

Form 990: Key Observations and Lessons Learned



Eva Mruk, Director of Tax Compliance, provides a full range of tax compliance and consulting services to tax-exempt organizations. She has extensive knowledge of IRS Forms 990 and 990-T and related state tax returns. She also has significant experience in addressing such issues as intermediate sanctions, employment classification and compensation, fund raising, unrelated business income tax, tax implications and reporting of alternative partnership investments, foreign tax reporting and state and local tax issues.

The 2008 redesign of IRS Form 990 is no longer headline news in not-for-profit tax circles. Top billing has shifted to the many lessons being learned now that practitioners and the not-for-profit community have worked with the new form. The shortcomings of the redesign, the ambiguities, the implications of the new questions and even the resources required to prepare the form are still being absorbed and considered.

With our entire practice exclusively focused on not-for-profit organizations, we prepare and review over a thousand 990 forms each year. This wealth of experience results in our ability to assist our clients and industry colleagues as they navigate through the new 990 environment. We have outlined below our key observations with a view toward elucidating the most common areas of concern and uncertainty.

Policies and Governance

The Policies and Governance section (Part IV) has generated the most discussion among organizations of all types. Organizations should keep in mind that the policies contained in this section generally are not required by law but are best practices that the IRS would like to see implemented by not-for-profit organizations. The Sarbanes-Oxley Act includes a provision under federal law which prohibits all corporations, including not-for-profit organizations, from retaliating against employees who “blow the whistle” on their

employer’s accounting practices. Adopting a strong internal process for addressing complaints, including a whistleblower protection/anti-retaliation policy, can protect the organization from the risk of violating state and federal laws that afford protection to whistleblowers, and ensures that problems will be investigated and resolved.

Furthermore, the Sarbanes-Oxley Act imposes criminal liability on an exempt organization that alters, falsifies, covers up or destroys records with the intent to obstruct a federal investigation. As a result of this liability, exempt organizations must be vigilant in monitoring and justifying document destruction practices. Form 990 asks whether the filing organization has adopted a written document retention and destruction policy. Although not legally required, adopting such a policy will help ensure that the exempt organization complies with Sarbanes-Oxley requirements and also retains records for appropriate periods.

Thus, a “no” response to any or all of these questions does not imply legal wrongdoing. However, countless “no” answers might cause the IRS to make inquiries about the organization’s governance. Moreover, since Form 990 is a public document, most organizations do not want to disclose information that may convey a weakness in an organization’s governance structure. Consideration should also be given as to how your not-for-profit organization stacks up against similar organizations.

Therefore, most organizations try to answer as many of these questions as possible with a positive “yes”; but some have found that it was too late to implement a policy for the 2008 tax year. As stated in the Form 990 FAQ section on the IRS website, organizations must have implemented the policy prior to the year end of the Form 990 tax year in order to answer “yes.” If the organization has adopted the policy subsequent to year end, an explanation should be provided on Schedule O. According to an IRS official in the Tax-Exempt and Government Entities Division, in the future the IRS will take responses to particular Part IV questions into consideration when determining which organizations are most at risk of not complying with the tax laws.

The specific question that has probably yielded the greatest misunderstanding and concern is the question that asks whether board members were given a copy of Form 990 prior to filing. That question is followed by a line saying that the 990 review process, if there is one, should be explained in Schedule O. Many organizations have interpreted this to mean that the IRS would like the entire board to review and approve the final version of the 990—a task that would be impractical for many not-for-profits with large boards. However, the only “best practice” applicable to the entire board is that the final Form 990 be circulated to every board member—they are not required to review or approve it. The Schedule O explanation for review and approval of the Form 990 does not have any particular requirements. The review may be performed by a person on the governing body, the treasurer, for example, or by the audit/finance committee, an ad hoc committee, management, or combination thereof.

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Disclosure Questions

Part IV contains several questions about public disclosure. One asks how Forms 990, 990-T and the exemption application are made public. One of the choices is “another’s website.” Some organizations have asked if public posting on GuideStar qualifies as “another’s

website.” The IRS has provided clarification in its 2009 Form 990 instructions stating that posting on GuideStar does not qualify. The IRS reasons that an organization cannot know if the GuideStar posting is timely and further that GuideStar does not post either exemption applications or Form 990-T.

Mission and Activities

Form 990 asks the not-for-profit organization to describe its mission or most significant activities and disclose its program service accomplishments. A not-for-profit has a responsibility to establish and regularly determine clear performance measurements and should share those results with the public. Many organizations miss an opportunity to sell their mission and convey their successes on their Form 990 due to inadequate disclosure. Some not-for-profit organizations provide only cursory details, particularly in Part III, “Statement of Program Service Accomplishments,” which asks for a statement of purpose and a list of program activities. In completing this section, not-for-profit organizations should remember that grant-makers, the media and others will make judgments about the organization based on the quality of information presented.

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Number of Employees

Part I asks how many employees the organization has based on the number of W-2s reported on Part V. This question can create confusion. For example, all of an organization’s employees may be paid by a related organization or, in some cases, may be paid in foreign countries. This can lead the reader to question how the organization operates without personnel. Many not-for-profits are including supplemental information in Schedule O to describe the payroll arrangement and how many staff the reporting organization employs. The 2009 Form 990 instructions clarify that the number of employees to be reported includes those reported on Form W-3 by both the filing organization and its reporting agents, including common paymasters and payroll agents, for the calendar year ending with or within the filing organization’s tax year.

Compensation — Part VII and Schedule J

All officers must be listed on Part VII. Per the instructions, this includes any organization officers as defined in organizational documents and also automatically includes the top management official and the top financial official, regardless of salary level. In reporting key employees and highest compensated employees (current or former) and former officers or directors, the compensation threshold amounts are based on reportable compensation from Form W-2 (Medicare wages) or Form 1099-MISC. However, the requirement to complete the more detailed Schedule J is based on total compensation—Form W-2 or Form 1099-MISC—*plus* other payments, such as deferred compensation and nontaxable benefits.

Independent Directors

Form 990 inquires about the total number of directors and the number of independent directors who meet the definition in the instructions. Comparison of the numbers readily discloses the percentage of independent directors. A director is considered to be independent if all three of the following circumstances applied at all times during the organization's tax year: (1) the director was not compensated as an officer or other employee of the organization or of a related organization (there is a limited religious exception); (2) the director received total compensation as an independent contractor from the organization or other related entity of less than \$10,000 for the year (may receive reasonable compensation as a director, and may receive reimbursement of expenses); and (3) neither the director nor any family member was involved in a transaction, either with the organization or with a related organization, that was required to be reported on Schedule L, Transactions with Interested Persons.

The focus of the definition is on compensation received by the director or a relative from the organization or a related entity. This definition excludes ordinary members of membership associations and substantial donors who do not have other transactions with the organization.

A related question asks the organization to identify any officer, director or key employee who has a family relationship or a business relationship with another officer, director or key employee. The instructions make clear that this question does not refer to relationships in the ordinary course of business or to attorney-client or certain other professional relationships.

Statement of Revenue — Part VIII

The contributions area of this expanded statement has caused some misunderstanding. There is a line for membership dues (1b), which, for most organizations is considered program services revenue. The only "dues" that belong here are dues for which the "member" does not receive a substantial return benefit. For example, membership in a public radio or television station typically is a contribution because the only return benefit is perhaps a station guide. Membership dues for trade associations, on the other hand, provide significant benefits for members and belong in the program service revenue area.

There is also a line (1c) for fundraising events and another section in "other revenue" for fundraising event breakdown. The only portion of fundraising gross revenue that is reported in the contribution section is that portion which is greater than the fair market value of the return benefit or the deductible portion of the funds raised.

Financial Statements Question — Part IX

The question asks if the organization obtained audited financial statements. The instructions state that organizations that are audited as part of a consolidated financial statement must answer "no" to this question. Many large organizations are audited on a consolidated basis and were forced to indicate that an audit was not performed. The resolution for 2008 (other than obtaining separate audit opinions for each entity) is to answer "no" and to provide an explanation in Schedule O that the organization received a consolidated audit. For the 2009 Form 990, the IRS has adopted a new line 12A that asks whether the organization was included in a consolidated, independent audited financial statement for the tax year.

Public Support — Schedule J

Prior to 2008, this schedule was required to be prepared on the cash basis. Beginning with the 2008 tax year, organizations are required to complete this schedule based on their accounting method—in most cases, the accrual method. Organizations are required to retroactively convert this schedule to the accrual method for the current year and a four-year look-back period. In addition, the details of "disqualified" support will have to be adjusted based on the accrual method.

Foreign Activities — Schedule F

One portion of this new schedule requires disclosure of total expenditures in foreign countries, broken down by region. Organizations that conduct activities beyond U.S. borders must provide details of those activities, including programs, conferences, associated expenditures, offices, employees or agents outside the United States. The 2009 Form 990 instructions to Part I, column (f), provide that an expenditure is to be reported if it is an employment-related expense, an occupancy expense, a grant, a bank or financial account fee, or a payment to an agent, if the employee, office, grantee or agent is located outside the United States. Organizations may use different accounting procedures and practices to keep track of foreign expenses for financial statement purposes, so there may be variation in how organizations account for or allocate direct or indirect costs relating to their foreign activities. For 2009, allocations of indirect expenditures to foreign activities are not necessary if the organization does not separately track them.

Transactions with “Interested Persons” — Schedule L

This section requires reporting of loans to and from interested persons, grants to interested persons and business transactions with these parties. There has been some misinterpretation of the definition of an “interested person.” The instructions provide guidance and examples sufficient to analyze the transaction on a case-by-case basis. The IRS has stated that organizations must make a reasonable effort to determine these types of transactions; questionnaires distributed to each current and former

officer, director, trustee and key employee listed in Form 990, Part VII, Section A, can be relied upon as constituting reasonable effort. For the 2009 Form 990, the IRS has added line 28, which includes simplified trigger questions to help the organization determine whether it needs to complete Schedule L, Part IV.

The IRS instructions, FAQs and other materials have provided valuable insight on responding to the various questions. The instructions highlight areas of interest to general counsel and executive leadership relating to the definition of “independent voting member” of the board; definitions of “family member” and “business relationship” with respect to the disclosure of horizontal board member relationships; the materiality threshold for “material diversion of assets”; the definitions of “contemporaneous” and “documentation” as they relate to board meetings and board actions; expectations of a board-level review of the Form 990 before filing; application of the organization’s conflict-of-interest policy; satisfaction of the rebuttable presumption of reasonableness; and policies with respect to the charitable purposes of joint venture investments.

With the growing importance of the 990, it is also prudent to seek professional advice in preparing the 990, developing policies and procedures to ensure that the form is completed in the most positive possible light and to troubleshoot any specific areas of concern. Loeb & Troper is a market leader in assisting organizations, industry associations and fellow practitioners in all aspects of the 990. If you would like to discuss your needs, please contact Eva Mruk, Director of Tax Compliance, at 212-867-4000 or emruk@loebandtroper.com.

ANNOUNCEMENTS

Visit us at www.loebandtroper.com for updates and details.

- ▶ Loeb & Troper is pleased to exhibit at the New York State Association of Independent Schools’ Annual Business Officers Conference in New Paltz, NY, from May 4-6.
- ▶ Allan M. Blum, CPA, Partner, presents “Mergers and Collaborations,” and Brian O’Reilly, CPA, Partner, presents “Keeping Your Education Program in Line with SED Guidelines” at the 23rd Annual Financial Managers of NY Conference in Cooperstown on May 5.
- ▶ Loeb & Troper’s 2010 Private Schools Webinar Series — First Session May 11, 2010.
- ▶ Koy Dever, Principal, Kathy Gill, Manager, and Randi Roy, Senior Health Care Consultant, have been invited to present “Realizing the Vision: A Strategic and Financial Approach to Business Planning” at the New York Association of Homes and Services for the Aging’s 2010 Spring Training Institute and Exhibition in Saratoga on Tuesday, May 25. We are also pleased to exhibit at the Spring Institute from May 24-26.
- ▶ Loeb & Troper’s Annual Not-for-Profit Industry Conference will be held June 23, 2010.
- ▶ Loeb & Troper is developing an essential handbook for not-for-profit board members. . . Coming June 2010.