



DIVISION OF GOVERNMENT & PUBLIC AFFAIRS

501(c)(3) Due Diligence

Internal Revenue Service Form 990 Checklist

The Internal Revenue Service recently redesigned the Form 990. As a result, non-profit organizations will be required to disclose, under penalty of perjury, whether they have in place various policies and procedures, some of which are mandatory under the Internal Revenue Tax Code or Sarbanes-Oxley.

Other policies and procedures are voluntary but may become mandatory over time or may expose a non-profit to adverse publicity if absent. Below is a checklist of these rules, based primarily on the reporting requirements in the new Form 990.

The rules become effective for returns filed for the applicable deadline in 2009 for organizations with tax years beginning on or after Jan. 1, 2008.

Suggested or required *written* policies:

- Conflict of interest policy for board members, officers, and senior staff
 - Outlines procedures to determine whether a relationship, financial interest, or business affiliation results in a conflict of interest.
 - Details the appropriate response when a conflict is identified.
 - Requires annual disclosure of interests, such as a list of family members, substantial business or investment holdings, and other transactions or affiliations with businesses or other organizations .
 - Ensures any potential excess-benefit transactions are scrutinized and approved by a disinterested decision-making body.¹
 - Requires periodic review of compensation arrangements, partnerships, joint ventures, and arrangements with management organizations to prevent inurement, impermissible private benefit, or an excess benefit transaction.
- Whistleblower policy²
 - Establishes procedures for the receipt, retention, and treatment of employee complaints regarding suspected financial impropriety or misuse of the organization's resources.
- Document retention and destruction policy³

¹ Pursuant to I.R.C. § 4958, a manager of a tax-exempt organization who approves an excess-benefit transaction may be subject to intermediate sanctions.

² The Sarbanes-Oxley legislation imposes criminal liability on tax-exempt organizations for retaliation against whistleblowers. *See* 18 U.S.C. § 1513(e) (2008).

³ The Sarbanes-Oxley legislation imposes criminal liability on tax-exempt organizations for destruction of records with the intent to obstruct a federal investigation. *See* 18 U.S.C. § 1519 (2008).

This checklist was prepared by the Washington, DC law firm Arent Fox (June 2008).

- Provides guidelines for maintaining and documenting the storage and destruction of electronic and hard-copy files.
- Outlines backup procedures, archiving of documents, and regular check-ups of the reliability of the system.
- Investment and/or joint venture policy
 - Outlines procedure to evaluate relationship with taxable entity and safeguard the organization's exempt status.
- Gift acceptance policy
 - Requires review of any non-standard contributions.
 - Provides for substantiation of gifts of more than \$250.
 - Provides for periodic monitoring or compliance under state charitable solicitation laws.
- Easement policy
 - Describes the periodic monitoring, inspection, and enforcement of any conservation easements.
- Compensation policy (see also Compensation committee below)
 - Outlines the procedure for the payment, reimbursement, or provision of the following expenses:
 - First-class or charter travel
 - Travel for companions
 - Tax indemnification and gross-up payments
 - Discretionary spending account
 - Housing allowance or residence for personal use
 - Payments for business use of personal residence
 - Health or social club dues or initiation fees
 - Personal services (maid, chauffeur, chef)
 - Requires substantiation prior to reimbursement for the expenses listed above
- Parent-subordinate consistency policy
 - Ensures activities and operations of local chapters, branches, or affiliates are consistent with those of the parent organization.

Suggested procedures:

- Contemporaneous documentation of meeting minutes of board and committees.
- Board review of the Form 990 prior to submission to the IRS.
- Publicly available organizing documents.
- Provide donors and the public with information about fundraising costs and practices.
- Board composition reflects broad public interest and minimizes potential for misuse of charitable assets
 - Includes independent members
 - Is not dominated by individuals with family or business relationships related to the organization
 - Delegates responsibilities to executive committee or advisory committees (organizations with large boards)

- Periodic review with staff of the rules constraining lobbying and political activities.
- Uncertain tax positions recorded according to the two-step process outlined by the Financial Accounting Standards Board (FASB) in FIN 48.⁴

Suggested committees:

- Compensation committee
 - Relies on the rebuttable presumption test of section 4958 of the Internal Revenue Code and Treasury Regulation section 53.4958-6.
 - Independent review and approval (persons with a conflict of interest are excluded).
 - Comparability data for similarly qualified persons in functionally comparable positions at similarly situated organizations.
 - Contemporaneous substantiation (documentation and recordkeeping) of the deliberation and decision regarding the compensation arrangement.
- Audit committee
 - Assumes responsibility for oversight of the audit, review, or compilation of financial statements and selection of an independent accountant.

The following further best practices are specific to the type of organization (schools, hospitals, organizations providing grants or other assistance, and organizations issuing tax-exempt bonds).

Schools

Policy: Nondiscriminatory policy towards students included in charter, bylaws, other governing instrument, or in a resolution of its governing body.

- Policy included in all brochures, catalogues, and other written communications with the public dealing with student admissions, programs, and scholarships.
- Policy publicized through newspaper or broadcast media during the period of solicitation for students or during the registration period.

Records must be maintained with the following:

- Racial composition of the student body, faculty, and administrative staff.
- Provisions for awarding scholarships and other financial assistance on a racially nondiscriminatory basis.

The school must maintain copies of the following:

- Catalogues, brochures, announcements, and other written communications to the public dealing with student admissions, programs, and scholarships.
- Materials used by the organization or on its behalf to solicit contributions.

⁴ FIN 48 (Interpretation 48 of Financial Accounting Standard 109), effective for fiscal years beginning after December 15, 2006 (for nonpublic organizations, effective for fiscal years beginning after Dec. 15, 2007), requires tax-exempt organizations to record a liability for income when there are uncertainties as to whether its income is exempt from income tax. Although the Form 990 does not refer to FIN 48 specifically, the disclosure requirements may alert the IRS to potentially unrelated business income.

Hospitals

Written policies:

- Charity care policy
 - Provides free or discounted care to the “medically indigent.”
 - Does not include a per-patient limit on care funded out of the reserve for indigent patients.

- Debt collection policy
 - Contains provisions on the collection practices to be followed for patients who are known to qualify for charity care or financial assistance.

Procedures:

- Prepares annual community benefit report that is available to the public.
- Patient intake process informs and educates patients about their eligibility for assistance under federal, state, or local government programs, or under the hospital’s charity care policy.

Organizations Providing Grants and Other Assistance

- Maintains records to substantiate the amount of the grants or assistance, the grantees’ eligibility for the grants or assistance, and the selection criteria used to award the grants or assistance.

Organizations Issuing Tax-exempt Bonds

- Management policies and procedures ensure the post-issuance compliance of its tax-exempt bond liabilities.⁵

The adoption of the policies and procedures discussed above will prevent compliance issues before they arise. In the face of intensified scrutiny of non-profit governance, tax-exempt organizations can best defend themselves by being prepared.

⁵ Providing information about these policies will be optional for returns filed in 2009.