

Client Alert

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Keep Your Nonprofit Off The Front Page; One Simple Step for Boards of Directors

by
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Recently, the headlines in Rhode Island have decried allegations of corruption at a major local hospital. Whether the allegations are true, and whether the alleged practices are extraordinary or commonplace for hospitals, remains to be seen. However, at least one public official has vowed to file legislation in the 2006 session to require hospital executives to comply with a code of ethics similar to the code required for Blue Cross & Blue Shield of Rhode Island in 2004. While that legislation has not yet been filed, it is fairly certain that it will be filed, and that it will pass in some form.

This is a concern for all nonprofit hospitals. But is it also a concern for all Rhode Island nonprofits? Yes! Since 2004, there have been rumblings in the General Assembly that the type of legislation imposed on Blue Cross and in the works for hospitals will be extended to all nonprofits. In addition, since the adoption of Sarbanes-Oxley for public companies, a "best practice" for non-

profits has been to adhere to conflict of interest policies similar to those required of public companies. Finally, while adoption of a conflict of interest policy is not currently required to obtain tax-exempt status, the IRS now strongly recommends adopting the model policy or a similar policy to help minimize the possibility that an officer or director may receive an inappropriate personal benefit from the nonprofit. As a result, it seems only a matter of time before a code of ethics is mandatory for all tax-exempt charities in Rhode Island.

That being said, the fix is easy. The Blue Cross legislation that is being touted as the model for the new hospital legislation required that Blue Cross' board act in accordance with its fiduciary duties (as all boards must), and "[i]n accordance with a conflict of interest policy adopted by the board of directors that will be consistent with guidelines recommended and published by the U.S. Internal Revenue Service

for nonprofit entities.” The IRS very recently adopted a model code of ethics that it recommends newly-formed hospitals and nonprofits should use.

The IRS model is not particularly onerous. It essentially requires full disclosure and an impartial process when the nonprofit has financial dealings with its officers or board. The only real restriction is that persons who receive compensation from the nonprofit generally cannot vote on their own compensation matters.

There is no reason to wait for the hammer to fall. Adoption and implementation of the IRS model conflicts of interest policy is not overly burdensome, improves governance to a best practice level, and provides evidence of compliance with state and federal ethics-related standards. Therefore, nonprofits should consider acting now to adopt the IRS model conflict of interest policy (or a similar policy).

So what should you do next? Your board of directors can adopt the IRS model code of ethics, or a similar policy. There are other best practices that your organization can put in place, such as board of directors compliance manuals and self-evaluations, depending on the size and nature of your board and your organization.

The IRS model code of ethics can be reviewed at:
www.irs.gov/pub/irs-pdf/i1023.pdf,
Appendix A, page 25

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Since the publication of this Alert, two bills were introduced in the General Assembly to address this issue with regard to hospitals. The bills have not yet been scheduled for a hearing, but you can review the text of the bills at:

<http://www.rilin.state.ri.us/billtext/billtext06/housetext06/h7425.pdf>

<http://www.rilin.state.ri.us/billtext/billtext06/senatetext06/s2745.pdf>

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