NONPROFIT ORGANIZATIONS ARTICLE

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The New IRS Form 990: Nonprofit Corporate Governance and Management

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The Internal Revenue Service has substantially revised its Form 990, which is the annual information return filed by tax-exempt entities, for the 2008 tax year. The stated goals of the IRS in overhauling the Form 990 were "enhancing transparency, promoting tax compliance, and minimizing the burden on the filing organization." All nonprofits should be aware that the new Form 990 includes a series of questions focused on governance and management.

These Form 990 questions reflect emerging best practices for nonprofit governance and management but are not requirements of law. Although these standards are not legally required, keep in mind that the IRS believes that "good" governance (as defined in the new Form 990) correlates with tax law compliance. Accordingly, it is possible that nonprofits deviating from the Form 990 standards may be targeted for audit more frequently than organizations that are in compliance.

Also consider that information provided in the Form 990 is not only reviewed by the IRS, but also is subject to public disclosure. Potential donors, the media and other interested parties may request copies of certain recently filed Forms 990 directly from the nonprofit or easily access copies on the Internet (see www.guidestar.org). Increasingly, the Form 990 is used by multiple stakeholders to gather information about nonprofits and to evaluate their efficiency and effectiveness.

Some of these governance and management questions appeared in the prior version of the Form 990, but most are entirely new. Furthermore, never before have these issues been segregated in a separate and easily accessed section of the form. For these and other reasons, it is critical that nonprofits prepare themselves for the new Form 990 (see the IRS website - http://www.irs.gov/charities/article/0,,id=201398,00.html - for the new Form 990 and instructions). Following is a checklist of various governance practices and policies that should be considered:

• Board composition: The new Form 990, like the prior version, asks how many voting members serve on the nonprofit's governing board. By asking this question, the IRS reveals its concern about boards of directors that are too small (typically fewer than five directors) and too large (depending on the organization, perhaps more than forty directors). The new Form 990 probes further, however, asking how many of the voting board members are "independent" (i.e., not compensated by the nonprofit or related to another director by family or business).

• Contemporaneous meeting minutes: The new Form 990 asks whether all meetings of a nonprofit's board of directors and any committee with board-delegated powers are contemporaneously documented (i.e., before the later of 60 days after the meeting or the next meeting). Nonprofits should be prepared to answer this question affirmatively.

• Management companies: The IRS may scrutinize nonprofits that delegate significant managerial decision making (in such areas as human resource functions, budgeting and financial operations, and supervising programs of the nonprofit) to third-party or affiliate management companies. In the new Form 990, the IRS requires disclosure of all such arrangements.

• Relationships with for-profits: The new Form 990 requests information about all entities in which ownership is shared with one or more for-profits (including corporations, limited liability companies and other joint ventures).

• Transactions with insiders: The IRS continues to focus on financial transactions and other arrangements between nonprofits and their insiders. In particular, the new Form 990 asks whether insiders are required to disclose annually interests that could give rise to conflicts. For purposes of the new Form 990, "insiders" include directors, trustees, officers and "key employees." The latter category is now defined as the nonprofit's twenty most highly compensated employees, provided that such individuals (i) receive annual compensation of $150,000 or more and (ii) have powers similar to a director, trustee or officer or have the authority to manage 10% of the programs or assets of the nonprofit.

• Executive compensation: The new Form 990 includes a series of questions designed to reveal whether the nonprofit satisfies the intermediate sanctions safe harbor requirements when approving executive compensation. In particular, the IRS asks whether compensation was reviewed and approved in advance by independent persons who relied on comparability data, and whether that approval was contemporaneously documented in meeting minutes.

• Written policies: The new Form 990 asks whether the nonprofit has a written conflict of interest policy, whistleblower policy and document retention/destruction policy. Most nonprofits should be prepared to answer each of the questions affirmatively. As stated above, the conflict of interest policy should require, among other things, advance written disclosure of actual and potential conflicts of interest.

- Form 990 review: The new Form 990 asks whether a copy of the Form 990 was provided to the governing body before filing. Nonprofits also must describe the process by which the Form 990 was reviewed. Accordingly, the Form 990 instructions suggest the board of directors and top management officials should be given the opportunity to review the draft Form 990. Further, a final copy of the Form 990 should be provided to each director before it is filed.

- Public disclosure of key documents: The new Form 990 asks whether the following documents are subject to public disclosure or inspection: Form 1023/1024 (unless filed before 1987), Forms 990 (last three years), Forms 990-T (last three years, public charities only), governing documents, conflict of interest policy, and financial statements. In most instances, a nonprofit should simply post these documents on its website.

We recommend that all nonprofits filing the Form 990 carefully assess their governance practices using this checklist and other available tools. With planning, most nonprofits will be able to adapt their governance policies and practices to conform to the new Form 990 standards.