HAVING GOOD POLICIES IS GOOD POLICY

The new Form 990 suggests new ways to meet the ever-increasing scrutiny of government and the public.

KEITH J. KEHRER AND JAMES M. MATTHEWS

Section 501(c) organizations ("EOs") enjoy exemption from federal income tax. To obtain and maintain their exemption, EOs must comply with certain state and federal laws. These laws restrict an EO's use of assets to certain exempt purposes, limit conflict of interest transactions, and generally prohibit the use of EO assets for personal benefit (including the payment of excessive compensation).

In recent years, EOs have been scrutinized for failure to comply with these laws. The perception has been that these failings thrive where a governance vacuum enables or does not adequately address them. In response, and at the encouragement of the Senate Finance Committee, the Panel on the Nonprofit Sector prepared "Principles for Good Governance and Ethical Practices—A Guide for Charities and Foundations" (October 2007).[1] The IRS similarly responded by releasing "Good Governance Practices for Section 501(c)(3)Organizations"[2] (a discussion draft) and "Governance and Related Topics—501(c)(3) Organizations."[3] The Panel and IRS reports include numerous recommendations to improve EO governance.

Despite these recommendations, there remains a concern that many EOs have not adopted, or do not follow, good governance policies. The IRS took a large step forward in addressing this concern by releasing a new version of Form 990 for 2008—the Form's first major redesign since 1979. Subject to certain exceptions (including an exception for private foundations, which must file IRS Form 990-PF[4]), all EOs that satisfy the reporting thresholds must file the 2008 Form 990.[5] IRS officials stress that the 2008 Form 990's redesign is "based on three guiding principles: enhancing transparency, promoting tax compliance, and minimizing the burden on the filing organization."[6]

Completing Form 990 will now require substantially more detailed disclosures and recordkeeping in several areas.[7] Among other changes, EOs will now need to disclose certain governance policies and procedures, many of which were included in the Panel and IRS reports on EO governance. Disclosure will have the practical effect of encouraging EOs to evaluate their existing governance policies and practices, and will pressure EOs to adopt or revise certain policies and procedures so they can respond favorably to the questions regarding such policies.[8]

The discussion below analyzes eight of the most common governance policies and procedures identified by the 2008 Form 990:

- Contemporaneous meeting documentation (Part VI, Section A, Line 8).
- Directors review of Form 990 (Part VI, Section A, Line 10).
- Compensation policy (Part VI, Section B, Lines 15a-b).
- Conflict of interest policy (Part VI, Section B, Line 12a).

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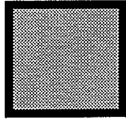

THERE REMAINS A CONCERN THAT MANY EOS HAVE NOT ADOPTED, OR DO NOT FOLLOW, GOOD GOVERNANCE POLICIES.

- Whistleblower policy (Part VI, Section B, Line 13).
- Record retention policy (Part VI, Section B, Line 14).
- Expense reimbursement policy (Part VI, Section A, Line 1b, Part VII, Section A, Lines 3-5 & Schedule J, Part I, Line 1b)
- Gift acceptance policy (Part IV, Lines 29-30, Part VIII, Line 1g & Schedule M).

What follows is a brief discussion of the role of policies in governance, a framework for adopting policies, and short summary of these policies, along with some practical considerations regarding their content and utility. A second article in a future issue of *Taxation of Exempts* will analyze additional governance policies covered by the 2008 Form 990 that apply in special circumstances, including policies related to hospitals; EOs with tax-exempt bonds; EOs with chapters, affiliates, and branches; EOs that engage in joint ventures with for-profit entities; EOs engaged in foreign activities; and EOs that have accepted property subject to a conservation easement.

The role of policies in governance

An EO's governing body bears the primary responsibility for ensuring that the EO complies with state and federal law.[9] In general, policies are principles and guidelines established by an EO's governing body to govern and standardize actions taken by its directors, officers, management, and employees. Policies are usually based on accepted, well-defined norms of ethics or practice, and in some instances the dictates of federal or state law. An overarching role of governance policies and procedures is to establish consistency, expectations, and patterns of behavior for people conducting an EO's operations and activities. According to the IRS, "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."[10] By adopting and following good governance policies, the EO's governing body increases the likelihood of complying with federal and state law and of identifying and addressing potential problems. Such policies also increase the likelihood of reduced sanctions if IRS or other government officials discover a legal violation that occurred in spite of good faith adoption of and compliance with those policies.

All policies should be in writing. Their coverage, application, and enforcement should be well documented. Closely associated are the needs to publicize these policies within the EO, to assign responsibilities for carrying out and enforcing them, and to monitor the policies for appropriateness and effectiveness. The EO must ensure that it has the necessary resources to implement and monitor each policy, or allocate additional resources in order to do so. It is also advisable that each policy include a provision that requires a periodic review to confirm the policy is enforced and effective, and to determine whether any revisions are necessary in light of changes in the law or operations. Because it generally is worse to have a policy that is not consistently followed or enforced than to have no policy at all, each EO must carefully consider whether it has the ability to fully communicate, comply with, and monitor any policy under consideration.

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[1] Available at http://www.nonprofitpanel.org/report/principles/Principles_Guide.pdf.

[2] Available at www.bryancave.com/goodgovernancepractices.

[3] Available at www.irs.gov/pub/irs-tege/governance_practices.pdf.

[4] To date, the IRS has not revised Form 990-PF, Return of Private Foundation, and has given no clear indication regarding the timing of any potential revision. It is possible the IRS could release an additional schedule to the Form 990-PF to address governance and other issues as an interim measure.

[5] In general, EOs with gross receipts of $1 million or more, and/or total assets of $2.5 million or more, must file the 2008 Form 990 for tax years beginning in 2008. Filing thresholds are reduced for 2009 and 2010. See generally, www.irs.ustreas.gov/charities/article/0,,id=184445,00.htm.

[6] "Background Paper—Summary of Form 990 Redesign Process" (8/19/08), available at http://www.irs.gov/pub/irs-tege/summary_form_990_redesign_process.pdf.

[7] See, e.g., Tenenbaum, Sitchler, and Hiller, "What the 2008 Form 990 Means for Your Organization," 20 Exempts 2, page 26 (Sep/Oct 2008).

[8] IRS officials have stated that increased transparency through broader disclosures hopefully will lead "an active, engaged, and independent board" towards improved governance. Remarks of IRS Commissioner Douglas Shulman to Independent Sector (11/10/08), referenced at CCH Advance Release Documents 2008 ARD 220-1 (11/11/08); see also 27 TMWR 1562 (11/17/08).

[9] An EO's governing body is the group of persons authorized under state law to make governance decisions on behalf of the EO. The governing body is, generally speaking, the board of directors of a corporation or the trustees of a trust.

[10] Instructions for Form 990 (Core Form), Part VI.

Finally, before a policy is adopted or revised, an EO should consult with an experienced advisor to ensure the new or revised policy reflects the latest legal and other relevant developments.[11]

Which policies should an EO adopt?

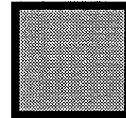
The policies covered in the 2008 Form 990 are not mandated by federal tax law and usually are not required by state law. The IRS cannot require an EO to adopt these policies, although on occasion the IRS has made adoption of one or more such policies a condition for the successful resolution of an audit when activities by the EO in violation of federal tax law have been discovered.[12] Indeed, one or more policies covered by the 2008 Form 990 may not be appropriate for every EO. For these reasons, an EO should resist the urge to merely adopt a policy so that it may respond favorably to a question on the Form.

An EO's governing body, however, should become familiar with the 2008 Form 990 and the EO's current policies, and make a reasoned decision regarding whether it should adopt or modify one or more of these policies. Each EO should consider its own facts and circumstances—including its size, type, and culture—when considering whether to adopt or revise policies and practices. Among other reasons, an EO's governing body may desire to adopt a policy to:

- Identify and/or highlight special issues or circumstances that require additional consideration.
- Provide an overall framework and guidance to EO personnel to identify, evaluate, investigate, and resolve particular issues.
- Facilitate compliance with federal or state law and avoidance of penalties for failure to satisfy legal obligations.
- Facilitate compliance with record-keeping obligations, including the gathering and maintenance of information necessary to complete the Form.
- Promote effective management.

In addition, an EO's governing body may desire to adopt one or more policies in order to increase public confidence by adhering to "best practices." In light of the public availability of the Form 990 (including publication on GuideStar.org), potential donors, grantmakers, and their advisors likely will review the 2008 Form 990 carefully to gauge an EO's commitment to governance issues such as accountability, internal controls, and transparency. The presence or absence of these governance policies can make an EO stand out, thereby enhancing—or reducing—its chances for success when competing for donations and grants. For EOs that attract significant media or other critical attention, because of the nature of their activities or for other reasons, adoption of such policies may also be a wise public relations move.

Finally, IRS representatives have stated that failure to adopt one or more policies will not automatically result in an audit, but responses will be used in connection with other information disclosed on the new Form to determine whether additional inquiry is necessary. Disclosure of no policy (or an inadequate policy) on the Form, particularly with respect to an area of frequent or perceived abuse (e.g., executive compensation, conflict of interest, joint ventures with for-profit persons and entities, etc.), may lead to additional inquiry by the IRS to the extent that the particular area is applicable or relevant to the EO. To avoid such scrutiny, EOs should carefully consider policies that are applicable or relevant to their particular operations.



AN EO SHOULD RESIST THE URGE TO MERELY ADOPT A POLICY SO THAT IT MAY RESPOND FAVORABLY TO A QUESTION ON THE FORM.

Particulars

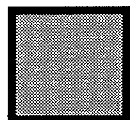
The 2008 Form 990 refers to several specific governance policies.

Contemporaneous meeting documentation. It is imperative for EOs to maintain corporate formalities, which includes holding meetings and keeping written records (minutes) of those meetings. Many nonprofit statutes require an EO's bylaws to "delegate to one of the officers responsibility for preparing minutes of the directors' and members' meetings ..."[13] Part VI.A, Line 8 of new Form

[11] Policies are normally adopted by a board resolution that incorporates the policy by reference, usually as an attachment. This approval can be via a vote of the EO's governing body at a meeting, or by written consent of the governing body given without a meeting, subject to majority or supermajority concurrence as provided by state law.

[12] State attorneys general are generally charged with EO oversight, but the IRS clearly has established a role in shaping EO governance policies. Although beyond the scope of this article, certain practitioners have expressed concern regarding the IRS's involvement in EO governance. For commentary on this point, see Owens, "Charities and Governance: Is the IRS Subject to Challenge?" 119 Tax Notes 613 (5/12/08).

[13] See e.g., section 8.40 of the Revised Model Nonprofit Corporation Act (Prentice Hall, 1987).



IT IS IMPERATIVE FOR EOS TO MAINTAIN CORPORATE FORMALITIES.

asks whether an EO contemporaneously documents the meetings held or actions taken by its governing body, and those of committees with authority to act on behalf of the governing body. For this purpose, "contemporaneous" means by the later of (1) the next meeting of the governing body or committee or (2) 60 days after the date of the meeting or written action.

In the authors' experience, most EOs do keep contemporaneous written minutes of meetings and decisions without a formal policy.[14] In addition, most EOs have appointed a board secretary to keep such minutes in accordance with an express provision of the bylaws. For many EOs, a formal policy regarding meeting minutes is therefore probably not necessary. It may, however be advisable for the EO's governing body to adopt a policy requiring the EO to maintain corporate formalities—including contemporaneous minute-keeping—if an EO does not have a history of consistently keeping minutes, the EO's governing body does not have experience with corporate governance, or the board secretary would benefit from guidance regarding the thresholds or parameters for inclusion of information.

A formal policy should require the EO to keep minutes and a written record of governing body and authorized committee meetings and decisions, and to consider the threshold or parameters for including associated details and descriptions of the circumstances leading up to (and supporting) their decisions. Such a policy should also require meetings to be documented contemporaneously and in a manner permitted under state law, which generally may include approved minutes, strings of e-mails, or similar writings that explain the action taken, when it was taken, and who made the decision.

Policy for governing body review of Form 990. To satisfy the fiduciary duty of care,[15] it is important for the EO's governing body to provide oversight regarding the EO's finances and operations. Part VI.A, Line 10 of the 2008 Form 990 asks whether a copy of the Form and all required schedules ultimately filed with the IRS were provided, in paper or electronic form, to the EO's governing body before it was filed. Though it is not necessary for a member of the governing body to review the Form 990 to satisfy his or her fiduciary duty of care, it is prudent that each member be given the opportunity to review the Form before it is filed. The instructions for the new Form confirm that the question on Line 10 may be answered in the affirmative as long the opportunity to review has been given, even if no member of the governing body actually reviews the Form 990 before or after filing.

It is advisable, however, that the EO's governing body, or a committee thereof (depending on the size of the governing body), review the Form 990 at a meeting (whether before or after filing). For EOs with a large governing body, it may be preferable to appoint a committee with financial expertise to review the Form 990 and report to the full body regarding the committee's conclusions and recommendations. For EOs with a small governing body, it is often preferable for the entire body to review the Form 990, possibly with the assistance of the EO's outside accountants or return preparers.

Part VI.A, Line 10 also requires an EO to describe in Schedule O the process, if any, by which any of its officers, directors, trustees, board committee members, or management reviewed the Form 990, whether before or after it was filed, including specifics regarding who conducted the review, when they conducted it, and the extent of any such review. The Form also requires an EO officer to sign a statement, under penalties of perjury, to the effect that the officer has examined the return and, to the best of his or her knowledge, found it to be true, correct, and complete. As a matter of best practice, it is advisable that the EO's chief executive officer and chief financial officer review the Form before it is filed.[16]

Compensation review policy. The IRS has an intense interest in how EO compensation is determined, and this issue will remain an area of top concern—and enforcement emphasis—for the foreseeable future. The excess benefit transaction regulations applicable to transactions

[14] Most boards submit the minutes for approval at a subsequent board meeting. On occasion, the author has observed the failure to keep minutes of authorized committee meetings.

[15] The general state law duty of care requires a board member to discharge his or her duties in good faith, with the care of an ordinarily prudent person and in a manner that he or she reasonably believes to be in the best interests of the EO. This care requires the board member to review financial information and make informed decisions.

[16] The Senate Finance Committee has proposed requiring an EO's chief executive officer to sign a declaration, under penalties of perjury, that processes and procedures are in place to ensure that the EO's Form 990 complies with the Code and that the chief executive officer was provided reasonable assurance of the accuracy and completeness of all material aspects of the return.

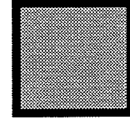
between a public charity and a "disqualified person"[17] include procedures by which a public charity can establish a "rebuttable presumption" that compensation is reasonable. Reg. 53.4958-6 provides that payments of compensation are presumed to be reasonable if (1) an "authorized body" composed of disinterested members of the governing body and/or other persons (or a committee thereof) (2) approves compensation based on comparability data obtained in advance and relied upon in rendering its decision and (3) the basis for its decision is adequately documented. Form 990 includes numerous questions concerning whether the EO follows procedures to establish compensation that are substantially identical to the procedures set forth in Reg. 53.4958-6.

Unlike the excess benefit transaction regulations, however, the 2008 Form 990 queries about compensation procedures are directed to *all* EOs (not just public charities and Section 501(c)(4) organizations covered by the excess benefit rules) and expand the scope of those procedures beyond disqualified persons. For example, Part VI.B, Lines 15a-b ask whether the process for determining the compensation of the EO's chief executive officer, executive director, or top management, officers, and "key employees" [18] includes a review and approval by independent persons, comparability data, and contemporaneous substantiation. It also requires a description of the details to be set out in Schedule O.[19]

An EO can support the reasonableness of compensation and make it possible to respond more favorably to the questions on compensation by adopting a compensation review policy that follows the procedures outlined in Reg. 53.4958-6. Such a policy should cover the EO's directors and officers, as well as key employees.[20]

Even if an EO finds it impossible or impractical to fully implement each step of the process described above, it is advisable that as many steps as possible, in whole or in part, be implemented in order to substantiate the reasonableness of compensation.[21] If an EO does not follow these procedures, it should provide a clear explanation of reasons why it has determined that they are not appropriate, since not following the procedures may draw negative IRS and public attention.

Conflict of interest policy and annual disclosures. A conflict of interest arises when a person in a position of authority over an EO may benefit financially from a decision he or she could make in that capacity. This covers direct benefits to himself or herself, as well as indirect benefits to family members or businesses with which he or she is closely associated.[22] A conflict of interest transaction may result, for public charities and Section 501(c)(4) organizations, in private inurement (loss of tax-exempt status) or imposition of an excise tax under the excess benefit transaction rules of Section 4958. If the conflict of interest transaction instead involves a private foundation, it may result in private inurement or an act of self-dealing (taxable under the rules of Section 4941). For any EO, such a transaction raises conflict of interest issues under state nonprofit law and the specter of bad publicity.[23]



THE IRS HAS AN INTENSE INTEREST IN HOW EO COMPENSATION IS DETERMINED.

[17] "Disqualified person" includes (1) directors, trustees, and the CEO and CFO; (2) certain family members; and (3) an entity in which one or more disqualified persons own more than 35% of the ownership interest thereof. "Disqualified person" also may include a founder of or substantial contributor to the EO; one who has or shares authority to control or determine a substantial portion of the EO's capital expenditures, budget, or employee compensation; the manager of a segment or activity of the EO that represents a substantial portion of its assets, income, or expenses; or one who participates in any management decisions affecting the EO. Regs. 53.4958-3(c), (e).

[18] A "key employee" is one who passes the $150,000 test, the responsibility test, and the top 20 test. The $150,000 test is met by any employee who receives more than $150,000 for the year from the EO and all related organizations. The responsibility test is met by an employee who (1) has responsibility, power, or influence over the organization as a whole that is similar to that of an officer, director, or trustee; (2) manages a discrete segment or activity of the EO that represents 10% or more of the EO's activities, income, or expenses, as compared to the EO as a whole; or (3) has or shares authority to control or determine 10% or more of the EO's capital expenditures, operating budget, or compensation. The top 20 test is met by any employee who is among the 20 most highly paid employees.

[19] Part VII.A of the Core Form and Schedule J also require compensation information for officers, directors, trustees, key employees, highly compensated employees, and independent contractors.

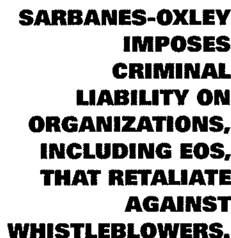
[20] A key employee is not necessarily a disqualified person. The IRS, however, seems to encourage the use of the rebuttable presumption procedures by asking whether such procedures are followed with respect to key employees.

[21] California has extended certain provisions of the Sarbanes-Oxley Act of 2002 (P.L. 107-204, 7/30/02) to California nonprofits, and requires similar procedures to be followed with respect to establishing compensation of the CEO and CFO.

[22] The instructions advise that a conflict of interest does not include questions about a person's competing or respective duties to the subject EO and another EO, such as by serving on both EOs' boards, so long as such person does not derive benefit or have a material financial interest.

[23] See Section 8.31 of the Revised Model Nonprofit Corporation Act (Prentice Hall, 1987).

Part VI.B, Lines 12a-b of Form 990 ask whether an EO has adopted a written conflict of interest policy, and whether officers, directors, trustees, and key employees are required to disclose annually interests that could give rise to conflicts. Line 12c asks whether the EO regularly and consistently monitors and enforces compliance with the policy and how this is done. A conflict of interest policy should be drafted in a way to satisfy applicable state conflict of interest laws and the excess benefit transaction (or self-dealing) rules, if applicable. The policy should emphasize that each person covered under the policy owes a fiduciary duty of loyalty and fidelity, which requires him or her to act in the best interest of the EO.



SARBANES-OXLEY IMPOSES CRIMINAL LIABILITY ON ORGANIZATIONS, INCLUDING EOS, THAT RETALIATE AGAINST WHISTLEBLOWERS.

A conflict of interest policy should provide procedures to be followed to (1) identify the classes of individuals subject to the policy; (2) determine whether a relationship, financial interest, or business affiliation might compromise the objectivity of a decision-maker or constitute an actual or potential conflict of interest; (3) extend guidance for conflict identification via examples of activities and transactions that illustrate conflict situations; (4) require annual disclosure of actual and potential conflicts; and (5) prescribe specific procedures to be followed in responding to or managing conflicts,[24] such as preventing a covered person from making a decision from which he or she could benefit financially, either directly or indirectly, including which disinterested parties (e.g., the non-conflicted members of the EO's board) will be responsible for determining the appropriate response.

The policy should identify the consequences for its violation, such as rescission, disgorgement of profits, and market-rate payment for improper benefits. It should also mandate periodic reviews, not only of the policy itself, but also of (1) any arrangements between the EO and its officers, directors, trustees, and key employees; as well as (2) arrangements with other entities managing, servicing, advising, or supplying the EO's facilities or operations. To respond favorably to Part VI.A, Line 12, it is recommended that disclosures be in written form and signed by each covered person, and that the duty to provide these disclosures be set out in the EO's conflict of interest policy and enforced without fail. These steps can be taken, for example, as agenda items at the EO's annual meeting.

Although not legally required, a conflict of interest policy is a key governing document and is highly recommended for all EOs. As a potential starting place, the appendix to the instructions for Form 1023, the application for recognition of exemption under Section 501(c)(3), includes a sample conflict of interest policy. In the authors' experience, conflict of interest policies often cover disqualified persons but not key employees. In addition, not all policies require annual disclosure of potential conflicts. In light of Form 990's emphasis on key employees and annual disclosures, it is advisable for EOs to adopt a conflict of interest policy (or modify an existing policy) to cover key employees and require annual disclosure.

An EO's governing body may also find that it advisable to expand the scope of its conflict of interest policy to capture the additional information necessary to complete the "interested person" disclosures required by Schedule L, regarding excess benefit transactions, loans to and from such persons, grants or assistance benefiting them, and business transactions involving them, as well as the governance disclosure requirements in Section A of Part VI regarding "independent" directors. [25]

A director generally is independent if he or she (1) is not compensated by the EO or a related organization as an officer or employee, (2) did not receive more than $10,000 in compensation as an independent contractor (other than as an expense reimbursement under an accountable plan or as reasonable compensation for serving as a director), and (3) if neither the director or any member of his or her family was involved in a transaction reported or reportable on Schedule L as a transaction with an "interested person."

The non-statutory term "interested person" is much more expansive than the more familiar statutory term "disqualified person." Interested persons can include, among others, key employees and highly compensated employees.[26] Given the large scope of people and trans-

[24] For example, a conflict of interest policy may prescribe special scrutiny and approval by a disinterested group selected from (or outside) the board to approve a transaction with a person covered by the policy.

[25] For example, a director is not "independent" for purposes of Part VI if either the director or any member of his or her family was involved in a transaction reported or reportable on Schedule L as a transaction with an "interested person."

[26] Applying the definition of "interested person" will be complex and problematic in many instances. The definition can include both former and current officers, directors, and key employees. The definition changes in each of the four parts of Schedule L, with different meanings for different purposes and for EOs with different exempt statuses. In several of its iterations, it also includes family members or other specially-defined "related persons" with certain connections to acknowledged interested persons or to the EO.

actions subject to reporting on Schedule L, it is advisable for a conflict of interest policy to (1) address the types of specific transactions identified on Schedule L, and (2) incorporate the interested person concept. It is worth noting that an EO does not have to include information about grants or other assistance to interested persons on the 2008 Form 990 if it has made a "reasonable effort" to obtain the information. For this purpose, an EO's distribution of a questionnaire to interested persons requiring an annual disclosure of such information should be treated as a "reasonable effort" to obtain the information.

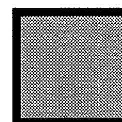
Whistleblower policy. The 2002 Sarbanes-Oxley act imposes criminal liability on organizations, including EOs, that retaliate against certain types of whistleblowers.[27] Part VI.B, Line 13 of the 2008 Form 990 asks whether the EO has a written whistleblower policy. Such a policy encourages staff members, volunteers, and those dealing with the EO to come forward and report good faith suspicion or credible information regarding such things as financial improprieties; improper destruction of records; misleading financial reporting; illegal, unethical, or other inappropriate activity or practices; or violations of EO policies without fear of retaliation.[28] Although not legally required, a whistleblower policy assists an EO's governing body and management in identifying and addressing problems proactively and helps ensure that an EO complies with Sarbanes-Oxley.

The whistleblower policy must reflect the laws of the state in which the EO is organized or operates. It can vary according to an EO's particular circumstances, such as its size, governance structure, review processes, and activities. In many instances it can be a relatively simple policy, its principal protections being to provide assurances to those reporting that the information they supply will be confidentially and evenhandedly evaluated, all without fear of retaliation. The policy should specify who is covered (directors, officers, and employees; perhaps also volunteers, grantees, contractors, and vendors) and the complaint reporting procedures (e.g., contact people and the preferred reporting procedures). It should also promise confidentiality to the extent possible, provide assurances that the EO has a zero-tolerance policy for retaliation, identify the compliance officer or other "lead" people investigating complaints, and set out clear procedures on when and how suspected violations will be documented, investigated, and resolved.

A policy may also provide a method for reporting anonymously to either a board member or external entity, and may include a toll-free telephone number or e-mail address. Lastly, it is critical that the EO's whistleblower policy be well-publicized within the EO, so potential reporters are aware of its existence, what it covers, its assurances, its procedures, and its contact people.

Document retention and destruction policy. Sarbanes-Oxley also imposes criminal liability on an EO that alters, falsifies, covers up, or destroys records (or persuades another to do so) with the intent to obstruct a federal investigation.[29] As a result, intentional document destruction must now be monitored, justified, and overseen with vigilance. That generally makes it a good idea to have a clear policy regarding retention and, once they are no longer needed, destruction of documents. Part VI.B, Line 14 of Form 990 asks whether an EO has adopted a written document retention and destruction policy. Although not legally required, such a policy will help ensure that an EO complies with Sarbanes-Oxley and also retains records for appropriate periods.

A document retention policy should address the special types of documents and electronic records with which the EO typically deals, as well as any specific retention requirements that the EO's activities may necessitate. A resource for this purpose is IRS Publication 4221, "Compliance Guide for 501(c)(3) Tax-Exempt Organizations," which provides document retention details, such as a listing of supporting documents that should be retained because they evidence transactions and accounting entries, as well as retention periods for permanent records, employment tax records, and non-tax records. A document retention/destruction policy should also prohibit destruction of certain documents, such as "permanent" documents (e.g., articles of incorporation, bylaws, minutes and resolutions, IRS exemption application and determination letter, and previously-filed Form 990s).



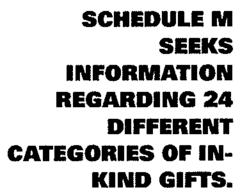
FORM 990 ASKS VARIOUS QUESTIONS REGARDING WHETHER THE EO MAKES EXPENSE REIMBURSEMENTS UNDER AN 'ACCOUNTABLE PLAN.'

[27] See 18 U.S.C. section 1513(e).

[28] See Panel on the Nonprofit Sector, "Principles of Good Governance and Ethical Practices" at http://www.nonprofitpanel.org/report/principles/Principles_Guide.pdf, page 10.

[29] See 18 U.S.C. section 1519.

A document retention policy also should be designed to (1) prevent accidental or innocent destruction of records, (2) facilitate an EO's operations by promoting efficiency, and (3) comply with the standards set out in Sarbanes-Oxley and the new Federal Rules of Civil Procedure (FRCP) regarding "e-discovery" (including voicemail).[30] The policy should cover the responsibilities of staff, volunteers, members of the governing body, and outsiders to maintain, store, or dispose of the EO's records. Such a policy should guide the systematic review, retention, and destruction of all records and documents received or created by the EO in connection with its activities and business, regardless of their physical form. It also should contain guidelines for how long certain documents should be kept and how records should be destroyed (unless retained due to litigation or like exceptions). Such a policy should provide procedures for maintaining and documenting the storage and destruction of electronic and hard-copy files, for backing-up and archiving documents, and for regular check-ups to determine the reliability of the chosen procedures. Finally, the policy should also provide that all document destruction must cease if a federal investigation is known or even suspected, so as to avoid exposure to criminal obstruction charges. An EO should also consult state law to determine whether any additional rules apply.



SCHEDULE M SEEKS INFORMATION REGARDING 24 DIFFERENT CATEGORIES OF IN-KIND GIFTS.

Expense reimbursement policy. The 2008 Form 990 asks various questions regarding whether the EO makes expense reimbursements under an "accountable plan." For example, Schedule J of the new Form 990 requires an EO providing certain benefits to disclose whether it has and follows a written policy regarding such benefits and whether it requires substantiation prior to paying or reimbursing such expenses under an "accountable plan."[31] Similarly, Part VI.A., Line 1b of the 2008 Form 990 asks about the number of independent directors, which as noted above is defined in part to exclude a member whose compensation or other payments exceed $10,000, other than payments representing reimbursement of expenses under an accountable plan or reasonable compensation for services as a director.

The instructions to Schedule J define an accountable plan as a "working condition fringe" under Section 132. To qualify as an accountable plan (1) the expenses covered by the plan must be reasonable business expenses deductible under Section 162, (2) the officer or employee must adequately account to the EO for such expenses within a reasonable time, and (3) the officer or employee must return any amount of excess allowance or reimbursement within a reasonable time.[32] Reimbursements and allowances received under an "accountable plan" are not taxable to the officer or employee. Lavish or extravagant reimbursements, or those made under a nonaccountable plan, are includable in taxable compensation and may result in an "automatic" excess benefit transaction to the extent not properly reported by the EO.[33]

Regardless of whether an EO provides any of the potentially abusive benefits discussed in Form 990, it is desirable to adopt an expense reimbursement policy that applies to reimbursement of all expenses and follows the accountable plan rules. From a practical standpoint, these rules can be difficult to follow precisely, and sometimes are not fully understood or appreciated. By following an accountable plan, however, the EO can ensure that all reimbursements are properly characterized and reported for income tax purposes.

Gift acceptance policy. Schedule M seeks information regarding 24 different categories of in-kind gifts (including artwork, real estate, securities, clothing, books, etc.). Schedule M also requires additional information if an EO either (1) reported receipt of more than $25,000 of aggregate noncash contributions on Form 990, Part VIII, line 1g or (2) received contributions of works of art, historical treasures, other similar assets, or qualified conservation contributions, regardless of whether it reported any revenues from these contributions. These expanded reporting requirements almost certainly will require an EO to adopt procedures

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[30] Amendments to the FRCP became effective on 12/1/06. Organizations must now manage their electronically stored information (ESI) so it can be produced in a timely and complete manner during discovery. An organization involved in litigation must disclose how and where ESI is stored during pretrial proceedings, must preserve ESI in a compliant manner, must be able to produce it with specified metadata (i.e., data about data) intact, and must turn over ESI within discovery timelines. Sanctions for noncompliance can include fines, sanctions, and/or executive liability.

[31] These benefits include first-class or charter travel; travel for companions; tax indemnification and gross-up payments; discretionary spending accounts; housing allowances or residence for personal use; payments for business use of personal residence, health, or social club dues or initiation fees; or personal services (e.g., maid, chauffeur, or chef).

[32] See Reg. 1.62-2 and IRS Publication 535, "Business Expenses," for an explanation of accountable plans.

[33] See Section 4958(c)(1)(A); Reg. 53.4958-4(c)(1).

commensurate with their scope so it can compile reports on such items, including the precise number of donations accepted in many of these categories, their assigned value, and the valuation method used. Such procedures also may be advisable if an EO is offered in-kind gifts that it perhaps ought not accept, such as real property that will require management and may contain environmental problems or other hidden liabilities.

Schedule M, Line 31 also asks whether the EO has adopted a gift acceptance policy that requires the review of non-standard contributions.[34] To respond affirmatively, it will normally be necessary for an EO to have a gift acceptance policy in place. A gift acceptance policy can also (1) provide guidance to an EO's governing body regarding the proper acceptance of gifts, (2) highlight circumstances under which special consideration should be given to the acceptance of the gift (e.g., acceptance of a non-standard contribution, vehicle, charitable gift annuity, life insurance etc.), (3) ensure that the EO obtains all necessary information in order to complete Form 990, Schedule M, and other recordkeeping obligations, (4) ensure that all reporting and receipt obligations are satisfied (including substantiation of "quid pro quo donations" in excess of $75 and written acknowledgement of donor contributions of $250 or more),[35] (5) ensure compliance with state charitable solicitations laws and regulations, and (6) address how the EO engages other entities (third parties or related persons) to solicit, process, or market non-standard contributions.

To the extent an EO engages in little or no fundraising, or solely accepts cash gifts, it may not be necessary to adopt a fundraising policy. Similarly, the Schedule M compliance burden may lead an EO to decide to discontinue or curtail acceptance of any appreciable volume of in-kind gifts or of certain gifts (e.g., artwork or conservation easements) so as to fall outside of its reporting threshold.

Many EOs have seen their donations and endowments decrease due to the recent financial downturn. IRS has signaled that it is aware of this and that some EOs may consider "engage[ing] in questionable fundraising practices or improper transactions that generate fees."[36] The point to take from this advice is that the IRS can be expected to have an active interest in in-kind asset valuations, particularly of non-standard contributions, providing further reason to have a policy in place to address these circumstances.

Conclusion

The 2008 Form 990 introduces numerous questions concerning an EO's governance policies and procedures. Because of concern that a negative response may result in scrutiny from the IRS, the public, or both, there will be substantially greater pressure on EOs to adopt governance policies covered by the Form. An EO must resist the temptation to merely adopt each covered policy in order to respond affirmatively to the Form's questions. While an EO with good governance policies and procedures is more likely to be in compliance with the federal income tax laws, mere adoption of a policy, without more, is worse than no policy at all. An EO should take this opportunity to carefully review existing policies and proposed policies to determine whether a revision or adoption of a policy is appropriate, whether the EO has sufficient resources to implement and enforce the policy, and whether the EO should allocate more resources to a particular policy in order to satisfy an area of potential weakness in governance. ■

[34] A contribution is "non-standard" if the EO does not expect to satisfy or further its charitable operations from the use of the contributed item (aside from using its disposition proceeds) *and* the item cannot be readily converted into cash due to the absence of a ready market for it, making its value speculative or difficult to determine.

[35] Sections 170(f)(8), 6115; See generally, IRS Publication 526, "Charitable Contributions."

[36] Remarks of IRS Commissioner Douglas Shulman, *supra* note 8.