and confidentially.

B. California Labor Code

California Labor Code section 1102.5 provides that:

(b) An employer may not retaliate against an employee for disclosing information to a government or law enforcement agency, where the employee has reasonable cause to believe that the information discloses a violation of state or federal statute, or a violation or noncompliance with a state or federal rule or regulation.

Civil and criminal sanctions may be imposed on a corporation and any individual within the corporation who is responsible for the retaliatory action.

Labor Code section 1102.8 also requires that all employers display a posting describing employees' rights and responsibilities under the whistleblower laws. The California Division of Labor Standards Enforcement has made a sample posting available on its website at www.dir.ca.gov/dlse/WhistleblowersNotice.pdf.

C. False Claims Act and other Whistleblower Protections

Various other state and federal laws relating to reporting of criminal activity and fraud contain provisions that protect whistleblowers from retaliation. Nonprofit corporations operating in regulated industries should be sure to review the laws applicable to the particular industry.

One set of laws that may be applicable to nonprofit organizations receiving government funding are false claims acts. The Federal False Claims Act contains such a provision. 31 U.S.C. section 3729(h) (Relief from Retaliatory Action) provides that:

(1) IN GENERAL.—Any employee, contractor, or agent shall be entitled to all relief necessary to make that employee, contractor, or agent whole, if that employee, contractor, or agent is discharged, demoted, suspended, threatened, harassed, or in any other manner discriminated against in the terms and conditions of employment because of lawful acts done by the employee, contractor, or agent on behalf of the employee, contractor, or agent or associated others in furtherance of other efforts to stop 1 or more violations of this subchapter.

The California False Claims Act also contains a provision protecting whistleblowers. Cal. Gov't Code section 12653 (Employer interference with employee disclosures, etc.; liability of employer, remedies of employee) provides that:

(b) No employer shall discharge, demote, suspend, threaten, harass, deny promotion to, or in any other manner discriminate against, an employee in the terms and conditions of employment because of lawful acts done by the employee on behalf of the employee or others in disclosing information to a government or law enforcement agency or in furthering a false claims action, including investigation for, initiation of, testimony for, or assistance in, an action filed or to be filed under Section 12652.

In these statutes retaliation includes any negative employment action, not just firing or harassment.

D. Independent Sector's Panel on the Nonprofit Sector *Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations*

The panel on the Nonprofit Sector convened by the Independent Sector published in 2007 a set of principles for good governance and ethical practices by charities and foundations. These principles do not hold the force of law, but have informed the IRS in its revision of the Form 990 as well as Congressional efforts to regulate nonprofits.

Legal Compliance and Public Disclosure Principle 4 states that:

A charitable organization should establish and implement policies and procedures that enable individuals to come forward with information on illegal practices or violations of organizational policies. This "whistleblower" policy should specify that the organization will not retaliate against, and will protect the confidentiality of, individuals who make good-faith reports.

Although Sarbanes Oxley and other laws generally limit the meaning of the term "whistleblower" to those who are reporting violations of law, the panel recommends that the whistleblower policy protect those who report violations of the organization's policies as well as violations of law, and clarifies that only good faith reporting is protected. While the report was directed at charitable organizations, these principles may serve as a guide for all nonprofits.

E. Form 990 and Instructions

Part VI, Section B, Line 13 of the new Form 990 asks: "Does the organization have a written whistleblower policy?" The new Form 990 Instructions relating to this topic state:

A whistleblower policy encourages staff and volunteers to come forward with credible information on illegal practices or violations of adopted policies of the organization, specifies that the organization will protect the individual from retaliation, and identifies those staff or board members or outside parties to whom such information can be reported

Under these instructions, a “whistleblower” includes both staff and volunteers. The Form 990 Instructions also follow the recommendation of the Panel on the Nonprofit Sector in stating that the policy should protect people who report violations of the corporation’s official policies as well as violations of law.

4. Considerations and Procedures for Implementation of the Policy

A. Prior to adoption, it should be determined where the policy should be placed in the organization’s documentation. Alternatives may include, for example, in an employee manual, in the bylaws, in a board policies and procedures manual, or as a stand-alone item. As noted in Section 3.E. above, in order to respond “Yes” to the relevant question on the Form 990, the policy must cover volunteers as well as employees. A policy that is included only in the employee manual will not likely come to the attention of volunteers. Because the policy is intended to encourage whistleblowing by anyone who may have relevant information, the policy should include and be disseminated to all affected constituencies such as, for example, employees, directors, members and volunteers.

It is very important that any whistleblower policy adopted by the organization be consistent with, or expressly supersede, any policies that already exist within the organization, such as employee protection policies. A practitioner advising an organization on the adoption of a whistleblower policy should carefully check the client’s existing policies to avoid inconsistencies.

B. The manner in which the policy must or will be adopted should also be determined. A whistleblower policy may be drafted and implemented by management, but it is recommended that the policy be submitted to an appropriate committee and the full board of directors for approval.

C. The client should be cautioned that in creating a whistleblower policy, it is very important to institute procedures that the corporation is likely to be able to comply with consistently in the long term. Therefore, each user of the sample policy should think through every provision carefully, and should not draft any provisions that will be too burdensome for the corporation to follow under its circumstances. It could well be worse to adopt a policy which is not followed than to have no policy at all.

D. In drafting the policy, care should be taken in determining who will be responsible for receiving and investigating complaints. The draft policy set forth in this memorandum provides for the establishment of a Compliance Officer. In smaller nonprofits, this function may be performed by the Executive Director or CEO, or by a Board member or officer or other responsible individual. If the organization already has reporting procedures in place for sexual harassment complaints or other employment related issues, it may be efficient to choose the same compliance officer for whistleblower complaints. In order to make sure potential whistleblowers will be

comfortable coming forward, the client may wish to designate both one senior management person and one board member to receive complaints. In any case, there should be a clear alternative procedure to follow if the complaint relates to the Compliance Officer. Although nonprofit corporations are not subject to the provisions of Sarbanes Oxley that require the audit committee to administer the policy, a nonprofit organization that has an audit committee should determine whether it is appropriate for the audit committee or another committee of the Board to oversee the policy, including whether the policy should provide that any complaints relating to the Compliance Officer should be brought to the audit committee rather than the full Board. Finally, some organizations may wish to outsource the compliance officer function to a person who is not a director, officer or employee, whether because no such persons have the time and capacity to receive and respond to complaints, or to further ensure that potential whistleblowers will be comfortable reporting allegations relating to directors or officers.

E. The policy should make clear what types of activity should be reported, and what reporting will be protected by the policy. As noted above, retaliation is prohibited by law when a whistleblower reports illegal or fraudulent activity. The policy may include other items, such as violation of the organization's conflict of interest policy or other policies. Depending on how the client intends to deliver the policy to its employees, and especially if distribution of the written policy will serve as the main means to do so, the client may consider including more detail in the policy, including some examples of violations that should be reported. The client should also consider making clear in the policy that a reporting person must act in good faith, that all good faith reporting will be protected, but that a person found to be intentionally making a false report may be disciplined.

F. The Whistleblower Policy should be carefully explained to and adopted by the Board of Directors. If the audit committee will have the responsibility for administering the Whistleblower Policy, it is advisable to explain the policy to the audit committee and have the audit committee approve the policy before it is adopted by the full Board.

G. Either within the policy, or following approval of the policy, the organization should develop implementation and enforcement mechanisms. Although the first step – creating an environment where a whistleblower will report problems that exist – is the crucial one, to be fully effective a whistleblower policy must be consistently applied, claims investigated and evaluated and proper enforcement action taken when necessary.

The implementation procedures should explain how claims will be investigated once received and whether the employee should expect to receive any feedback. These procedures might include:

- (1) documenting every reported violation;
- (2) working with legal counsel to decide whether the problem requires review by the compliance officer or should be directed to another department such as Human Resources;
- (3) keeping the board of directors and the audit committee, if applicable, informed of the progress of the investigation;

- (4) interviewing employees;
- (5) requesting and reviewing all relevant documents of the corporation, and/or requesting that an auditor or counsel investigate the complaint; and
- (6) preparing a written record of the reported violation and its disposition, to be retained for such period of time as the board of directors may determine.

Regardless of the specific mechanisms selected, there should be a process for communicating with complainants, receiving information and addressing identified concerns. If there is no mechanism for communicating back to the whistleblower that the issue has been heard and investigated, the whistleblower may be more likely to go forward to report the suspected impropriety outside the corporation. If a mechanism is established, consider setting a time deadline by which the reporting person will (unless anonymous) receive an update as to the status of the complaint.

In addition, the client should consider establishing a procedure for anonymous reporting of violations. Depending on its size and budget, and the number of employees or volunteers who are likely to have relevant information to report, the organization may consider establishing hot-lines, anonymous voicemail or email boxes, or secure suggestion drop boxes to facilitate the anonymous complaint process. For smaller organizations that cannot afford to pay for extensive procedures and where it may be difficult to maintain anonymity, the client may consider requesting its outside auditor to receive complaints and notify the Board of the receipt of information without notifying the Board of the identity of the informant. A procedure for anonymous reporting may increase the likelihood that sensitive issues will be reported, although it may also increase the likelihood of false reports. If the client wishes to include a procedure for anonymous reporting in the policy, the client may choose to use one or more of the examples of procedures found in brackets in paragraph D of the sample policy.

H. Once the policy is adopted and implementation and enforcement mechanisms are created, these should be explained to employees and volunteers, including the procedure for reporting and the assurance that no retaliation will be taken against the whistleblower. If feasible, the corporation should consider adding information about the policy to its training for new hires (and its volunteer orientation trainings, if applicable). In order to emphasize to employees and volunteers that the protection against retaliation is real, the client should consider having senior management explain the policy and the no retaliation rule and explain that it is an important policy of the nonprofit to encourage openness and not to engage in retaliation.

I. Again, it cannot be stressed enough, that the organization should only adopt policies which it is confident it can follow.

5. Sample Policy or Policies

A. Application. This Whistleblower Protection Policy applies to all of the Organization's staff, whether full-time, part-time, or temporary employees, to all

volunteers, to all who provide contract services, and to all officers and directors, each of whom shall be entitled to protection.

B. Reporting Credible Information. A protected person shall be encouraged to report information relating to illegal practices or violations of policies of the Organization (a "Violation") that such person in good faith has reasonable cause to believe is credible. Information shall be reported to the [Insert title of person designated for this position] (the "Compliance Officer"), unless the report relates to the Compliance Officer, in which case the report shall be made to [Insert another person's title, or the Board of Directors, or the Audit Committee or another appropriate committee of the Board of Directors] which shall be responsible to provide an alternative procedure.

Anyone reporting a Violation must act in good faith, and have reasonable grounds for believing that the information shared in the report indicates that a Violation has occurred.

C. Investigating Information. The Compliance Officer shall promptly investigate each such report and prepare a written report to the Board of Directors. In connection with such investigation all persons entitled to protection shall provide the Compliance Officer with credible information. All actions of the Compliance Officer in receiving and investigating the report and additional information shall endeavor to protect the confidentiality of all persons entitled to protection.

D. Confidentiality

The Organization encourages anyone reporting a Violation to identify himself or herself when making a report in order to facilitate the investigation of the Violation. However, reports may be submitted anonymously by *[select one or more of the following (or insert other procedure):* [filling out a "Whistleblower Reporting Form" and depositing the form in a designated box] / [filling out a "Whistleblower Reporting Form" and mailing it to [insert appropriate recipient, such as the chair of the appropriate committee]] / [calling the anonymous hotline established by the Organization for this purpose]]. Reports of Violations or suspected Violations will be kept confidential to the extent possible, with the understanding that confidentiality may not be maintained where identification is required by law or in order to enable the Organization or law enforcement to conduct an adequate investigation.

E. Protection from Retaliation. No person entitled to protection shall be subjected to retaliation, intimidation, harassment, or other adverse action for reporting information in accordance with this Policy. Any person entitled to protection who believes that he or she is the subject of any form of retaliation for such participation should immediately report the same as a violation of and in accordance with this Policy.

Any individual within the Organization who retaliates against another individual who has reported a Violation in good faith or who, in good faith, has cooperated in the

investigation of a Violation is subject to discipline, including termination of employment or volunteer status.

F. Dissemination and Implementation of Policy. This Policy shall be disseminated in writing to all affected constituencies. The Organization shall adopt procedures for implementation of this Policy, which may include:

- (1) documenting reported Violations;
- (2) working with legal counsel to decide whether the reported Violation requires review by the Compliance Officer or should be directed to another person or department;
- (3) keeping the board of directors [and the audit committee or other applicable committee] informed of the progress of the investigation;
- (4) interviewing employees;
- (5) requesting and reviewing relevant documents, and/or requesting that an auditor or counsel investigate the complaint; and
- (6) preparing a written record of the reported violation and its disposition, to be retained for a specified period of time.

The procedures for implementation of this Policy shall include a process for communicating with a complainant about the status of the complaint, to the extent that the complainant's identity is disclosed, and to the extent consistent with any privacy or confidentiality limitations.

Typical Board-Executive Director Relationship Missteps

- Board Fails to Understand Fiduciary Responsibilities to the Organization
- Board Fails to Provide Effective Oversight or Supervision Over the Executive Director
- Executive Director Fails to Keep the Board Properly Up to Date
- Board Provides Too Much Deference to the Executive Director
- Executive Director Ignores the Guidance of the Board
- Board Gets Far Too Involved in Routine Operational Issues
- Entity Maintains Insufficient Conflict Management Controls
- Board Does Not Approve Executive Director's Conflict Transactions



Resources

IRS Governance Check Sheet

- Overview
 - **Implemented by the IRS in December '09**
 - **Only will be issued to exempt organizations under IRS audit**
 - **Objectives**
 - Obtain data for IRS study regarding whether good governance = better compliance
 - NOT to dictate to exempt organization what IRS thinks good governance should look like
- Specific inquiries
 - **Governing body & management**
 - Written mission statement
 - Updated copies of organizational documents provided to Board members
 - Frequency of Board meetings
 - **Compensation**
 - Satisfaction of all 3 prongs of the rebuttable presumption of reasonableness
 - **Organizational control**
 - Family / Business relationships amongst Board members



Resources (cont'd)

IRS Governance Check Sheet (cont'd)

- Specific inquiries (cont'd)
 - **Conflicts of interest**
 - Written conflict of interest policy
 - Address recusals**
 - Annual Conflict of Interest Questionnaire**
 - **Financial oversight**
 - Internal controls
 - Financials provided to Board on periodic basis
 - Board review of Form 990
 - Audited financial statements
 - **Document retention**
 - Written document retention and destruction policy
 - Contemporaneous documentation of Board meetings
- Recommendation
 - **Organization should utilize to conduct "check-up" regarding their specific governance practices**



Governance Check Sheet

This check sheet is to be used by EO Revenue Agents in the examination of I.R.C. 501(c)(3) public charities. Please complete all parts of this check sheet.

Part 1 - Revenue Agent and Exempt Organization Information

1. Agent Name	<input type="text"/>	Group Number	<input type="text"/>
2. Organization Name	<input type="text"/>		
3. EIN	<input type="text"/>		
4. Tax Period(s) Examined	<input type="text"/>	<input type="text"/>	<input type="text"/>
5. Form Being Examined	<input type="text"/>		
6. Foundation Code	<input type="text"/>		

Part 2 - Governing Body and Management

7. Does the organization have a written mission statement that articulates its current I.R.C. § 501(c)(3) purpose(s)? Select one of the options.

8. Do the organization's bylaws set forth the following information for the members of the governing body and the organization's officers? Select one of the options from each of the drop down boxes.
Composition Duties Qualifications Voting Rights

9. Have copies of the most recent versions of the organization's articles and bylaws been provided to the following? Select all that apply.
 All Board Members Only Voting Board Members General Public (by request) General Public (online) Not Provided

10. At the beginning of the primary year under examination, what was the number of board members with voting rights? Enter a whole number.

11a. How often did a quorum of voting board members meet during the primary year under examination? Enter a whole number.

11b. How often did the full board meet during the primary year under examination? Select one of the options.

12. Did the number of meetings referred in 11a and 11b meet or exceed the meeting requirements set forth in the organization's bylaws? Select one of the options.

Part 3 - Compensation

13. Are compensation arrangements for all officers, directors, trustees, and key employees approved in advance by an authorized body of the organization composed of individuals with no conflict of interest with respect to the compensation arrangement? Select one of the options.

14a. Does the authorized body rely upon comparability data in making compensation determinations? Select one of the options.

14b. If "Always" or "Sometimes" for 14a, select the comparability data considered by the organization? Select all that apply.
 Exempt Organizations Non-Profit Entities Not Exempt From Tax Governmental Entities For-Profit Entities Other

14c. If the "Other" box is checked for 14b, provide a brief explanation of the other source.

15. Is the basis for all compensation determinations contemporaneously documented. Select one of the options.

Part 4 - Organizational Control

16a. Did any of the organization's voting board members have a family relationship and/or outside business relationship with any other voting or non-voting board member, officer, director, trustee, or key employee? Select one of the options.

16b. If YES to 16a, list the number of relationships between the officers, directors, trustees, or key employees.

16c. Number with Family Relationships Number with Business Relationships Number with Both Relationships
Total Number of Relationships (should equal the amount listed in 16b)

17. Does effective control of the organization rest with a single or select few individuals? Select one of the options.

Part 5 - Conflict of Interest

18a. Does the organization have a written conflict of interest policy? Select one of the options.

18b. If **YES** to 18a, does the policy address recusals? Select one of the options.

18c. If **YES** to 18a, does the policy require annual written disclosures of conflicts of interest? Select one of the options.

18d. If **YES** to 18a, during the primary year under examination, if any actual or potential conflicts of interest were disclosed, was the organization's conflict of interest policy adhered to? Select one of the options.

Part 6 - Financial Oversight

19. Are there systems or procedures in place intended to make sure assets are properly used, consistent with the organization's mission? Select one of the options.

20a. How often did the organization provide board members with written reports of the organization's financial activities? Select one of the options.

20b. How often did the board discuss/consider reports of the organization's financial activities? Select one of the options.

21. Prior to filing, was the Form 990 reviewed by the full board and/or a designated committee? Select one of the options.

22a. During the primary year under examination, was an independent accountant's report prepared? Select one of the options.

22b. If **YES** to 22a, was the accountant's report discussed/considered by the full board and/or a designated committee? Select one of the options.

23a. Was a management letter prepared by the independent accountant? Select one of the options.

23b. If **YES** to 23a, was the management letter reviewed by the full board and/or a designated committee? Select one of the options.

23c. If **YES** to 23a, did the organization adopt any of the recommendations contained in the management letter? Select one of the options.

Part 7 - Document Retention

24a. Does the organization have a written policy for document retention and destruction? Select one of the options.

24b. If **YES** to 24a, does the organization adhere to its written policy for document retention and destruction? Select one of the options.

25. Does the board contemporaneously document its meetings and retain this documentation? Select one of the options.

26. Was your examination hindered by a lack of necessary documentation? Select one of the options.

Part 8 - Disposition

27. Examination Disposal Code for Primary Return

28. Principal Issue Codes for Primary Return

First Issue

Second Issue

Third Issue

Fourth Issue

Governance Project
Guide Sheet for Completing the Project Check Sheet

1. Enter the Agent's name and group number.
2. Enter the name of the organization examined.
3. Enter the EIN of the organization examined.
4. Enter the tax period or periods examined.
5. Enter the Form being examined (Form 990, Form 990-EZ, or Form 990-N). If different Forms were filed, enter the Form filed for the primary year under examination. If the organization was not required to file a Form 990, Form 990-EZ, or Form 990-N, select Not Applicable.
6. Enter the organization's foundation code.
7. Select Yes or No depending on whether the organization has a **written** mission statement that reflects its **current** I.R.C. § 501(c)(3) purpose(s). If the organization does not have a written mission statement, answer No. Likewise, if the organization has a written mission statement but its current activities do not reflect that mission statement, answer No even if the organization is fulfilling other appropriate I.R.C. § 501(c)(3) purposes.
8. For each item, select Yes – just officers, Yes – just directors, or Yes – both, as appropriate, based upon whether the organization's bylaws address the listed information with respect to those individuals. Select No if the bylaws do not address the listed information at all, or N/A – No Bylaws if the organization has no bylaws.
9. Select the appropriate box or boxes corresponding to those individuals or groups of individuals to whom the organization provides copies of its most recent articles and bylaws.
10. Enter the number of board members *with voting rights* as of the first date of the primary tax year under examination.
11.
 - a. Select the appropriate response (Once per year, Twice per year, Quarterly, Once per month, Twice per month, or Other) depending on the number of times the board met during the primary year under examination.
 - b. Select the appropriate response (Once per year, Twice per year, Quarterly, Once per month, Twice per month, or Other) depending on the number of times the board met during the primary year under examination. The board includes members with voting rights as well as those without voting rights. For purposes of this question, the term full board does not require that all board members actually be present.
Example: If all board members were invited to attend a meeting and the board actually met, then this would qualify as a meeting of the full board.
12. Select the appropriate response (Yes-met the requirements, Yes-exceeded the requirements, No-did not meet the requirements) depending on whether the number of meetings actually held by the board met or exceeded the meeting requirements as set forth in the bylaws. For example, if the bylaws provided that the board would

meet monthly (twelve times in a year) and the board only met ten times during the primary year under examination, then the response would be No. If the board does not have bylaws, the appropriate response is N/A – No bylaws.

- 13.** Select Yes or No depending on whether compensation arrangements for all officers, directors, trustees, and key employees are approved in advance by an authorized body of the organization composed of individuals with no conflict of interest with respect to the compensation arrangement. If anyone with a conflict of interest with respect to a particular compensation arrangement participated in the approval of that particular compensation arrangement, the appropriate response is No. Select N/A – No Compensation Provided as appropriate. For purposes of this question, officers, directors, trustees, and key employees are the same as the definitions contained under I.R.C. § 4958.
- 14.**
- a.** Select Always, Sometimes, or Never depending on whether the organization’s authorized body relies upon comparability data in making compensation determinations. Select N/A – No Compensation Provided as appropriate.
 - b.** If you responded Always or Sometimes to 14a, select the appropriate box or boxes corresponding to the comparability data considered by the organization in making its compensation determinations.
 - c.** If the Other response is selected for 14b, please write in a brief description of the other comparability data referred to.
- 15.** Select Yes or No depending on whether the organization contemporaneously documents the basis for its compensation determinations. For example, do the organization’s meeting minutes or other documents, created at the time compensation is approved, reflect the reasons underlying particular compensation determinations? Select N/A – No Compensation Provided as appropriate.
- 16.**
- a.** Select Yes or No depending on whether any of the organization’s *voting board members* have either a family or business relationship with any other voting or non-voting board member, officer, director, trustee, or key employee. Family relationships include those of spouses, brothers or sisters, spouses of brothers or sisters, ancestors, children, grandchildren, great grandchildren, and spouses of children, grandchildren and great grandchildren. For purposes of this question, officers, directors, trustees, and key employees are the same as the definitions contained under I.R.C. § 4958.
 - b.** If you responded Yes to question 16a, enter the number of such family or business relationships that exist.
 - c.** If you responded Yes to question 16a, enter the number of voting members with family relationships, the number of voting members with business relationships, and the number of voting members with *both* types of relationships with any other voting or non-voting board member, officer, director, trustee, or key employee. The number of family, business, or both relationships should equal the number of relationships indicated in question 16b.

Example: An organization has a total of ten board members. Husband and Wife both serve on the board. Wife and another board member are the sole shareholders in a

- for-profit corporation. In addition, Wife and Husband are partners in a for-profit organization. For 16a, the answer would be yes. For 16b, the total number relationships would be two. For 16c, the answer would be one business relationship (the relationship between Wife and the other board member) and one for both (since Husband and Wife have both a family relationship and business relationship).
- 17.** Select Yes or No depending on whether effective control of the organization rests with a single or select few individuals. For example, is there a single individual or small group of individuals to whom the board typically defers?
- 18.**
- a.** Enter Yes or No depending on whether the organization has a *written* conflict of interest policy.
 - b.** If you responded Yes to question 18a, select Yes or No depending on whether the conflict of interest policy addresses recusals. If you responded No to 18a, select Not Applicable.
 - c.** If you respond Yes to 18a, select Yes or No depending on whether the conflict of interest policy requires annual written disclosures of conflicts of interest. If you responded No to 18a, select Not Applicable.
 - d.** Select Never adhered to, Sometimes adhered to, Always adhered to, or Not Applicable depending on whether the organization's conflict of interest policy was adhered to. For example, did those with a conflict of interest on a particular matter recuse themselves from the corresponding decision making process? If you responded No to 18a, select Not Applicable. If no actual or potential conflicts of interest were disclosed during the primary year under examination, select Not Applicable.
- 19.** Select Yes or No depending on whether the organization has systems or procedures in place intended to ensure that assets are used properly and consistently with the organization's mission.
- 20.**
- a.** Select Never, Once per year, Twice per year, Quarterly, Once per month, Twice per month, or Other depending on how often the organization provided board members with written reports of the organization's financial activities. The board includes members with voting rights as well as those without voting rights.
 - b.** Select Never, Once per year, Twice per year, Quarterly, Once per month, Twice per month, or Other depending on how often the board discussed/considered reports of the organization's financial activities. For example, look at whether the organization maintained complete, current, and accurate financial records, and whether the board had and exercised the opportunity to discuss/consider those reports and records. The board includes members with voting rights as well as those without voting rights.
- 21.** Select Yes or No based on whether, prior to filing, the organization's Form 990 was reviewed by *either* the full board or a designated committee. Please note that the question addresses a *review* of the Form 990 prior to filing, not merely *receipt* of the Form 990 prior to filing. If the organization was not required to file a Form 990, Form 990-EZ, or Form 990-N then select Not Applicable.

- 22.** **a.** Select Yes or No depending on whether an independent accountant’s report was prepared during the primary year under examination.
- b.** If you responded Yes to 22a, select Yes or No depending on whether the accountant’s report was discussed/considered by either the full board or a designated committee. If you responded No to 22a, select Not Applicable.
- 23.** **a.** Select Yes or No depending on whether a management letter was prepared by an independent accountant during the primary year under examination.
- b.** If you responded Yes to 23a, select Yes or No depending on whether the management letter was reviewed by either the full board or a designated committee. If you responded No to 23a, select Not Applicable.
- c.** If you responded Yes to 23a, select the appropriate response (Yes - adopted some, Yes – adopted all, or No – adopted none) based on whether the organization adopted any of the recommendations contained in the management letter. If you responded No to 23a, select Not Applicable.
- 24.** **a.** Select Yes or No depending on whether the organization has a written policy for document retention and destruction.
- b.** If you responded Yes to 24a, select the appropriate response (Yes – all of the time, Yes – some of the time, or No – none of the time) depending on whether the organization adhered to its written document retention and destruction policies during the primary year under examination. If you responded No to 24a, select Not Applicable.
- 25.** Select the appropriate response (Yes – all of the time, Yes – some of the time, or No – none of the time) depending on how often the board of the organization contemporaneously documents its meetings *and* retains this documentation.
- 26.** Select the appropriate response depending on whether your examination was hindered by a lack of necessary documentation. Consider whether documents that should have been available were never produced, prematurely destroyed, or otherwise unaccounted for.
- 27.** Select the examination disposal code for the primary return from the drop down menu.
- 28.** Select the principal issue codes for the primary return from the drop down menus.

For More Information...

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