

## **Compliance Alert**

### **Form 990 Now Requires Governance, Management and Disclosure Information**

By: Gregory J. Naclerio\*

In May 2009, IRS Form 990, which is required to be filed by all not-for-profit (NFP) organizations was changed. IRS Form 990 now includes Part VI which addresses “Governance, Management and Disclosure.” While no provision of the IRS Code gives the IRS oversight over NFP governance, the IRS is convinced that good corporate governance is a keystone in ensuring that an organization lives up to its mission and tax-exempt status. In comments made at Georgetown University on June 23, 2009, Sarah Hall Ingram, the then former IRS Commissioner for Tax Exempt and Government Services, said:

They are not expressly laid out in the Code, nor do they need to be, but the principles of governance that are of concern to the IRS should derive from the requirements for tax exemption and should aid an organization in meeting them.

Further more, Commissioner Ingram stated:

I believe that adherence to principles of good governance is entirely consistent with both your task to accomplish your charitable objections, and ours, to see that the tax-exempt section complies with the code. I think practicing good governance helps advance these goals.

While controversy certainly exists over the position adopted by the IRS, NFP’s will have to comply with the new IRS requirements unless Congress intervenes. These requirements are contained in Part VI of the 990 Form address “Governance, Management, and Disclosure.”

The instructions for this Section of Form 990 echoes the tone set forth by Commissioner Ingram:

Even though governance, management and disclosure policies and procedures generally are not required under to Internal Revenue Code, the IRS considers such policies and procedures to generally improve tax compliance. The absence of appropriate policies and procedures may lead to opportunities for **excess benefit transactions**, inurement, operation for non-exempt purposes, or other activities inconsistent with exempt status. (Form 990 Instructions, p 15, emphasis in original).

#### Section A: Governance, Management and Disclosure.

The “Governing Body and Management” section of the Form 990 lists 11 questions to be answered “yes” or “no.” For certain responses, the NFP must “describe the circumstances process or changes” in Schedule O. Some of the questions posed include:

- The number of governing board directors who are “independent.”

- Whether an officer, director, trustee or key employee has a family or business relationship with any other officer, director, trustee or key employee.
- Was management of the NFP delegated to a management company?
- Is the organization aware of any material diversion (by theft or embezzlement) of its assets?
- Does the NFP “contemporaneously document meetings of the governing body/or executive committee?”

One of the most interesting questions is whether a copy of the 990 was provided to the governing body before it was filed. The instructions for this question states: “Answer: “yes” only if a copy of the organization final Form 990 (including required schedules) as ultimately filed with the IRS was provided to each **voting member of the organization’s governing body.**” (Instructions to Question 10, emphasis in original).

Not satisfied with just a “yes” or “no” answer, the IRS requires the NFP to set out on Schedule O the process, if any, by which the governing body reviewed the 990. Specifically, the IRS wants to know: was the 990 reviewed before or after it was filed; who conducted the review; when the review was conducted; and finally, the extent of the review.

If no review was conducted, the IRS wants the “no” amplified by having the NFP state on Schedule O, “No review was or will be conducted.”

Section B: Policies.

This section addresses the NFPs policies and asks:

- Does the NFP have a written conflict of interest policy? The IRS defines a conflict of interest as arising:  

when a person in a position of authority over an organization, such as an officer, director or manager, may benefit financially from a decision he or she could make in such capacity including indirect benefits such as to family members or businesses with which the person is closely associated.
- Is there a policy for annual disclosures by officers, director, trustee, key employees of potential conflicts?
- Does the NFP have a “written whistleblower policy?”

The IRS describes such a whistleblower policy as one that:

...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.

- Does the NFP have a written document retention and destruction policy?
- Did the process for determining the compensation for the NFP's CEO, officers and other key employees include "review by independent person(s);" comparability data and contemporaneous substantiation of the deliberation and decision. The NFP must use Schedule O to describe the process.

#### Section C: Disclosure.

The IRS Code requires the NFP to make certain of its documents available to the public. Here, the IRS asks how is this accomplished. Inquiry is also made as to whether the NFP makes its "governing documents," "conflict of interest policy" and "financial statements" available to the public. Interestingly, in the 990 Instructions, the IRS acknowledges, "federal law does not require that such documents be made publicly available..." If that is the case, the IRS seems to be using Form 990 as their "bully pulpit" in order to encourage transparency in the not-for-profit world.

Form 990 is only the start of the IRS and its campaign to bring Sarbanes-Oxley - like reforms to the NFP community. Commissioner Ingram also stated:

We are going to start asking agents, at the end of each examination, to fill out a check sheet about certain of the examined organization's governance practices and internal controls. The check sheet is intended to identify instances of noncompliance found during the exam, and also to gather information about whether the organization had, and used, any internal controls.

#### Conclusion

What the IRS intends to do with the information collected from Form 990 and its field audit checklists is not as yet clear. However, certain conclusions can be drawn:

- 1) The IRS believes that NFP's are not being run with the safeguards currently used by for profits as a result of Sarbanes-Oxley (SOX).
- 2) The collection of data by the IRS will most likely support its working hypothesis.



Congress will be called upon to bring a version of SOX to the NFP community to ensure NFP contributors that the NFP's mission, which justifies its tax-exempt status, is being met.

\* Gregory J. Naclerio is a partner at Ruskin Moscou Faltischek, where he is Chair of the Health Law Regulatory Department and co-chair of the White Collar Crime & Investigations Group. He is also a member of the Corporate Governance Practice Group