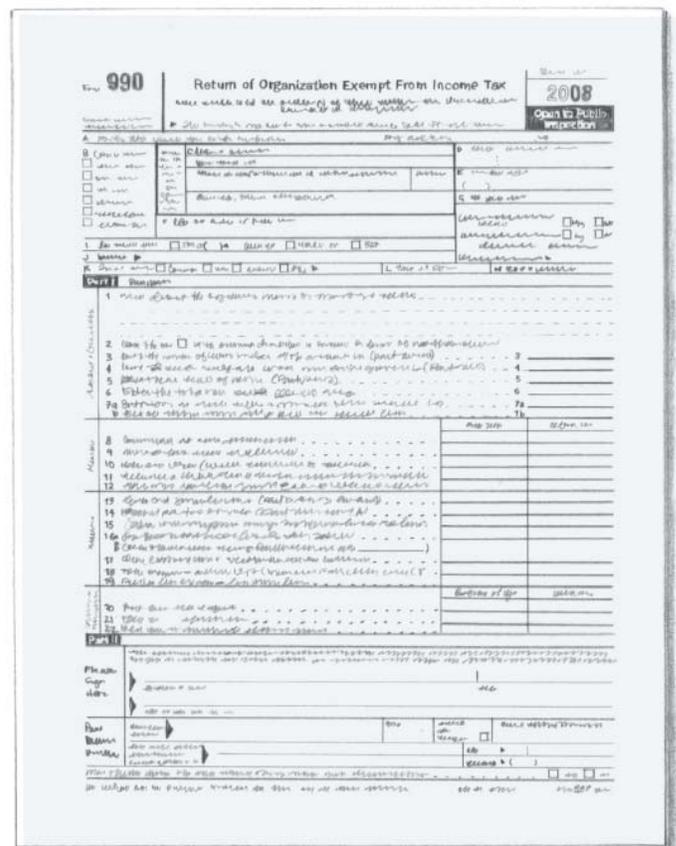


New Form 990 focuses on your governance, and more

Not-for-Profit Special Tax Bulletin Fall 2008



“Is your organization ready for the new Form 990? The appropriate presentation of Form 990 information can influence everyone from donors to regulators to the media. Therefore, tax-exempt organizations should pay attention to the information included in the Form 990, or be prepared to get unwanted attention.”



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The buzz swirling around the changes to the Form 990 results from a significant redesign in format and content as compared to the current form. The redesign is extensive and touches so many areas that you may want to do a readiness assessment to be sure you can address, and properly respond to, the new questions concerning the policies, procedures and practices already in place (or that you may need to adopt) for your organization.

Doing an assessment now will also help you capture and prepare the new information that you will be required to disclose.

Major change areas include:

- a front-page summary that provides a snapshot of key financial and operating information;
- a checklist of required new schedules based on your specific activities and operations;
- a section to highlight your governance policies, procedures and practices; and
- revised compensation and related organization reporting.

Quite noticeably, the new Form 990 was designed to enhance the transparency of your mission, financial information, operations and use of resources. The front page of the return provides a two-year comparison of summary financial information and a brief description of the organization's mission and most significant activities. Organizations must also indicate their gross and net unrelated business income on the front page. The IRS has pointed out that net unrelated business income is generally negative and their concern is that this may be due to aggressive expense allocation methods.

Expense allocations (and the losses created by them) must be supportable tax positions under the tax law for Form 990 purposes, and for purposes of FIN 48, discussed on page 6.

New approach – Core form with supplemental schedules

The IRS wants more disclosure. The new Form 990 consists of an 11-page core form (containing 11 parts) to be completed by all filers and 16 supplemental schedules to provide additional detailed information. Whether these supplemental schedules are required depends on the information provided in the core form. “Follow the money” seems to drive the need for several of the supplemental schedules. Most large organizations will be required to complete several to nearly all of the supplemental schedules.

A checklist of required supplemental schedules also provides a quick view of whether the filing organization is conducting activities that raise IRS concern, such as lobbying, political campaign activities, transactions with insiders or members of their family or closely associated businesses, and major dispositions of assets. The activities you conduct need to be consistent with your tax-exempt purpose or mission (whether or not they generate revenue). The return also includes an entire section for you to provide information about your tax-exempt mission, a detailed description of the three largest activities (by expenditures) you conduct to accomplish your mission, new activities adopted during the year and any activities that ceased during the year.

The new form contains many more very pointed “yes/no” questions designed to determine the level of your tax compliance. Examples include the unrelated business income and excise tax provisions, rules associated with reportable payments, certain state laws, tax-exempt bond provisions, private inurement prohibitions, excess benefit transaction rules, avoidance of substantial private benefit, applicable lobbying provisions and specific rules relating to political activity.

Board members (and the policies they have in place) are in the spotlight more than ever before.

The importance of the new governance and management section

Considerable focus is placed on your organization’s governance. While the IRS acknowledges that some questions about policies or practices are not legally required by the Internal Revenue Code, all filing organizations must answer these new Form 990 questions. The IRS reasoning for its intense focus on governance is as follows:

The new form requires each filing organization to provide certain information regarding the composition of its board or governing body, certain of its governance policies and practices, and the means by which it is held accountable to the public by making governance and financial information publicly available. Many of the questions request information on practices or policies that are not required by federal tax law. However, good governance and accountability practices provide safeguards that the organization’s assets will be used consistently with its exempt purposes. This is a critical tax compliance consideration, especially for organizations that are subject to private benefit, excess benefit and private inurement prohibitions. In addition, well-governed and well-managed organizations are more likely to be transparent organizations with regard to their operations, finances, fundraising practices and use of assets for exempt and unrelated purposes.

Part VI of the core Form 990 contains three sections: Governing Body and Management, Policies and Disclosure.

Board members (and the policies they have in place) are in the spotlight more than ever before. For example, on the new Form 990 you will disclose who is on your board, the number of board members who can vote, the number of board members who are independent, whether board members have family or business relationships with each other, any employees or vendors and whether the board’s decisions are ultimately subject to approval by some other body. You must also state whether meetings held or board actions taken during the year were “contemporaneously documented” in written minutes by the later of the date of the next meeting or the passage of 60 days. Governance descriptions extend to local chapters, branches or affiliates; if you have them, you must disclose whether you have written policies and procedures governing their activities. To ensure the board is actively engaged in and fully aware of the information disclosed on Form 990, you are also required to describe the process for the board to review Form 990.

Definitions for terms such as governing body, voting member and independent voting member are provided in the instructions. Conventional wisdom is that the great majority of your board members should be “independent” with respect to the organization directors. To be independent, a board member must:

- not be compensated as an officer or employee of the organization,
- not receive more than \$10,000 for independent contractor services,
- not be involved in a transaction or relationship that was reportable on the current year’s Schedule L (Transactions with Interested Persons), and
- not have any family members that received compensation or were involved in a transaction or relationship that was reportable on the current year’s Schedule L.

Accountability is key. The governance section of the return also requires the disclosure of material diversions of assets, including diversions that happened in prior years, if the organization just became aware of the diversion during the current year. “Material” is defined as the lesser of \$250,000 or 5 percent of gross receipts or total assets. You must explain the nature of the diversion, the amount of the diversion and the corrective action taken, but you generally should not identify the person involved.

The focus on governance clearly indicates the kind of policies, practices and procedures that the IRS believes responsible persons should have in place to exercise their fiduciary duty. Therefore, the policies the board has in place to ensure that assets are used for charitable purposes will be disclosed on Form 990. Specifically, organizations must check “yes/no” as to whether certain specific policies are in place and in some cases, you must include descriptions. For example:

- **Policies:** You must state whether you have a conflict-of-interest policy; whether officers, directors, trustees and key employees are required to update their disclosure forms annually; and whether you regularly and consistently monitor and enforce compliance with the policy. Questions about policies that spilled over from the Sarbanes-Oxley provisions include whether you have a whistleblower policy and a document-retention and destruction policy.

- **Compensation:** You must state whether your process for setting compensation meets the standards for the rebuttable presumption of reasonableness for your CEO, other officers and key employees and include a description of the process.
- **Joint ventures:** You must disclose whether the organization participates in certain types of joint ventures with taxable entities. If so, is there a written joint venture policy to safeguard your tax-exempt status? Elements of a protective joint venture policy generally include sufficient control over the venture or arrangement to ensure furtherance of your tax-exempt purposes, that the venture not engage in activities that would jeopardize your tax-exempt status, and that all contracts entered into by the venture will be at arm’s length or more favorable to the organization.

The Disclosure section includes a potentially self-incriminating, question (i.e., “List the States with which a copy of this Form 990 is required to be filed”). Many states have registration or licensing requirements for organizations that directly or indirectly solicit contributions from individuals, businesses or other exempt organizations, located within their state. To respond to the question, as it is phrased, you will need to determine in which states you are required to file; not necessarily where you are actually filing.

There is a related question appearing in Schedule G where you list the states in which the organization is registered or licensed to solicit funds or has been notified that it is exempt from registration or licensing.

A comparison between your responses to these two questions may expose a potential compliance gap. In the remainder of the Disclosure section, you explain how you make documents (both those which are open to public inspection by law and those that you voluntarily make available) available for public inspection.



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Compensation – Significant new disclosures required

In a continued theme of transparency, the return also includes major modifications for reporting compensation from your organization and all related organizations. The reporting of total compensation packages and arrangements is designed to provide more complete information regarding complicated compensation and financial arrangements that may raise concerns about private inurement, excess benefit transactions and substantial private benefit.

Compensation must be disclosed for officers, directors, trustees and key employees. The instructions will expand the definition of key employees. The revised definition of what constitutes a “key employee” will now have three prongs. Under the new definition, key employees are those persons (other than officers, directors and trustees), who

- had reportable compensation exceeding \$150,000 for the year (the “\$150,000 test”);
- had or shared organization-wide control or influence similar to that of an officer, director or trustee, or managed or had authority or control over at least 10 percent of the organization’s activities (the “responsibility test”); and
- were within that group of the organization’s top 20 highest paid persons for the year who satisfied both the \$150,000 test and the responsibility test.

Another new requirement is that you must describe your process for determining the compensation of your CEO, executive director, other officers and key employees. The classification of “officer” is determined by reference to state law, but it always includes the organization’s top management official.

If you are required to attach Schedule J, you must also disclose the base compensation, bonus amount and other compensation for your insiders as well as your process for determining incentive compensation.

Supplemental schedules

In addition to the core form, depending on your answers to numerous questions about your activities and operations, you will be required to complete certain supplemental schedules. For example, there are supplemental schedules to report foreign activities, grants to domestic organizations, the use of tax-exempt bond proceeds and extensive information that hospitals must address. The complete list of the 16 supplemental schedules is as follows:

- Schedule A – Public Charity Status and Public Support
- Schedule B – Schedule of Contributors
- Schedule C – Political Campaign and Lobbying Activities
- Schedule D – Supplemental Financial Statements
- Schedule E – Schools
- Schedule F – Statement of Activities Outside the U.S.
- Schedule G – Fundraising and Gaming Activities
- Schedule H – Hospitals
- Schedule I – Grants and Other Assistance In the U.S.
- Schedule J – Compensation Information
- Schedule K – Tax Exempt Bonds
- Schedule L – Transactions with Interested Persons
- Schedule M – Non-cash Contributions
- Schedule N – Liquidation, Termination, Dissolution or Significant Distribution of Assets
- Schedule O – Supplemental Information to Form 990
- Schedule R – Related Organizations and Unrelated Partnerships

Several of the supplemental schedules, discussed on the following pages, are particularly noteworthy because of their wide application and the additional required disclosures.

Schedules B and M

Donor identity and non-cash contributions received (i.e., Schedules B and M), will notify the IRS which organizations are receiving contributions of property. Using that disclosure, the IRS can more easily scrutinize particular types of contributions for compliance with valuation and charitable deduction requirements pertaining to donors.

Schedule D

Nearly every organization will be required to complete supplemental Schedule D. There, you must report specific types of assets and liabilities, including donor-advised funds, collections of art, spending and accumulation of endowments assets, and your liability, if any, for “Federal Income Taxes,” together with a requirement to include the text of the footnote to the organization’s financial statements that reports the organization’s liability for uncertain tax positions under FIN 48.

In some cases, FIN 48 requires a tax-exempt organization to record a liability for potential income taxes. Every organization “takes” tax positions and since the application of tax law to specific facts is uncertain by its very nature, some positions may be uncertain. For example, the IRS has stated that the net unrelated business income on Form 990-T is usually negative, causing IRS concern that losses may be the result of aggressive expense allocation methods. FIN 48 requires that you take a critical look at your tax positions (including your expense allocations), assess the likelihood that they would be sustained, and document management’s level of certainty about its positions.

In view of the continued scrutiny of tax-exempt organizations by the IRS, FIN 48 may ultimately turn out to be a blessing in disguise. You can best defend your organization by proactively identifying and understanding your tax positions, determining whether the weight of tax authority (e.g., statutes, regulations and court cases) tips in your favor or in favor of the IRS, and taking steps to appropriately strengthen your tax positions. If under a FIN 48 analysis an organization’s net operating loss carry-forwards are the result of supportable tax positions, it may be time to consider whether recording a deferred tax asset is appropriate. For example, if alternative investments are expected to generate unrelated business taxable income, the loss carry-forwards may be available to offset such taxable income.

Schedule J

Schedule J (where required) pertains to all officers, directors, trustees and key employees listed on the core form. Starting with a check-the-box reporting format for the types of benefits you provided, new disclosures are required:

- First-class or charter travel (includes airplane or boat owned by the organization)
- Travel for companions (not for bona fide business purpose)
- Tax indemnification and gross-up payments
- Discretionary spending accounts (not accountable plans)
- Housing allowance or personal residence
- Payment for business use of personal residence
- Health or social club dues or initiation fees (does not include onsite use of facility)
- Personal services (e.g., chef, chauffeur, maid, financial planner, nanny, physician, tax preparer)

Schedule J also requires you to check boxes to indicate the processes used to establish the compensation for the top executive (i.e., the CEO/executive director):

- Compensation committee
- Independent compensation consultant
- Forms 990 of other organizations
- Written employment contract
- Compensation survey or study
- Approval by board or compensation committee

Finally, if you are required to attach Schedule J for certain officers, directors, trustees, key employees and highest-compensated employees, the compensation disclosure must not only show the base compensation, bonus amount and other compensation separately, but in Schedule J you must also indicate whether you provide severance or change of control payments, supplemental nonqualified retirement benefits, equity-based compensation arrangements, compensation contingent on revenues or net earnings, and a description of any non-fixed payments.

Schedule K

Newly revised Schedule K contains four parts, however, only Part I is required for the 2008 reporting year. Part I requires a detailed listing of all outstanding tax-exempt loans greater than \$100,000 as of the last day of the tax year and issued post-Dec. 31, 2002.

For years after 2008, organizations will need to complete the other parts of Schedule K and that may take some research. For example, Part II asks for detailed information about the use of tax-exempt proceeds. Specifically, this section requires reporting of the various uses of bond proceeds for items such as reserve funds, defeasance escrows, amounts unspent, issuance costs, both working capital and capitalized costs, and the year of project completion. As the capstone, you will be required to state whether adequate books and records are maintained to support your allocations.

In Part III, organizations with tax-exempt bonds are required to indicate their private business use even if the use adheres to specific safe-harbor standards established under the Treasury Regulations. The IRS is apparently looking for some level of precision because the reporting of the average percentage of private business use during the tax year must be rounded to the nearest tenth of one percentage point. However, you will not be required to report private business use associated with refunding bonds issued after the Dec. 31, 2002, effective date, as well as the refinanced tax-exempt debt.

Finally, Part IV rounds out Schedule K with detailed inquiries regarding your compliance with existing arbitrage rebate provisions including whether or not Form 8038-T has been filed and the amount of any rebate payments.



Schedule L

Loans to or from a current or former officer, director, trustee, key employee, certain of your highest-paid employees or any disqualified person – as well as grants or other assistance provided – are reported on Schedule L. In addition, Schedule L provides for reporting the discovery of excess benefit transactions.

You must also use Schedule L to report whether any current or former officers, directors, trustees or key employees have a direct business relationship or have an indirect business relationship through ownership of more than 35 percent in another entity (individually or collectively with other persons listed in Part VII, Section A) with you, the filing organization.

Finally, Schedule L requires disclosure of business relationships between and among the organization and certain individuals and companies with which they are associated. Specifically, any current or former officers, directors, trustees or key employees' family member who had a direct or indirect business relationship with the organization, served as an officer, director, trustee, key employee, partner, member of an entity, or was a shareholder of a professional corporation doing business with the organization are reported on Schedule L.

Action items

1. Conduct a readiness assessment to understand what measures will be necessary and advisable for your organization. For example, as stated above, the conventional wisdom is that you should have “yes” answers in response to whether you have certain policies in place. In fact, certain negative answers require additional explanations. Therefore, a proactive assessment will provide time to develop, update and adopt policies while there is still time to do so.
2. Determine how many of your directors are “independent” under the new independence standard; from a practical standpoint, the vast majority of your directors should be independent.
3. Prepare draft responses to the questions that require descriptions of your policies, procedures and practices (especially those related to compensation) so they can be vetted prior to the due date for filing Form 990.

Quick reference: Policies, Procedures and Practices Disclosure on the Form 990

It is very important to understand that the required disclosures on Form 990 will be unique to your organization. To assist you with your analysis, refer to Grant Thornton's Chart of Policies, Procedures and Practices that are referenced to in the new Form 990. Some of our suggestions are specifically addressed in the new Form 990 while others will help you comply with the new filing requirements for the return.

Since several of the suggested items are likely to overlap multiple areas, as you update and expand your existing policies, practices and procedures, (or create new ones) you will need to avoid redundancy and dueling documents. Therefore, as you prepare to file the new Form 990, you may benefit greatly (saving time and energy) by using outside tax accountants and legal counsel as resources with a fresh perspective to help your audit committee manage the process. Accordingly, a coordinated approach will be the key to success.

Questions?

For additional information, please contact:



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