

# Catholic Cemetery



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CATHOLIC  
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## **Making Your Cemetery Technology- friendly**

The importance of updating cemetery office equipment and records for easier access and better reliability.

page 6

## **Cemetery Computerization - Is it Necessary?**

Frank Cardon talks about the need for cemeteries to move forward into the age of high tech, and how easy it really can be.

page 11

## **Rick Touchette Talks About Salaried Pre-need Sales**

"Point-Counter point," Rick Touchette explains why salaried sales people work best at his cemetery.

page 20

## **This Wonderful Ministry We Call Catholic Cemeterian**

Rick Davis ties the value of CCC membership into his ministry as a Catholic Cemeterian.

page 29

# Good Governance and Good Stewardship: PRESCRIPTION

## FOR SUCCESS

— by **Mark E. Chopko, Esq.**

**Editor's Note:** The following information was presented to attendees of CCC's 59th Annual Convention in Orlando. It has been edited for print.

As world economies rise and fall in unpredictable ways, the nation's non-profit sector is not immune from the volatility affecting banking, credit and other markets. As competition for diminishing donor dollars becomes more intense, charities look for ways to distinguish themselves from – dare we say it – their competitors.

Complicating the competition for donations, charities face an increasingly difficult array of obstacles — grumpy regulators, interfering courts, and other agencies that every day evidences the increasing role of the state in policing nonprofits, including religious nonprofits. Plainly, the legal and regulatory system has a profound impact on operations and practices in charities, including cemeteries. The Internal Revenue Service (IRS) has issued new rules and changed significantly its forms for reporting information about the conduct of public charities (Form 990). State Attorney Generals have expanded authority and an expanded vision of the scope of their responsibilities to police the internal affairs of charities.

Scandals in the public sector have created scrutiny from sector and trade associations, such as Independent Sector, which empanelled its own task force to propose "best practices" for charities as a way of slowing down government requirements. Even if all



of these regulatory pressures were miraculously to evaporate, donors and other stakeholders in the good conduct of the charity are insisting on adherence to such amorphous "best practices" as the predicate for attracting donations. And failing to heed these various pressures and constituencies results in a form of negative accountability through the press and others. Who wants to be exposed in the press as a sloppy charity? Truly, these are complicated times.

This article explores some of the contours of the problems confronting charities with special emphasis on "best practices" of governance and stewardship. It begins with an explanation of the environment in which we operate, turns to an exploration of some legislative and regulatory developments effecting governance, and ends with a review of trends. In many ways, the best advice one can give to charities in this difficult

financial and regulatory environment is to return to basics. Be fair, accountable, and honest. Those are the hallmarks of sound charities, ones worthy of the respect and trust of regulators and donors alike.

### Good Business Starts with Respect for Structure

All charities have some civil structure. That structure fixes its rights and responsibilities to the world outside the charity, and also the extent to which its assets are protected or at risk. It is simple to illustrate those points when a charity has a separate civil identity through incorporation or a trust document. One examines the documents and reviews the applicable civil law as the starting point of that analysis. What is less obvious is that a charity which is not incorporated or organized pursuant to a formal trust document has some form that the civil

continued on page 16



## Good Governance, continued

law will recognize or even supply. Even charities that claim that they are unincorporated, all relate to a civil structure, one that will be implied by law. In other words, if a cemetery lacks its own civil identity as a corporation or a trust, it will likely be deemed to be an activity of the sponsoring parish or diocese. Therefore, its duties, obligations, and protections will all be measured according to those provided in the law to the parish or diocese.

In all likelihood, cemetery employees will be deemed parish or diocesan employees, and its assets, absent some clear structural delineation, will be the assets of the sponsoring parish or diocese. The grave risks to consolidated assets in dioceses and parishes have been exposed through the endless stream of liability litigation unrelated to the operations of cemeteries or other charitable agencies. In recent years, because of this exposure and because of a desire to give renewed attention to proper canonical administration of the temporal goods of the Church, dioceses and parishes have given attention to questions of structure. Asset protection, like good governance, begins with structure.

A good practice for a parish or diocese is to separate its various apostolates and activities according to their operations and risks. Some operations and risks will be given separate civil identity through the act of incorporation. For example, if the diocese undertakes transportation of school children as a normal part of its operations, it might consolidate those transportation activities into a separate corporation given the high degree of risk associated with transportation. To take another example, if a diocese has a capital campaign for specific kinds of improvements, it would normally undertake a process to give those restricted receipts the protection of a trust document, indicating that those assets have been designated for unique charitable purposes and are not available to the general creditors of the diocese.

If the diocese intends that one of its activities be treated as separate from

the general operations of the diocese, that choice for separation should be documented. If the diocese does not separate and document its apostolates, all those works could likely be deemed "departments" of the diocese, and both assets and risks/liabilities would "belong" to the diocese. Waiting for a crisis to do so is too late.

Although one need not incorporate or erect a formal trust for an apostolate to be treated as a separate activity, it is doubtful that courts would treat it as entirely separate without some civil document attesting to its unique character. In the bankruptcy proceeding filed by the Spokane Diocese, for example, the bankruptcy judge grouped all undocumented activities (parishes and other agencies) under the umbrella of the diocesan corporation sole. All were potentially available to satisfy claims of diocesan creditors.

On appeal, a federal district judge reversed and said there was some evidence of a trust relationship with respect to the intentions of donor parishioners and parish assets that warranted exploration. Even though there was no separate legal action to insulate parish assets, the judge was persuaded that the pattern of donations and the consistent actions of parish and diocesan officials treated the parishes as if they were civilly separate. But that process, in the midst of a litigation crisis, seems hardly adequate to resolve questions of structure and separate identity.

In any event, the bankruptcy was settled before that proposition – built on donor intent and consistent action – was tested, a process that would proceed literally asset by asset. That extreme case is not a model for demonstrating the separate integrity of unique charitable operations and their assets, and one that does not counsel repeating. Prudence dictates that separate apostolates be formally treated as separate civil entities in some way.

### Sound Governance Takes the Work of Management Seriously

In our context, it cannot be stressed enough that the Catholic cemeteries

are integral parts of the Church's mission. All operations are within that communion and serve the overall work of the Church in the community. To say it another way, the entity could not be Catholic and unconnected to the Church. But a cemetery may also be seen as a separate agency without losing its identity or connection.

Separating apostolates or activities can create a sense of identity and mission that might strengthen the esprit de corps of the workforce and create an appeal both to donors and in the larger community. But a separate form brings with it certain responsibilities. Some of these are related to the civil law. If incorporated, for example, the cemetery corporation must follow the rules of the civil jurisdiction on annual reports, board meetings, and other issues. If a trust, the state Attorney General's office may have its own oversight requirements. Those requirements must be followed.

But apart from civil requirements, here are some hallmarks of a separate organization:

- **Identity** – The entity has a mission statement that clearly identifies who it is and how it operates. The statement addresses key expectations of the managers and conveys a sense of responsibility to the community.

- **Independence** – The entity cannot be dominated by some other entity. It has its own board or its own advisors and follows their lead. That said, however, a religious entity like a cemetery must be connected to the religious communion, and that connection must also be set forth in its governing documents. The two concepts – connection and independence – are not inconsistent. Corporate entities have corporate subsidiaries. The subsidiary respects that it is an integral part of the corporation, but the separation is normally respected by regulators and courts.

In the Church, apostolates may have their own legitimate autonomy to conduct their affairs, but, because they are Catholic, their actions and limitations are described within the constellation of the Church.

● **Transparency** – The entity is responsible for its own funding and own behavior. Some commentators have noted that transparent entities are less prone to error, perform better, and are more economically viable, because the community has trust in their operations.

● **Accountability** – The entity is responsible for assessing and following the intentions of donors. And the entity has the fiscal integrity to assure donors that their gifts and funds will not be diverted to any activity inconsistent with that intent.

For separate apostolates, these key concepts are infused with a sense of responsibility, an ethic if you will, that the charity is worthy of trust. Many commentators write that a sound and engaged board of directors or advisors is at the heart of assuring the propriety of operations and administration.

Individual members must demonstrate probity and commitment to the work of the apostolate and understand that their efforts are key to the charity's success. Board members must be in a position to devote themselves to their tasks without impediment. For this reason, commentators also write that an essential way to assure the integrity of the entity is to insist that those operating, governing, or advising the apostolate be free of any conflicts of interest.

"Conflicts of interest" is a term of art. Corporate officers and directors are duty-bound to govern and operate an entity with absolute loyalty to the goals of the corporation. Those leaders must devote themselves to the proper function of the corporation and not allow their offices to be a vehicle for private gain, for themselves or for their friends and families.

In many of the public scandals in the corporate world, some conflict of interest was at its heart. A director or officer put private gain over corporate responsibility.

Thus, an awareness of the need to prevent conflicts of interest is essential. Some of the more common ways

in which a conflict can occur are as follows:

-A member of a board serves on the board of an entity competing for resources with the cemetery, or a key employee "moonlights" at a competing business.

-An advisor has a family member who is an adjacent landowner.

-Key employees or advisors lend or borrow money that belongs to the organization, or accept gifts or favors from those who seek its business.

-Confidential information acquired through one's service is used to advance another's agenda.

Those are some ways in which conflicts can occur. The important factors in preventing these abuses are that potential conflicts be identified as early as possible, that the conflicts be disclosed to the leadership, and that the situation be reviewed promptly (often with legal counsel) to determine what should happen.

None of this is new. It has been around for many years. Corporate lawyers and managers often root the duties of officers, employees and directors in "loyalty" and "obedience" to the mission of the corporation. Likewise, trustees have stringent requirements to discharge faithfully their fiduciary duties to the beneficiaries of a trust. Perhaps because the mantra of avoiding "conflicts of interest" was so "old hat" that it started to be ignored in practice.

Over the last few years, and even in the midst of downturn, recession, bankruptcy and bailout, one sees evidence that conflicts of interest are present. It was failures in leading publicly traded companies to follow the basics of conflicts of interest policies created the scandals that led to the Sarbanes-Oxley Law in 2002, with its own set of requirements backed by the federal criminal law.

### Avoid Creeping SOX

Seemingly everyone has heard about SOX! For the four people in the

corporate world who haven't, here's a brief refresher. SOX, my acronym for Sarbanes-Oxley, is named for its principal Senate and House sponsors. It is federal criminal legislation applicable to publicly traded companies, the basis for federal jurisdiction in this situation.

SOX, however, is not applicable to nonprofit entities, except for two specific aspects. The anti-retaliation and the document retention portions of the law apply to all companies, but only if there is a basis for federal jurisdiction. It is illegal for a company to retaliate against an employee who is assisting a federal investigation. And it is illegal for a company to destroy documents in the face of a possible federal investigation. For example, suppose a nonprofit fired an employee who tipped off the immigration enforcement folks about the presence of illegal day-laborers, and then shred his file in anticipation of a visit from federal law enforcement. All the elements are there for a SOX violation.

At the same time, because SOX on its face is largely inapplicable, a nonprofit has the luxury to study the principles of SOX and decide whether those practices should be incorporated into the governance structure. Built on a for profit corporate model, SOX places great emphasis on the role of the board in governance of an organization. There is much to be gained, however, by reflecting on SOX principles, starting with the role of members of a board.

SOX emphasizes that some board members should be "independent" which is to say that they should be from outside of the realm of internal operations of the corporation. How would this work in a charity? An entity that serves the community, for example, might want to appoint several members of the board from that community to make sure that it is being responsive to their needs. SOX also places the important responsibility to monitor compliance and investigate complaints on the board.

Many organizations, including larger nonprofits, have adopted so-called

*continued on page 18*



Good Governance, continued

"whistleblower mechanisms" such as hot lines and other means to facilitate complaints about any improprieties in the entity's fiscal responsibilities. Another principle at the heart of SOX is fiscal integrity. The law imposes audit committees, made up of members of the board who are responsible for hiring the outside auditors and seeing that the company's finances are beyond question. That might not work in a smaller charity, but the idea that management should not be hiring the auditors is one that can be implemented in a variety of ways.

Another principle is that compensation for corporate officers should be consistent with the nature of the entity, its finances, and other administrative matters. Because excessive corporate compensation is a persistent problem not confined to the for profit world, one could pay attention to some of the lessons of SOX which requires that the board empower a separate "compensation committee" to set and review executive compensation. Again, the concept that management does not have the discretion to write its own paycheck seems self-evident and able to be fulfilled in many ways.

Finally, SOX attempts to assure operational integrity through a series of **requirements** about document retention and the setting of various codes of ethics and conduct within the organization. This last principle is coupled with an emphasis on disclosure of institutional information, not only to shareholders and regulators, but to the public. The theory behind SOX is that transparency fuels accountability and enforces a regime built on integrity.

While SOX is largely inapplicable to nonprofits, some states have flirted with incorporating SOX principles into state regulatory initiatives.

It is uncertain the extent to which states will rewrite corporate compliance rules and make those rules applicable generally in the nonprofit world. Even without a legislative requirement, it makes sense for organizations **struggling** to stay ahead in this competitive

environment and volatile economy to reflect on the principles in SOX and pay attention to improving their practices. For example, SOX makes the board the centerpiece of effective governance.

How do our boards, whether governing or advisory, really **function** in our institutions? Are the members of those boards empowered and expected to engage in real oversight or are they really expected not to rock the boat all that much. In my view, there is no substitute for frank discussion around a boardroom table. Members should be encouraged to participate, take a real interest, and not hesitate to ask tough questions. Members should show that they are willing to take stands on principle, even if it **makes** things a little uncomfortable. After all, having bright, insightful **individuals serving** as advisers means that "**corporate**" action might be subjected to greater scrutiny. That scrutiny usually will produce a set of decisions and actions on which managers might more readily rely. An agency may have the best written policies in the world, but there really is no substitute for good people serving in governance and advisory roles.

#### **IRS Takes Up the Cause of Governance and Integrity**

Unfortunately, good **governance will** not necessarily pre-empt the kind of scrutiny which the nonprofit sector is facing. Not only from state regulators, but now from federal regulators, there are greater efforts made on corporate accountability. The IRS, for example, has recently expanded information returns, also known as Form 990, to include detailed information about governance and fiscal and corporate integrity.

Among other things the new Form 990 requests information about:

- the salary of the five highest-paid employees and how that salary was determined and approved,
- the composition of the governing board and disclosure of certain of its policies (for example, on conflicts of interest), and

- financial information including any excess benefit transactions and tax-exempt debt financing.

The new form will be phased in over three years and slowly moved downstream, from larger to medium sized and then to more modest charities, to capture more information from more of the nonprofit community.

Some say that the IRS has no authority to ask for this kind of information and that the legality of the IRS's expansion has not been tested. But all tax exempt entities can expect heightened scrutiny in some way, and there are no signs that the IRS will desist from this path. Recently, the IRS published a list of its 10 "**Best Practices**" for charities none of which deals directly with tax exemption **matters**:

1. Does the agency have a Mission Statement?
2. Has it adopted a Code of Ethics for boards and a process to facilitate complaints by "whistleblowers?"
3. Does it have policies designed to assure that board members receive accurate and thoroughgoing **information** about operations?
4. Does it have in place effective conflict of interest policies?
5. Does it make a full and accurate disclosure of its activities and finances (including through the Form 990)?
6. Does it have policies governing the operations of fundraisers and fund-raising? †
7. Is there a requirement for an annual financial audit conducted under the auspices of a committee of the governing board?
  - Does it have in **place** practices by which the board can set a **reasonable** executive compensation?
9. Has it adopted effective document retention policies?

That is quite a bit for any organization to implement, but especially smaller charities that serve the community. It

may not be practical for a nonprofit to adopt each and every one of these actions, if the end result is to put in place a new bureaucracy designed solely to facilitate compliance with IRS's best practices. But any management consultant, looking at the new environment in which nonprofits must function, will tell you that they are worth serious study because of their own merits and because the IRS has indicated it intends nonprofits to take them seriously. The IRS says "any decision by the Service to conduct a review of operations subsequent to exemption will be influenced by whether an organization has voluntarily adopted good governance practices."

It will be interesting to see how the Service pursues a self-adopted mandate.

### The Future is Now

For entities studying how they can make themselves better by paying attention to these basics of sound governance built on accountability, disclosure, and integrity, they already notice external pressures on the rise. There will be increased attention given to board oversight, and nonprofits seeking to grow in this environment will

stress the importance and vitality of directors, whether they are of governing or advisory boards.

Nonprofits, including tax exempt charities, are already seeing more rigorous external sector compliance through the efforts of the IRS and state agencies that regulate charities. Some thoughtful attention is also being given to whether state governments may create new agencies to consolidate the oversight of charities between law enforcement and tax exemption authorities. In this environment it is no surprise that potential donors have not been silent. Many times, donors use the Internet and other devices to measure what charities are up to. It is expected that so-called "seal of approval" entities such as Guidestar or the "Wise Giving Alliance" of the Better Business Bureau will grow. The rise of these agencies confirms that there is already competition for funding.

In lean economic times, which charities will attract declining donor dollars? Many observers on the nonprofit world conclude that those agencies that do a good job maintaining the integrity, accountability, and trans-

parency of their operations and communicate that commitment to interested members of the community, potential beneficiaries and potential donors alike, will reap the most benefits.

In the end, it comes back to questions built on the structure and governance of the charity. Structure is not merely some form or formality. It defines how an agency will be treated under the law. If an agency is an activity of a larger organization, but yet has separate identity in the public's mind, the public may judge the adequacy of that charity's efforts both by how well it does on its own and how well its corporate parent is doing. But governance matters, too.

Those charities with a strong sense of mission, guided by insightful board members, operated with integrity, not afraid to communicate to the public will fare best of all. So... how does your cemetery measure up?

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This article is a reasonable facsimile of a talk Mr. Chopko presented to the annual CCC meeting in Orlando. In addition to his practice, Mr. Chopko is Adjunct Professor of Law at Georgetown University Law Center where he teaches a seminar on Church-State law. He is a graduate of the University of Scranton and the Cornell Law School. For twenty years, he served as general counsel for the United States Conference of Catholic Bishops. Mr. Chopko thanks his partner Christopher Cummings, chair of the Law and Legislation Committee of the CCC, for his kind introduction in Orlando and thoughtful review of this article.



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