

Best Practices for Exempt Organizations and Form 990

New questions provide the opportunity for CPAs to guide and educate nonprofit directors and officers.

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September 1, 2010

Tax-exempt organizations required to file federal Form 990, *Return of Organization Exempt From Income Tax*, which was expanded and revised beginning in 2008 tax years, now have some experience with the new requirements. They may have experienced much anxiety as they and their CPAs learned that the new Form 990 is not simply a numbers game. It is a direct effort by the IRS to make tax-exempt organizations follow some of the policy requirements that the Sarbanes-Oxley Act imposed on public companies and to otherwise require them to adopt best practices. Crafting and implementing these best-practice policies requires careful attention before preparation of Form 990 is started.

Furthermore, unlike most other tax returns, Form 990 is clearly in the public eye, due to its disclosure requirements. These features make preparing Form 990 a special opportunity for CPAs to serve nonprofit clients.

Much of the new Form 990's emphasis on compliance with rules governing exempt organizations and establishing and following sound policies and best practices is demonstrated in the many new questions it asks. Particularly, it asks more closely than before about the degree of involvement of the board of directors in establishing and assessing policies supporting proper governance, including a review within the organization and by its directors of the completed Form 990 itself.

For example, Part VI, Question 11A asks for a description of "the process, if any, used by the organization to review this Form 990." Other than the CFO, officers and directors may have seldom looked at tax returns in the past. These reviews during the last year were something of an eye-opener at many organizations. In our experience, board members reading the returns raised many questions and issues and in some cases caught errors that had long been reported in the cookie-cutter Forms 990 of past years.

The CPA needs to talk to the board and officers and help them understand Form 990, how to read it and what to look for. This education of the board is critical for the board to properly fulfill its oversight role for Form 990. The CPA is uniquely qualified to provide this vital education. The CPA should provide this training to the board periodically or in orientation for new members.

In addition to its oversight role, the board should adopt or strengthen policies that Form 990 now asks about. Part VI, Section B focuses specifically on "policies not required by the Internal Revenue Code." The purpose is ostensibly to support the organization's compliance with requirements of the Tax Code and regulations, but these policies go beyond the letter of the tax laws and are valuable measures in themselves for ensuring sound governance and demonstrating it to donors and the public. The instructions to Form 990 state on page 16 that the policies are not required by the Internal Revenue Code, but they also say "the IRS considers such policies and procedures to generally improve tax compliance."

While the organization's attorney may initially draft these governance policies, many organizations are reluctant to contact their attorney each time a policy question arises. The CPA is often more accessible than the attorney and is working on the Form 990. Therefore, the CPA must be poised to provide practical guidance on the policies. He or she also might be the advocate to the organization or its attorney as to why a policy needs to be changed or adapted to the needs of an organization.

Specifically, in Form 990 the IRS asks if the organization has written policies on the acceptance of gifts and the handling of whistleblowers, document retention and destruction, and conflicts of interest. It goes further and asks about various potential conflicts of interest, forcing the board to focus on potential conflicts and reveal any. Also it asks in Part XI if the organization's financial statements were compiled, reviewed or audited by an "independent accountant," and whether there is also an audit committee.

Organizations that have a joint venture with a taxable entity must say at Part VI, Section B, Questions 16a and b whether they have a written policy requiring them to evaluate such ventures for compliance with federal law and whether they have taken steps to safeguard their tax-exempt status with respect to such ventures.

While answering “no” to the existence of these best practices does not carry a real penalty (other than a perceived one that the “no” answer might increase the IRS audit risk), these “no” answers do not paint the entity in a favorable light to supporters and potential supporters, including potential donors. As discussed below, these “no” answers will be quite visible to the public. Thus, the CPA needs to help clients understand the importance of these policies and practices and guide them toward adopting them. That adoption might occur after Form 990 is filed for a year. In that case the CPA might note on Form 990 that the policy was subsequently adopted. That answer might help satisfy the IRS, and it will also satisfy donors and others interested in the exempt organization that the organization is aggressively moving to a best-practices level.

Gift acceptance policy. The gift acceptance policy often originates in the development office and can be critical for the organization properly to handle donated items. The question on Schedule M of Form 990 focuses on nonstandard gifts, but generally, having a gift acceptance policy can protect the organization from risks, including public relations risks. For example, the policy should provide steps for protection against environmental liability prior to accepting real estate. Also, the policy can enable the organization to handle potentially controversial gifts, allowing it to refuse acceptance of a gift when appropriate. For example, a charity with a capital campaign in full swing would want the ability to refuse a gift that necessitated naming its new building after a notorious figure. The Bernie Madoff wing of a new building might not present the desired public image. The CPA should discuss this policy with the development office and with the organization’s officers and board so they understand its value.

Whistleblower policy. A whistleblower policy typically provides simply that anyone reporting wrongdoing will not be punished for reporting it. The Sarbanes-Oxley Act was intended in part to address fears that employees who report corporate financial improprieties would be threatened with termination as a way to silence them. Having a well-publicized whistleblower policy gives all members of the organization the freedom to do what is right without fear of retaliation.

Clearly, that is a policy board members should support. Still, these whistleblower policies must be carefully crafted. To whom should someone report wrongdoing? What if the wrongdoer is the designated recipient of the report? How should the reported information be handled, both to assure adequate investigation but also to protect privacy to avoid damaging reputations or causing defamation actions against the organization? Part VI, Section B, Question 13 forces the organization to focus on such issues and to help assure that financial impropriety will be reported when discovered.

Document retention and destruction. The document retention and destruction policy is another seemingly boilerplate policy that the CPA should assist clients in understanding and making effective. It provides that documents may not be destroyed if they concern a matter under investigation—a logical Sarbanes-Oxley-type policy. Properly drafted, such a policy will also provide for routine destruction of superfluous documents. Ideally, the policy will have a schedule listing types of documents and how long they should be retained. Some documents, such as corporate minutes, should never be destroyed, but others, like routine purchase orders, can eventually be discarded. The CPA can help clients identify the relevant documents for the organization and, working with legal counsel, help establish appropriate retention or destruction policies tailored to the organization. The CPA generally has a much better working knowledge of client records than the attorney, and so the CPA’s assistance in putting together the retention/destruction schedule can turn a boilerplate schedule into something truly helpful to the organization beyond simply permitting a “yes” answer to Form 990, Part VI, Section B, Question 14.

Conflicts of interest. Finally, no policy of an organization is as critical and as potentially emotionally charged for the board or its officers as the conflict-of-interest policy. The CPA has a vital but often difficult role in this area beyond simply responding to Part VI, Section B, Questions 12a, b and c. Schedule L of Form 990 focuses on transactions between interested persons (such as board members) and the

organization. Schedule J reviews the procedures for establishing compensation. The CPA needs to assist clients in identifying reportable transactions and analyzing their ramifications. This independent professional judgment can be invaluable in determining and documenting the fairness of actions.

It is also worth noting that conflicts of interest are governed in several other ways beyond the conflict-of-interest policy. For example, many organizations are subject to state laws that specifically describe conflicts and other improper actions by boards and officers. Also, many tax provisions have conflict elements to them, such as the private inurement provisions for charities, the intermediate sanctions provisions for excess benefits to disqualified persons, or even the self-dealing rules for private foundations.

As a best practice, an organization should have a well-developed and carefully thought through conflict-of-interest policy. The IRS provides a sample form that is a good starting place for such a policy and should be considered in preparing a conflict-of-interest policy. See instructions to Form 1023, [Application for Recognition of Exemption Under Section 501\(c\)\(3\) of the Internal Revenue Code](#). The goals of a good conflict-of-interest policy are to identify conflicts and then to determine the risk of the conflict and how the organization should deal with it. Not all conflicts of interest are necessarily bad, but they do need to be identified and affirmatively considered by independent minds. The CPA can assist in this independent assessment as a service to the clients and their boards.

The CPA needs to educate the board on identifying conflicts of interest. Some conflicts are obvious. For example, if the organization pays excessive compensation to its president and that compensation is set by his brother who is chairman of the board, there is clearly a conflict. Most conflicts, however, are not that obvious. They can be a delicate subject. They may occur because a well-meaning board member is doing a favor for the organization. Is it a conflict of interest for the board chair to provide investment services to the charity? Does it alter the analysis if he or she charges less than any other investment adviser would for those services? Or that he or she is the best qualified person to provide specialized services within the geographic area? Sometimes a conflict-of-interest situation is necessary, and if so, the board and CPA should say so.

The organization needs to grapple with these difficult conflict issues. Part of this effort involves identifying issues but then bringing the right minds to bear on them to determine the best resolution under the applicable conflicts provisions. CPAs are often at the front line for this analysis. The CPA may be the one who identifies the conflict during work for the organization. Ultimately, the CPA may become the “bad guy” who has to report the conflict on Form 990, potentially embarrassing an important board member or even a donor. That reporting on the very public Form 990 could cause a good board member in an innocent situation to quit board service.

Form 990 also asks if board members are required to make annual disclosures of potential conflicts. Some board members may find this annual personal interrogation offensive. The CPA can help them understand the need to report this information and so may lessen some of the anger.

The CPA, while helping to prepare the Form 990, needs to be sensitive to the human elements of situations and disclosures. While the CPA has to answer tax return questions properly, the CPA and the organization should consider that an answer might create public embarrassment for the individuals involved. Further, the CPA might think about the proper discussion of a conflict. While the form may describe a conflict, it could go further in the answer or in an attachment and say that, for example, after the conflict was discovered, certain actions were taken to remedy it, or assure that it would not happen again, or that the conflict was essentially necessary and any compensation not excessive.

IN THE PUBLIC EYE

Because Form 990 must be made available for public inspection, it may be a way for tax-exempt organizations to present themselves and their mission and value to the public. In fact, many organizations fulfill this requirement by posting their Forms 990 on their own websites, in addition to their availability through services such as GuideStar ([guidestar.org](http://www.guidestar.org)). Any organization filing a Form 990 must understand this public exposure and craft the Form 990 with special attention to its readers, not just to the IRS. The CPA can help nonprofit clients make best use of the form for this purpose.

The first page of Form 990 is the organization's statement to the world as to why the organization is important and vital. Question 1 says to "briefly describe the organization's mission or most significant activities." A response of "to provide an innovative private school to educate young minds to prepare them to thrive in a global society" may be more inspiring to students' families and donors than simply "to operate a private school." The CPA can point out this opportunity for the organization to state its mission in a way that can help it garner public support.

Later questions on the form ask about the organization's significant program services and mission. Once again, the CPA can suggest that the organization not simply cut and paste the previous year's answers but rather focus on important services and accomplishments during the preceding year. This thoughtful crafting of Form 990 will let an organization put its best foot forward to the public. The CPA should partner with clients in creating this positive public image. This is true client service by the CPA beyond simple compliance with tax laws.

The new Form 990 is not cut, paste and attach. It is the opportunity for the CPA to partner with clients to move them into the best-practice level throughout the organization. It also provides a way to think outside the box and answer questions that help the organization tell its positive story to the world. Form 990 presents an opportunity for the CPA to add real value for clients and to be a true adviser—it is the CPA's opportunity to shine.

EXECUTIVE SUMMARY

■ **Exempt organizations required to file Form 990**, *Return of Organization Exempt From Income Tax*, are likely to find that the expanded and revised version of the form instituted for 2008 and following tax years asks whether they have instituted certain best practices. Even without such inquiries, these policies and procedures can be worthwhile for an organization's sound governance.

■ **Several such policies and reporting on them on Form 990** require a greater degree of involvement than before by more organization officials and directors and give CPAs an opportunity to help nonprofit clients understand and implement them.

■ **For example, the form asks whether the organization has written policies** concerning gift acceptance, whistleblowers, document retention and destruction, conflicts of interest, and joint ventures with taxable entities. While an absence of any of these policies will not necessarily endanger an organization's tax-exempt status, the IRS says they "generally improve tax compliance." They are likely to safeguard or improve the organization in other ways as well.

■ **One way such instituted or enhanced policies can help an organization** is in giving prospective donors greater confidence that their gifts will be used in the most effective and proper manner possible. For the same reason, because Form 990 must be made publicly available, organizations often can thereby give prospective donors and others using the information more specifics about the activities and goals of the organization simply by answering some of its questions more fully and with particular attention to the impact the form may have on readers other than the IRS.

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