

IRS FORM 990 REVISIONS MADE EASY

A Workbook and Checklist of Actions to Ensure That Your Nonprofit Organization Will be Ready

*Prepared by **avenue2possibilities LLP** providing an **avenue to possibilities** for nonprofit organizations. An **avenue** is a channel for pursuing your desired objective; **possibilities** are potential or prospective values, your organization's highest degree of ability and capacity.*

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Mission

The Internal Revenue Service encourages charities to establish and review regularly the organization's mission. A clearly articulated mission, adopted by the board of directors, serves to explain and popularize the charity's purpose and guide its work. It also addresses why the charity exists, what it hopes to accomplish, and what activities it will undertake, where, and for whom. Organizations required to file Form 990 may describe their mission in Part I, Line 1 and are required to describe their mission in Part III, Line 1.¹

Questions:

- Review your mission statement, is it accurate and current?

Actions:

- Write a brief description of your organization's mission or most significant activities for Form 990.

Recommendations:

- If your mission statement has changed, you are required to report those changes in the organization's "purposes or activities" to the IRS to ensure the changes are consistent with your status as an exempt organization or as a public charity.²

Organizational Documents

Regardless of whether a charity is a trust, corporation, unincorporated association, or other type of organization, it must have organizational documents that provide the framework for its governance and management. State law often prescribes the type of organizational document and its content. The organizational document of a trust is usually the trust agreement or declaration of trust, and of a corporation, its articles of incorporation. State law may also require corporations to adopt bylaws. The Internal Revenue Service requires the submission of organizational documents and bylaws, if adopted, with an application for exemption under section 501(c)(3), and will review these documents to ensure that the applicant is organized exclusively for exempt purposes and that the applicant's proposed or actual activities are consistent with those documents. Organizations required to file Form 990 will find that Part VI, Section A, Line 4 requires organizations to report significant changes to their organizational documents since the prior Form 990 was filed.³

Questions:

- Did the organizing documents change (the trust instrument, corporate charter, articles of incorporation, articles of association, or other written instrument by which the organization is created under state law)?
- Did your organization's by-laws change?
- Has your organization's registration to conduct charitable solicitations been renewed with the Secretary of State in any state where you conduct fundraising activities?

Actions:

- If the organizing documents or by-laws have changed since the prior Form 990 was filed, describe the circumstances, process, or changes in *Schedule O, Supplemental Information to Form 990*.

Recommendations:

- If your organizing documents or by-laws have changed since your original 501(c)(3) determination letter, you are required to report those changes to the IRS.

¹ Governance and Related Topics - 501(c)(3) Organizations, February 14, 2008

² <http://www.irs.gov/charities/charitable/article/0,,id=123213,00.html>

³ Governance and Related Topics - 501(c)(3) Organizations, February 14, 2008

Governing Body

The Internal Revenue Service encourages an active and engaged board believing that it is important to the success of a charity and to its compliance with applicable tax law requirements. Governing boards should be composed of persons who are informed and active in overseeing a charity's operations and finances. If a governing board tolerates a climate of secrecy or neglect, we are concerned that charitable assets are more likely to be diverted to benefit the private interests of insiders at the expense of public and charitable interests. Successful governing boards include individuals who not only are knowledgeable and engaged, but selected with the organization's needs in mind (e.g. accounting, finance, compensation, and ethics).

Attention should also be paid to the size of the board ensuring that it is the appropriate size to effectively make sure that the organization obeys tax laws, safeguards its charitable assets, and furthers its charitable purposes. Very small or very large governing boards may not adequately serve the needs of the organization. Small boards run the risk of not representing a sufficiently broad public interest and of lacking the required skills and other resources required to effectively govern the organization.

On the other hand, very large boards may have a more difficult time getting down to business and making decisions. If an organization's governing board is large, the organization may want to establish an executive committee with delegated responsibilities or advisory committees.

Irrespective of size, a governing board should include independent members and should not be dominated by employees or others who are not, by their very nature, independent individuals because of family or business relationships. The Internal Revenue Service reviews the board composition of charities to determine whether the board represents a broad public interest, and to identify the potential for insider transactions that could result in misuse of charitable assets. The Internal Revenue Service also reviews whether an organization has independent members, stockholders, or other persons with the authority to elect members of the board or approve or reject board decisions, and whether the organization has delegated control or key management authority to a management company or other persons. Organizations that file Form 990 will find that Part VI, Section A, Lines 1, 2, 3, and 7 ask questions about the governing body.⁴

If an organization has local chapters, branches, or affiliates, the Internal Revenue Service encourages it to have procedures and policies in place to ensure that the activities and operations of such subordinates are consistent with those of the parent organization. Organizations that file Form 990 will find that Part VI, Section A, Line 9 asks about such procedures and policies.⁵

Questions:

- Is the composition of your board representative of the programmatic and administrative needs of your organization?
- Is your board active and engaged in overseeing your finances and operations?

Recommendations:

- Perform an assessment of the expertise, skills and experience of current board members to determine if there are any significant gaps in your organization's leadership.

⁴ Governance and Related Topics - 501(c)(3) Organizations, February 14, 2008

⁵ Governance and Related Topics - 501(c)(3) Organizations, February 14, 2008

Governance and Management Policies

Although the Internal Revenue Code does not require charities to have governance and management policies, the Internal Revenue Service will review an organization's application for exemption and annual information returns to determine whether the organization has implemented policies relating to executive compensation, conflicts of interest, investments, fundraising, documenting governance decisions, document retention and destruction, and whistleblower claims.⁶

Recommendations:

- Although a Board Job Description, Roles and Responsibilities and Code of Conduct policies are not required, as stated in Section 3 above, "the Internal Revenue Service encourages an active and engaged board." Instituting any or all of these would guide your organization's board in performing their functions.

Visit www.accga2p.com/materials.html for sample policies

Executive Compensation

A charity may not pay more than reasonable compensation for services rendered. Although the Internal Revenue Code does not require charities to follow a particular process in determining the amount of compensation to pay, the compensation of officers, directors, trustees, key employees, and others in a position to exercise substantial influence over the affairs of the charity should be determined by persons who are knowledgeable in compensation matters and who have no financial interest in the determination. Organizations that file Form 990 will find that Part VI, Section B, Line 15 asks whether the process used to determine the compensation of an organization's top management official and other officers and key employees included a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision.

The Internal Revenue Service encourages a charity to rely on the rebuttable presumption test ... when determining compensation of its executives. Under this test, compensation payments are presumed to be reasonable if the compensation arrangement is approved in advance by an authorized body composed entirely of individuals who do not have a conflict of interest with respect to the arrangement, the authorized body obtained and relied upon appropriate data as to comparability prior to making its determination, and the authorized body adequately documented the basis for its determination concurrently with making the determination.

Comparability data generally involves looking to compensation levels paid by similarly situated organizations for functionally comparable positions. One method is to obtain compensation surveys or studies from outside compensation consultants for this purpose. The Internal Revenue Service will look to the independence of any compensation consultant used, and the quality of any study, survey, or other data, used to establish executive compensation. Once that test is met, the Internal Revenue Service may rebut the presumption that an amount of compensation is reasonable only if it develops sufficient contrary evidence to rebut the probative value of the comparability data relied upon by the authorized governing body.

The Internal Revenue Service has observed significant errors or omissions in the reporting of executive compensation on the IRS Form 990 and other information returns (e.g., Form W-2 and employment tax returns). Organizations should take steps to ensure accurate and complete compensation reporting on these forms, and to also ensure that appropriate income and employment taxes are withheld and deposited with the Internal Revenue Service. Executive compensation continues to be a focus point in our examination program.⁷

⁶ Ibid.

⁷ Governance and Related Topics - 501(c)(3) Organizations, February 14, 2008

Questions:

- Did you use third-party salary data in determining the compensation for top management and key employees (i.e. regional nonprofit salary surveys)?
- Are top management and key employee salary ranges approved by the board or an appropriate committee?

Actions:

- Review your compensation process for compliance with IRS regulations.
- Describe this process in *Schedule O, Supplemental Information to Form 990*.

Recommendations:

- Ensure that Form 990, *Part VII, Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors* is accurate and complete.

Conflicts of Interest

The directors of a charity owe it a duty of loyalty. The duty of loyalty requires a director to act in the interest of the charity rather than in the personal interest of the director or some other person or organization. In particular, the duty of loyalty requires a director to avoid conflicts of interest that are detrimental to the charity. Many charities have adopted a written conflict of interest policy to address potential conflicts of interest involving their directors, trustees, officers, and other employees.

The Internal Revenue Service encourages a charity's board of directors to adopt and regularly evaluate a written conflict of interest policy that requires directors and staff to act solely in the interests of the charity without regard for personal interests; includes written procedures for determining whether a relationship, financial interest, or business affiliation results in a conflict of interest; and prescribes a course of action in the event a conflict of interest is identified.

The Internal Revenue Service encourages organizations to require its directors, trustees, officers and others covered by the policy to disclose, in writing, on a periodic basis any known financial interest that the individual, or a member of the individual's family, has in any business entity that transacts business with the charity. The organization should regularly and consistently monitor and enforce compliance with the conflict of interest policy. Instructions to Form 1023 contain a sample conflict of interest policy. Organizations are urged to tailor the sample policy to their own particular situations and needs, with the help of competent counsel if necessary. Organizations that file Form 990 will find that Part VI, Section B, Line 12 asks whether an organization has a written conflict of interest policy, and whether it regularly and consistently monitors and enforces compliance with the policy.⁸

Visit www.accga2p.com/materials.html for a sample Conflict of Interest Policy approved by the National Council of Nonprofit Associations⁹

⁸ Governance and Related Topics - 501(c)(3) Organizations, February 14, 2008

⁹ ©2004 National Council of Nonprofit Associations, May be duplicated, with attribution, by charitable organizations.

Investments

The governing body or certain other persons may be required either by state law or by the organizational documents to oversee or approve major investments made by the organization. Increasingly, charities are investing in joint ventures, for-profit entities, and complicated and sophisticated financial products or investments that require financial and investment expertise and, in some cases, the advice of outside investment advisors.

The Internal Revenue Service encourages charities that make such investments to adopt written policies and procedures requiring the charity to evaluate its participation in these investments and to take steps to safeguard the organization's assets and exempt status if they could be affected by the investment arrangement. The Internal Revenue Service reviews compensation arrangements with investment advisors to see that they comply with federal tax law.

Organizations that file Form 990 will find that Part VI, Section B, Line 16 asks whether an organization has adopted procedures and policies regarding participation in a joint venture or similar arrangement with a taxable entity. In addition, Form 990, Schedule D, asks detailed information about certain investments.¹⁰

Questions:

- Is your organization currently investing in joint ventures, for-profit entities, or sophisticated financial products?

Actions:

- If your answer is yes, the board must adopt written policies or procedures to evaluate participation in joint venture arrangements under applicable Federal tax law and take steps to safeguard the organization's exempt status.
- Provide detailed information in Form 990 *Schedule D*.

Recommendations:

- Consider seeking the advice of a qualified outside investment advisor.

Fundraising

Charitable fundraising is an important source of financial support for many charities. The Internal Revenue Service encourages charities to adopt and monitor policies to ensure that fundraising solicitations meet federal and state law requirements and solicitation materials are accurate, truthful, and candid. Charities are encouraged to keep their fundraising costs reasonable and to provide information about fundraising costs and practices to donors and the public. Organizations that file Form 990 will find that schedules G and M solicit information about fundraising activities, revenues and expenses.¹¹

Recommendation:

- The board can adopt a resolution to require the staff to comply with *Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations*¹².

Visit www.accga2p.com/materials.html for the text of these policies

Governing body minutes and records

The Internal Revenue Service encourages the governing bodies and authorized sub-committees to take steps to ensure that minutes of their meetings, and actions taken by written action or outside of meetings, are contemporaneously documented. Organizations that file Form 990 will find that Part VI, Line 8 asks whether an organization contemporaneously documents meetings or written actions undertaken during the year by its governing body and each committee with authority to act on behalf of the governing body.¹³

¹⁰ Governance and Related Topics - 501(c)(3) Organizations, February 14, 2008

¹¹ Governance and Related Topics - 501(c)(3) Organizations, February 14, 2008

¹² www.nonprofitpanel.org

¹³ Governance and Related Topics - 501(c)(3) Organizations, February 14, 2008

Questions:

- Does your organization take minutes at meetings of the board and/or authorized board committees and provide a written record of their proceedings and actions?

Actions:

- If your answer is no, the board must take steps to ensure minutes of their meetings are taken simultaneous to the discussions and actions.

Recommendations:

- Copies of minutes should be distributed to board members within a specified period of time.

Document Retention and Destruction Policy

The Internal Revenue Service encourages charities to adopt a written policy establishing standards for document integrity, retention, and destruction. The document retention policy should include guidelines for handling electronic files. The policy should cover backup procedures, archiving of documents, and regular check-ups of the reliability of the system. For more information, see IRS Publication 4221, Compliance Guide for 501(c)(3) Tax-Exempt Organizations, available on the IRS website. Charities are required by the Internal Revenue Code to keep books and records that are relevant to its tax exemption and its filings with the Internal Revenue Service. Organizations that file Form 990 will find that Part VI, Section B, Line 14, asks about whether an organization has a written document retention and destruction policy.¹⁴

Recommendations:

- Develop a document retention policy with guidelines for handling electronic files, backup procedures, archiving of documents and regular check-ups of the reliability of computer systems.
- The board can adopt a resolution to require the staff to comply with IRS Publication 4221, *Compliance Guide for 501 (c) (3) Tax-Exempt Organizations*

Visit www.accga2p.com/materials.html for the full text of the policy

Ethics and Whistleblower Policy

The public expects a charity to abide by ethical standards that promote the public good. The organization's governing body bears the ultimate responsibility for setting ethical standards and ensuring they permeate the organization and inform its practices. The Internal Revenue Service encourages a charity's board or trustees to consider adopting and regularly evaluating a code of ethics that describes behavior it wants to encourage and behavior it wants to discourage. A code of ethics will serve to communicate and further a strong culture of legal compliance and ethical integrity to all persons associated with the organization.

The Internal Revenue Service encourages the board of directors to adopt an effective policy for handling employee complaints and to establish procedures for employees to report in confidence any suspected financial impropriety or misuse of the charity's resources. Such policies are sometimes referred to as whistleblower policies. The Internal Revenue Service will review an organization to determine whether insiders or others associated with the organization have materially diverted organizational assets. Organizations that file Form 990 will find that Part VI, Section A, Line 5 and Section B, Line 13 ask whether the organization became aware during the year of a material diversion of its assets, and whether an organization has a written whistleblower policy.¹⁵

¹⁴ Ibid.

¹⁵ Governance and Related Topics - 501(c)(3) Organizations, February 14, 2008

Recommendations:

- Although not required, as stated in Section 4g above, “the Internal Revenue Service encourages a charity’s board or trustees to consider adopting and regularly evaluating a Code of Ethics” and “to adopt an effective policy for handling employee complaints.” Note that the Whistleblower Policy will require appointment of a Compliance Officer.

Visit www.accga2p.com/materials.html for sample policies

Financial Statements and Form 990 Reporting

Directors are stewards of a charity’s financial and other resources. The Internal Revenue Service encourages the board, either directly or through a board-authorized committee, to ensure that financial resources are used to further charitable purposes and that the organization’s funds are appropriately accounted for by regularly receiving and reviewing up-to-date financial statements and any auditor’s letters or finance and audit committee reports..¹⁶

Financial Statements

Some organizations prepare financial statements without any involvement of outside accountants or auditors. Others use outside accountants to prepare compiled or reviewed financial statements, while others obtain audited financial statements. State law may impose audit requirements on certain charities, and a charity must ensure that it abides by the requirements of state law. Many organizations that receive federal funds are required to undergo one or more audits as set forth in the Single Audit Act and OMB Circular A-133. However, even if an audit is not required, a charity with substantial assets or revenue should consider obtaining an audit of its financial statements by an independent auditor.

The board may establish an independent audit committee to select and oversee an independent auditor. An audit committee generally is responsible for selecting the independent auditor and reviewing its performance, with a focus on whether the auditor has the competence and independence necessary to conduct the audit engagement, the overall quality of the audit, and, in particular, the independence and competence of the key personnel on the audit engagement teams. The Internal Revenue Service encourages all charities to take steps to ensure the continuing independence of any auditor that conducts an audit of the organization. Organizations that file Form 990, will find that Part XI, Line 2, asks whether the organization’s financial statements were compiled or reviewed by an independent accountant, audited by an independent accountant, and subject to oversight by a committee within the organization. And, Part XI, Line 3 asks whether, as a result of a federal award, the organization was required to undergo an audit as set forth in the Single Audit Act and OMB Circular A-133.¹⁷

Questions:

- Is your organization required by state law to undergo an audit by an independent auditor?
- Has your organization received federal funds which require one or more audits?

Actions:

- If your answer is yes, the board may establish a committee to select and oversee the independent auditor.

Recommendations:

- The Internal Revenue Service encourages nonprofit organizations to have their financial statements compiled or reviewed by an independent accountant and when necessary audited by a qualified third-party.

¹⁶ Governance and Related Topics - 501(c)(3) Organizations, February 14, 2008

¹⁷ Ibid.

Form 990

Although not required to do so by the Internal Revenue Code, some organizations provide copies of the IRS Form 990 to its governing body and other internal governance or management officials, either prior to or after it is filed with the Internal Revenue Service. Practices differ widely as to who sees the form, when they see it, and the extent of their input, review, or approval. Some, especially smaller organizations, may provide a copy of the Form 990 to the full board for review or approval before it is filed. Others provide a copy of the form to a portion of the governing body, or to a committee or top management officials, before it is filed. Still others provide a copy to the board, a committee or top management officials, but not until after it is filed. Organizations that file Form 990 will find that Part VI, Section A, Line 10 asks whether the organization provides a copy of Form 990 to its governing body, and requires the organization to explain any process of review by its directors or management.¹⁸

Questions:

- Does your organization provide copies of Form 990 to the board?

Actions:

- Describe the process your organization uses to review Form 990 in *Schedule O, Supplemental Information to Form 990*.

Transparency and Accountability

By making full and accurate information about its mission, activities, finance, and governance publicly available, a charity encourages transparency and accountability to its constituents. The Internal Revenue Code requires a charity to make its Form 1023 exemption application, Form 990, and Form 990-T, available for public inspection. The Internal Revenue Service encourages every charity to adopt and monitor procedures to ensure that its Form 1023, Form 990, Form 990-T, annual reports, and financial statements, are complete and accurate, are posted on its public website, and are made available to the public upon request. Organizations that file Form 990 will find that Part VI, Section C, Lines 18 and 19, ask whether and how an organization makes its Form 1023, Form 990 and Form 990-T, governing documents, conflict of interest policy, and financial statements available to the public.¹⁹

Actions:

- Describe how your organization makes your governing documents, conflict of interest policy, and financial statements available to the public in *Schedule O, Supplemental Information to Form 990*.

Recommendations:

- Adopt procedures to ensure that Form 1023, Form 990, Form 990-T, annual reports, and financial statements are posted on the organization's website and made available to the public upon request.
- The board can adopt a resolution to require the staff to comply with IRS Publication 4221, Compliance Guide for 501 (c)(3) Tax-Exempt Organization.

Visit www.accga2p.com/materials.html for the text of these policies

¹⁸ Governance and Related Topics - 501(c)(3) Organizations, February 14, 2008

¹⁹ Governance and Related Topics - 501(c)(3) Organizations, February 14, 2008