

Form 990 Policy Series

The attached Memorandum is a part of the *Form 990 Policy Series*, developed by a group of lawyers, all members of the California bar and practicing nonprofit law (the “Form 990 Policy Series Group”). The *Form 990 Policy Series* includes Memoranda containing rationales and procedures for legal counsel to use in advising their clients on drafting and adopting appropriate policies responding to the new Form 990 as well as form policies and/or questionnaires.

The members of the Form 990 Policy Series Group with respect to the attached Memorandum (posted July, 2011) were as follows: Joel S. Corwin, Co-Chair; Barbara Rosen, Co-Chair; Elizabeth Bluestein; Lani Meanley Collins; the late Gerald A. Laster; Henry Lesser; Nancy McGlamery; Louis Michelson; Joy P. Paeske; Alicia Plerhoples; Lisa A. Runquist; Robert Siemer; Myron Steeves; Patrick Sternal; and Martin J. Trupiano. The views expressed in the Memoranda do not necessarily reflect the views of the law firms or employers at which these lawyers practice or any individual member of the Group.

The date at the top of the attached Memorandum is the date that the Memorandum was finalized, and the Memorandum may not reflect changes in law or practice since that date.

**FORM 990 POLICY SERIES
MEMORANDUM**

**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 governance questions contained in 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 question in the Form. The subject matter of that question implicates a broad array of legal and practical issues ranging far beyond the immediate subject matter of the question 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 asks 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 oversight under California law, there may be portions of this material that are relevant only to nonprofits organized under, or (by reason of their California-related activities) otherwise subject to, 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.