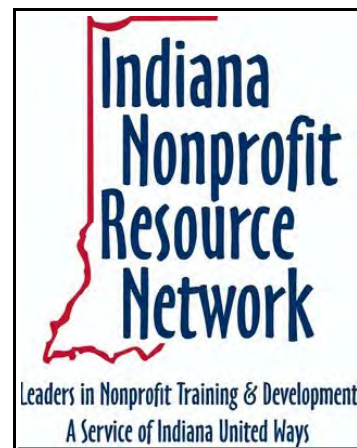


Safeguarding Your Organization's Nonprofit Status

Avoid Common Mistakes
Prevent Loss of §501(c)(3) Status



June 20, 2011

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Safeguarding Your Organization’s Nonprofit Status

Prevent Loss of §501(c)(3) Status

TABLE OF CONTENTS

Presentation Slides	1
Sample Conflict of Interest Policy..	14
Sample Financial Control Policy..	16
Sample Document Destruction Guidelines..	17
Sample Risk Management Policy..	18
IRS Good Governance Practices for §501(c)(3) Organizations	19
Indiana Charity Gaming Outline	27
Independent Contractor or Employee - IRS Guidance	28



* The standard disclaimer applies – the author is an attorney, but not YOUR attorney. Any information presented in the workshop materials are yours to use, but at YOUR OWN RISK. The author recommends that you (a) review any forms carefully and modify them to suit your particular circumstances and (b) have your attorney review the materials before implementation, to be sure that they are legally appropriate for your organization.

Safeguarding Your Organization's Nonprofit status

Avoid common mistakes

Prevent loss of §501(c)(3) status

Sponsored by:
Indiana Nonprofit Resource Network
LaGrange Community Foundation

Presenter:
Miriam Robeson,
Attorney

Why Are We Here?

- Starting with 2010, the IRS has increased scrutiny of nonprofits with an aggressive program to revoke nonprofit status for out-of-compliance nonprofits
- Economy has *decreased* available funds for nonprofit budgets, but *increased* criticism of nonprofit
- Increase in media attention on unscrupulous nonprofits and nonprofit directors/officers
- It's easier to PREVENT problems with nonprofit status - after problems become public, it may be too late to fix

Information Level - Beginning to Intermediate

**Why Are We Here - Part 2
The Horror Stories and Bad Press**

- "Three Cups of Tea" scandal and lawsuit - fraudulent solicitation of donations based upon inaccurate book
- Investigation of Fiesta, Sugar, and Orange Bowl games for abuse of nonprofit status and "extravagant compensation"
- Investigation of Humane Society of the United States for excessive executive compensation
- Medical Association of Atlanta ED pleads guilty to embezzling more than \$300,000
- Nonprofit Status of 30 credit counseling organizations revoked for failure to achieve a nonprofit purpose and for excessive executive compensation

Why We are Here – Part 3 The IRS

- IRS increases nonprofit oversight
 - Employment Taxes
 - Executive Compensation
 - Activist Agenda
 - Compliance (Tax forms)
- Since 2008, the IRS has added more than 100 employees to the Exempt Organizations Section
- As of June, 2011, the IRS has "automatically revoked the nonprofit status of more than 275,000 nonprofits

Keys to Safeguarding Nonprofit Status

- Compliance
- Accountability
- Transparency
- Danger Zones



Compliance

- Government and other technical requirements

Compliance – State Requirements

- Indiana Secretary of State
- We exist!
- Failure to file – Administrative Dissolution
 - Must file Application for Reinstatement
 - Clearance Letter from State Department of Revenue
- Catch up on delinquent reports
- Time-consuming, tedious, and easy to make errors
- Can cause trouble with IRS nonprofit status

Compliance – Secretary of State

- Check out IN SOS Office to verify “in good standing”
- https://secure.in.gov/sos/online_corps/name_search.aspx
- OR – in.gov/sos and select “business search” from the navigation menu

Compliance – State Requirements

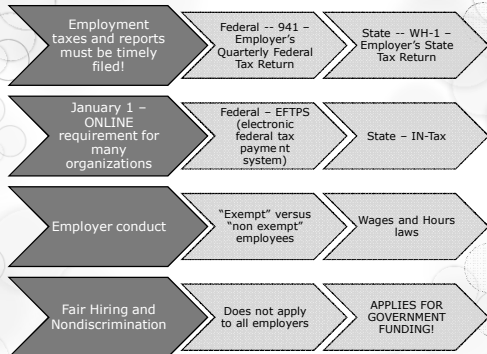
- Indiana Department of Revenue
- We Exist! Also attach IRS 990EZ or 990, if filed
- Failure to file – possible tax assessment – possible audit

Compliance - Federal

IRS – 990 Form

- <\$50,000 – 990 N
 - Change in thresh hold effective for tax years ending in 2010
 - On-line ONLY
 - Due 5 + 15 after end of fiscal year
 - NO extensions of time!
 - Failure to file – *automatic* revocation of §501(c)(3) status
- >\$50,000 – 990 EZ / 990
 - Due 5 + 15
 - 6 month automatic extension of time
 - For most nonprofits – 990 EZ
 - Minimal property or real estate
 - Normal gross receipts < \$200,000
 - Total Assets < \$500,000

Compliance - Employment



Compliance - UBIT

UBIT – Unrelated Business Income Tax

- (A) Trade or business
- (B) regularly carried on
- (C) not "substantially related" to exempt purpose

Examples:

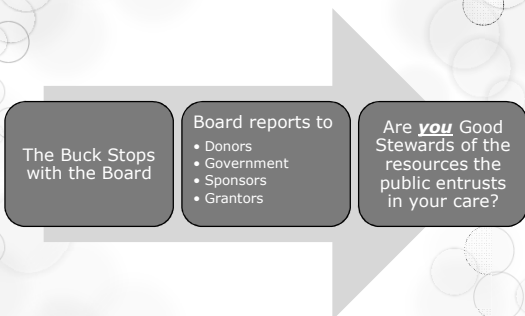
- Apartment rental income
- Charity gaming income

If UBIT constitutes "substantial portion" of income, nonprofit can lose exempt status!

Compliance – Is your nonprofit “on the list?”

- **IRS Publication 78** – Cumulative List of Nonprofit Organizations approved by the IRS
- <http://www.irs.gov/charities/article/0,,id=96136,00.html>
- Go to IRS website and search “Publication 78”
- Incorporation as a State (Indiana) nonprofit does not equal IRS nonprofit - 501(c)(3) - Status

Accountability



Accountability - Financial

- Financial Policies
- Financial Controls
- Monitor appropriate use of nonprofit funds
- Audit - review

Accountability -
Financial Governance Policies

- Policies for –
 - Handling Money
 - Recording Money
 - Reporting Money

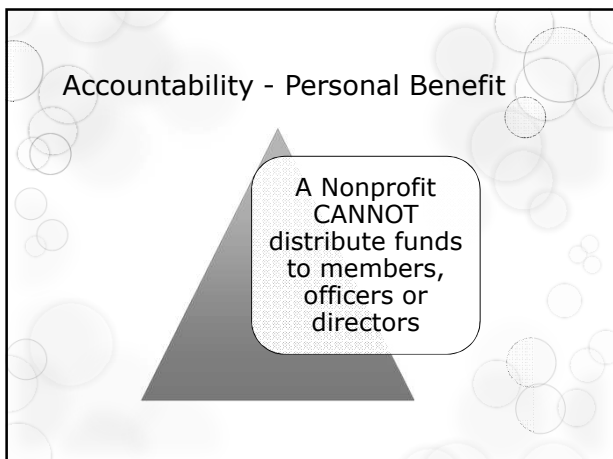
Accountability - Governance

- Conflict of Interest
- Ethical Standards

Accountability - Conflicts of Interest

Watch Appearance of Impropriety!

Accountability - Personal Benefit



A Nonprofit
CANNOT
distribute funds
to members,
officers or
directors

Accountability – Ethics
Executive Compensation

- Exempt Organizations with budgets of \$100,000 or more are expected to have paid staff
- EO's can pay market rates to staff
- EO's can look to "for-profit" compensation when determining "market rates"
- IRS has no standard formula, but looks at compensation as percent of budget, success of nonprofit mission
- If IRS finds abuse
 - IRS can fine the Board and Executive
 - IRS can revoke nonprofit status
- For "higher" compensated ED's, document salary decision with supporting research and recorded (written) board discussion

Accountability - Ethics



When are your
actions...

Legal? Illegal? Question-
able? Un-
ethical?

Nonprofit Ethical Issues - Examples

- Improper donor acknowledgements
 - Donations of time are not tax-deductible
- Improper arrangements with donors
 - Failing to include both spouses in joint gift paperwork
- Staff/ED/Board/Volunteer accepting gifts from donors
 - Lunch versus bequest in a Will?
 - "Professional Fund Raiser?"
- Failing to take responsibility ("Not My Fault")

Only 10% of the public believes that charities are ethical

More Examples - Ethics

- Failure to properly account and restrict use of donor-specified donations (illegal and unethical!)
 - Capital contributions used for operational expenses
 - "Borrowing" from restricted funds
- Purchases from Board-member business without proper disclosure (the copy shop example)
- Failure to consult professionals for assistance, when needed (lawyer – accountant)
- Improper oversight of spending (financial control policies)
 - Indianapolis Humane Society

Transparency – Credibility to Public

Regularly provide information to the Public

Required disclosures

- Tax returns
- Organizational Documents
 - Articles of Incorporation
 - Bylaws
- Funds used for lobbying
- Application for Exempt Status

Recommended disclosures

- Annual report
- Basic Financial Statement
- Report of Activities
- Mission/Vision

Other Danger Zones

Lobbying - political activity Charity Gaming Abuse of Nonprofit Status

Danger Zone - Lobbying

CANNOT DO	CAN DO
<ul style="list-style-type: none">• Endorse political candidate• Spend more than 5% of annual budget on lobbying activities• Directly lobby legislators	<ul style="list-style-type: none">• Hold Candidate forum• Educate the public on the issues important to the nonprofit• Encourage like-minded supporters to contact their legislators

Danger Zone - Charity Gaming

Rule 1 - Gambling is illegal in the State of Indiana Rule 2 - Charity Gaming is allowed, but regulated

What is "Charity Gaming?"

Games of chance -- "Pay to Play"

- Raffles
- 50-50 Raffles
- Program "sticker" prizes
- Bingo
- Casino Night

Door prizes for Cost-Admission Event

NOT Charity Gaming – NOT Regulated:

- Games of SKILL – Guess the pennies, shoot the basket
- Silent Auction

**Charity Gaming – Rule 1
Gambling is Illegal**

- Unlicensed gaming is illegal and subject to fines
 - \$1,000 for the first violation
 - \$2,500 for the second violation
 - \$5,000 for additional violations
- Same fines apply to improper gaming, failing to file reports, failing to pay tax
- Criminal charges may also apply – Class B Misdemeanor

**Charity Gaming Rule 2 –
Charity Gaming is Regulated**

- Must be charitable organization
- Must be in existence (§501(c)(3) status) for > 5 years
- Must apply for and receive license
- Must conduct gaming activities properly
- NOTE – if properly licensed, conducted and reported, there are NO income taxes from charity gaming

**Danger Zone –
Abuse of Nonprofit Status**

- Improper Conduct
- Executive Compensation
- “Private Inurement”
 - Excessive compensation
 - Unreasonable Rental Agreements
 - Unreasonable lending agreements
 - Unreasonable sales transaction

Consequences of Abuse of Status

- IRS Consequences – \$\$
 - Fines to Nonprofit
 - Fines to Board of Directors
 - Fines to Staff
 - PERSONAL LIABILITY FOR ALL!
- IRS Consequences – Revocation of Nonprofit Status

Has Your Status Been Revoked?

Google: “recent IRS revocations”
<http://www.irs.gov/charities/charitable/article/0,,id=141466,00.html>

**Comprehensive List of
“Automatic Revocations”
(organized by state)**
<http://www.irs.gov/charities/article/0,,id=240099,00.html>

What if you LOSE nonprofit status?

- If your organization loses nonprofit status, you are NOW a taxable corporation
- File 1120 Corporate Return
- Pay Income Tax (Federal and State)
- Donations NOT tax-deductible to donor
- Loss of eligibility for MOST grants, including pending grants

How can you get back NP Status?

- Loss of Status **cannot** be reversed or appealed
- Must go through re-application for tax exempt status
 - May include *request for retroactive reinstatement to avoid taxes for "interim period"*
 - Requires payment of user fee (\$400 or \$850)
 - Small nonprofits *might* be allowed to pay \$100 user fee
 - Must write "Automatically Revoked" on application
- If exemptions do not apply, **must** provide complete packet of information for re-application

Keys to Safeguarding Nonprofit Status

- Compliance
- Accountability
- Transparency
- Danger Zones

For More Information

- IRS.gov – Exempt Organizations
 - [Publication 557 – Tax Exempt Status Info](#)
 - [Publication 78 – Approved nonprofit list](#)
- [Indiana Charity Gaming Commission](#)
- [Indiana Secretary of State](#)
- [Indiana Department of Revenue](#)
- Guidestar.org
- [Charity Navigator](#)

**Thank you for your attention!
Any Questions?**

Save-The-World Nonprofit Conflict of Interest Policy

Section 1. General. The Board and Staff of STW NonProfit shall administer the affairs of STW NonProfit honestly and economically and exercise their best care, skill, and judgment for the benefit of the STW NonProfit. The Officers shall exercise the utmost good faith in all transactions relating to their duties for the STW NonProfit. In their dealings with and on behalf of STW NonProfit, they are held to a strict rule of honest and fair dealings. They shall not use their position, or knowledge gained therefrom, so that a conflict might arise between the STW NonProfit interest and that of the individual or an organization affiliated with the individual.

Section 2. Disclosure of Potential Conflict. Any officer, Director or Staff member of STW NonProfit shall have a duty to disclose any potential conflict of interest by virtue of business or charitable affiliation.

Section 3. Conflict of Interest Defined. A conflict of interest, or potential conflict of interest, or appearance of conflict of interest, occurs when an officer, Director, or Staff member of STW NonProfit is in a position to exert influence, in dealings with or on behalf of STW NonProfit, which would give preference to any other business or charitable organization with whom the officer, Director, or Staff member is affiliated, by virtue of employment with, membership in, ownership of, appointment to or election to said business or charitable organization.

Section 3. Waiver of Conflict. Whenever a conflict of interest arises, or the appearance of a conflict of interest, such director or officer with the conflict who is present at the meeting of the Board of Directors or of a committee of the Board, shall disclose in good faith the material facts as to such interest, or financial interest, or appearance of conflict of interest, and any action of the Corporation to approve activity in which a conflict of interest, or appearance of conflict of interest, exists, shall be approved by a majority of the disinterested directors.

Conflict of Interest – Board Member Affirmation and Disclosure Statement

My answers to this disclosure form are correctly stated to the best of my knowledge and belief. Should a possible conflict of interest arise in my responsibilities to the Corporation, I recognize that I have the obligation to notify, based on my position, the appropriate designated individual (President of the Board and/or the Board of Trustees), and to abstain from any participation in the matter unless and until the Corporation can determine whether a conflict exists and how that conflict shall be resolved. If any relevant changes occur in my affiliations, duties, or financial circumstances, I recognize that I have a continuing obligation to file an amended “Conflict of Interest Disclosure Form” with the appropriate designated office.

I understand that the information on this form is solely for use by the Corporation and is considered confidential information. Release of this information within the Corporation will be on a need-to-know basis only. Release to external parties will be only when required by law and/or federal regulations.

Signature

Date

Please complete the following questions, and submit this form to the Board President.

1. Are you or a member of your immediate family an officer, director, trustee, partner (general or limited), employee or regularly retained consultant of any company, firm or organization that presently has business dealings with the Corporation or which might reasonably be expected to have business dealings with the Corporation in the coming year?

_____Yes _____No

If yes, please list the name of the company, firm or organization, the position held, and the nature of the business which is currently being conducted with the Corporation or which may reasonably be expected to be conducted with the Corporation in the coming year:

2. Do you or does any member of your immediate family have a financial interest, direct or indirect, in a company, firm or organization which currently has business dealings with the Corporation or which may reasonably be expected to have such business dealings with the Corporation in the coming year?

_____Yes _____No

If yes, please list the name of the company, firm or organization, the nature of the interest and the name of the person holding the interest, and the nature of the business which is currently being conducted with the University or which may reasonably be expected to be conducted with the Corporation in the coming year:

3. Do you or does any member of your immediate family have a financial or personal interest in an entity in which the Corporation has a financial or other vested interest?

_____Yes _____No

If yes, please provide details below:

4. Have you or an immediate family member accepted gifts, gratuities, lodging, dining, or entertainment that might reasonably appear to influence your judgment or actions concerning the business of the Corporation?

_____Yes _____No

If yes, please provide details below:

5. Do you have any other interest or role in a firm or organization, where that interest or relationship might reasonably be expected to create an impression or suspicion among the public having knowledge of your acts that you engaged in conduct in violation of your trust as a trustee, officer, faculty or staff member?

_____Yes _____No

If yes, please provide details below:

Please add additional pages as needed.

If any material changes to the responses provided on the annual disclosure form occur before the next form is due, the trustee, officer or employee is required to update the information on this form in writing, and submit the update to the Board President.

Nonprofit Financial Control Policy

The Board desires to set a tone of accountability for managing finances. This policy establishes controls for handling receipts and disbursements, including notation of what transactions require Board approval.

1. Check-Signing Authority. The board chair, treasurer, chief executive, and one senior staff member other than the director of finance, as designated by the chief executive, are authorized to sign checks.
 - a. One Signature Authorized. Checks up to \$250 require one signature.
 - b. Two Signatures Required. Checks over \$250 require the signature of two of the following: the board chair, treasurer, chief executive, or other senior staff member as designated above.
 - c. Board Approval Required. Board Pre-approval for expenses in excess of \$1000 is required.
 - d. Self-signing Checks Prohibited. No one may sign a check payable to oneself, either as a sole or a secondary signature.
2. Accounting and Cash Management Security.
 - a. Counting Cash. For all fund raising activity or receipts of cash from events, two people will count the cash, together.
 - b. Deposits. All cash and checks will be processed immediately; if deposits cannot be made in a timely manner, checks and cash will be locked in a secure location.
 - c. Computer Controls. Computers will be password-protected and kept in a secure location. Laptops will be stored in a secure location when not in use.
 - d. Reconciling Accounts. All accounts will be reconciled monthly.
3. Cash Disbursements. Cash Disbursements are discouraged; however, an authorized check signer will make disbursements only upon review and approval of the transaction, including review of proper supporting documentation, such as a purchase order and evidence of the receipts of the goods and services.
4. Collection of Funds and Deposits. Ideally, the person that writes checks does not make deposits. For all deposits, careful record funds must be made, including fund account deposited to, purpose of deposit, donor (or payor), and amount. Copies of all checks are encouraged. If possible, deposits should be verified and initialed by another staff or Board member.
5. Board and Staff Fiduciary Duty. It is the duty of any Board and Staff member who has authority to sign check to verify that there are sufficient funds available for payment of the checks before affixing his or her signature.
6. Board Approval Required for all Credit and Borrowing Transactions. Board approval must be obtained for all applications of credit and loans. At least two signatures, at least one of which must be a Board Member, are required to obligation Acme for any loan or extension of credit.
7. Credit Cards and ACH Payments prohibited. Except for payroll and as otherwise specifically approved by the Board, use of company credit cards or ACH payment of expenses is prohibited.
8. Annual Audit or Review. The Board will conduct an annual audit or review of the financial accounts. If a third-party audit is not feasible, at least one Board Member, other than the Treasurer, will review all income and expenses, bank statements, and account balances for the year. A report will be made to the Board of any findings

Document Destruction Guidelines

The Sarbanes-Oxley Act addresses the destruction of business records and documents and turns intentional document destruction into a process that must be carefully monitored.

Nonprofit organizations should have a written, mandatory document retention and periodic destruction policy. Policies such as this will eliminate accidental or innocent destruction. In addition, it is important for administrative personnel to know the length of time records should be retained to be in compliance.

The following table provides the minimum requirements.

This information is provided as guidance in determining your organization's document retention policy.

Type of Document	Minimum Requirement
Accounts payable ledgers and schedules	7 years
Audit reports	Permanently
Bank Reconciliations	2 years
Bank statements	3 years
Checks (for important payments and purchases)	Permanently
Contracts, mortgages, notes and leases (expired)	7 years
Contracts (still in effect)	Permanently
Correspondence (general)	2 years
Correspondence (legal and important matters)	Permanently
Correspondence (with customers and vendors)	2 years
Deeds, mortgages, and bills of sale	Permanently
Depreciation Schedules	Permanently
Duplicate deposit slips	2 years
Employment applications	3 years
Expense Analyses/expense distribution schedules	7 years
Year End Financial Statements	Permanently
Insurance Policies (expired)	3 years
Insurance records, current accident reports, claims, policies, etc.	Permanently
Internal audit reports	3 years
Inventories of products, materials, and supplies	7 years
Invoices (to customers, from vendors)	7 years
Minute books, bylaws and charter	Permanently
Patents and related Papers	Permanently
Payroll records and summaries	7 years
Personnel files (terminated employees)	7 years
Retirement and pension records	Permanently
Tax returns and worksheets	Permanently
Timesheets	7 years
Trademark registrations and copyrights	Permanently
Withholding tax statements	7 years

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The National Council of Nonprofit Associations (NCNA) is the network of state and regional nonprofit associations serving over 22,000 members in 46 states and the District of Columbia. NCNA links local organizations to a national audience through state associations and helps small and mid-sized nonprofits: manage and lead more effectively; collaborate and exchange solutions; save money through group buying opportunities; engage in critical policy issues affecting the sector; and achieve greater impact in their communities.

Acme Nonprofit Risk Management Policy

Acme Nonprofit is committed to protecting its human, financial, tangible, real estate, and goodwill assets and resources through the practice of effective risk management.

Acme's board and management are dedicated to safeguarding the safety and dignity of its paid and volunteer staff, its clients, and anyone who has contact with the organization. To this end, the board will ensure that the organization has a risk management plan for the organization that is reviewed and updated on an annual basis.

1. Policy Overview. Financial resources of Acme are the responsibility of the board of directors. The board will:
 - a. Have a clear plan for acquisition of financial resources to pay for the programs and services provided by Acme
 - b. Provide guidelines for management and allocation of financial resources which will produce optimum benefit for those we serve.
 - c. Monitor and evaluate the financial plans and guidelines of Acme to ensure the financial integrity of Acme
2. Budget. An annual operating budget will be prepared by the executive director and presented to the board for approval at least 60 days prior to the beginning of the next fiscal year. The budget will reflect the cost of carrying out the programs and services of Acme for the next fiscal year. This budget will also reflect the anticipated revenues of Acme.
3. Budget Review and Implementation. The budget will be viewed by the board as the financial plan for Acme, and approval of the budget by the board will be authority for the executive director to manage Acme's finances according to the plan without seeking further approval of the board. However, the executive will keep the board well informed of the ongoing status of the financial plan, and will not make expenditures outside of the budget plan without seeking board approval to amend the budget. Amendments to the budget will be presented to the board for approval for any of the following reasons:
 - a. Acme enters into compacts or contracts that were not included in the approved budget.
 - b. Management proposes a major expenditure that was not included in the approved budget.
 - c. Significant unanticipated revenues are received or cost overruns occur
4. Capital Reserves. A working capital reserve sufficient to keep Acme operating for at least a 60-day period will be maintained at all times.
5. Accounting Systems. The accounting system used by Acme will utilize generally accepted accounting practices (GAAP) that are required and/or recommended by regulatory or lending agencies and the Acme auditor.

Governance and Related Topics - 501(c)(3) Organizations

The Internal Revenue Service believes that a well-governed charity is more likely to obey the tax laws, safeguard charitable assets, and serve charitable interests than one with poor or lax governance. A charity that has clearly articulated purposes that describe its mission, a knowledgeable and committed governing body and management team, and sound management practices is more likely to operate effectively and consistent with tax law requirements. And while the tax law generally does not mandate particular management structures, operational policies, or administrative practices, it is important that each charity be thoughtful about the governance practices that are most appropriate for that charity in assuring sound operations and compliance with the tax law. As a measure of our interest in this area, we ask about an organization's governance, both when it applies for tax-exempt status and then annually as part of the information return that many charities are required to file with the Internal Revenue Service.

Some of the policies and practices we commend for your consideration are divided into the topics below. Although the discussion that follows is generally directed to public charities, private foundations and other exempt organizations should also consider these topics. Depending on an organization's specific situation, some of the recommended policies and practices will be more appropriate than others. References to Form 990, *Return of Organization Exempt From Income Tax*, are to the 2008 Form 990.

[Mission](#)

[Organizational Documents](#)

[Governing Body](#)

[Governance and Management Policies](#)

[Financial Statements and Form 990 Reporting](#)

[Transparency and Accountability](#)

1. Mission

The Internal Revenue Service encourages charities to establish and review regularly the organization's mission. A clearly articulated mission, adopted by the board of directors, serves to explain and popularize the charity's purpose and guide its work. It also addresses why the charity exists, what it hopes to accomplish, and what activities it will undertake, where, and for whom. Organizations required to file Form 990 may describe their mission in Part I, Line 1 and are required to describe their mission in Part III, Line 1.

[Back to list](#)

2. Organizational Documents

Regardless of whether a charity is a trust, corporation, unincorporated association, or other type of organization, it must have organizational documents that provide the framework for its governance and management. State law often prescribes the type of organizational document and its content. The organizational document of a trust is usually the trust agreement or declaration of trust, and of a corporation, its articles of incorporation. State law may also require corporations to adopt bylaws. The Internal Revenue Service requires the submission of organizational documents and bylaws, if adopted, with an application for exemption under section 501(c)(3), and will review these documents to ensure that the applicant is organized exclusively for exempt purposes and that the applicant's proposed or actual activities are consistent with those documents. Organizations required to file Form 990 will find that Part VI, Section A, Line 4 requires organizations to report significant changes to their organizational documents since the prior Form 990 was filed.

[Back to list](#)

3. Governing Body

The Internal Revenue Service encourages an active and engaged board believing that it is important to the success of a charity and to its compliance with applicable tax law requirements. Governing boards should be composed of persons who are informed and active in overseeing a charity's operations and finances. If a governing board tolerates a climate of secrecy or neglect, we are concerned that charitable assets are more likely to be diverted to benefit the private interests of insiders at the expense of public and charitable interests. Successful governing boards include individuals who not only are knowledgeable and engaged, but selected with the organization's needs in mind (e.g. accounting, finance, compensation, and ethics).

Attention should also be paid to the size of the board ensuring that it is the appropriate size to effectively make sure that the organization obeys tax laws, safeguards its charitable assets, and furthers its charitable purposes. Very small or very large governing boards may not adequately serve the needs of the organization. Small boards run the risk of not representing a sufficiently broad public interest and of lacking the required skills and other resources required to effectively govern the organization.

On the other hand, very large boards may have a more difficult time getting down to business and making decisions. If an organization's governing board is large, the organization may want to establish an executive committee with delegated responsibilities or advisory committees.

Irrespective of size, a governing board should include independent members and should not be dominated by employees or others who are not, by their very nature, independent individuals because of family or business relationships. The Internal Revenue Service reviews the board composition of charities to determine whether the board represents a broad public interest, and to identify the potential for insider transactions that could result in misuse of charitable assets. The Internal Revenue Service also reviews whether an organization has independent members, stockholders, or other persons with the authority to elect members of the board or approve or reject board decisions, and whether the organization has delegated control or key management authority to a management company or other persons. Organizations that file Form 990 will find that Part VI, Section A, Lines 1, 2, 3, and 7 ask questions about the governing body.

If an organization has local chapters, branches, or affiliates, the Internal Revenue Service encourages it to have procedures and policies in place to ensure that the activities and operations of such subordinates are consistent with those of the parent organization. Organizations that file Form 990 will find that Part VI, Section A, Line 9 asks about such procedures and policies.

[Back to list](#)

4. Governance and Management Policies

Although the Internal Revenue Code does not require charities to have governance and management policies, the Internal Revenue Service will review an organization's application for exemption and annual information returns to determine whether the organization has implemented policies relating to executive compensation, conflicts of interest, investments, fundraising, documenting governance decisions, document retention and destruction, and whistleblower claims.

A. Executive compensation. A charity may not pay more than reasonable compensation for services rendered. Although the Internal Revenue Code does not require charities to follow a particular process in determining the amount of compensation to pay, the compensation of officers, directors, trustees, key employees, and others in a position to exercise substantial influence over the affairs of the charity should be determined by persons who are knowledgeable in compensation matters and who have no financial interest in the determination. Organizations that file Form 990 will find that Part VI, Section B, Line 15 asks whether the process used to determine the compensation of an organization's top management official and other officers and key employees included a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision. In addition, Form

990, Part VII and Form 990, Schedule J, solicit compensation information for certain officers, directors, trustees, key employees and highest compensated employees.

The Internal Revenue Service encourages a charity to rely on the rebuttable presumption test of section 4958 of the Internal Revenue Code and Treasury Regulation section 53.4958-6 when determining compensation of its executives. Under this test, compensation payments are presumed to be reasonable if the compensation arrangement is approved in advance by an authorized body composed entirely of individuals who do not have a conflict of interest with respect to the arrangement, the authorized body obtained and relied upon appropriate data as to comparability prior to making its determination, and the authorized body adequately documented the basis for its determination concurrently with making the determination.

Comparability data generally involves looking to compensation levels paid by similarly situated organizations for functionally comparable positions. One method is to obtain compensation surveys or studies from outside compensation consultants for this purpose. The Internal Revenue Service will look to the independence of any compensation consultant used, and the quality of any study, survey, or other data, used to establish executive compensation. Once that test is met, the Internal Revenue Service may rebut the presumption that an amount of compensation is reasonable only if it develops sufficient contrary evidence to rebut the probative value of the comparability data relied upon by the authorized governing body.

The Internal Revenue Service has observed significant errors or omissions in the reporting of executive compensation on the IRS Form 990 and other information returns (e.g., Form W-2 and employment tax returns). Organizations should take steps to ensure accurate and complete compensation reporting on these forms, and to also ensure that appropriate income and employment taxes are withheld and deposited with the Internal Revenue Service. Executive compensation continues to be a focus point in our examination program.

B. Conflicts of interest. The directors of a charity owe it a duty of loyalty. The duty of loyalty requires a director to act in the interest of the charity rather than in the personal interest of the director or some other person or organization. In particular, the duty of loyalty requires a director to avoid conflicts of interest that are detrimental to the charity. Many charities have adopted a written conflict of interest policy to address potential conflicts of interest involving their directors, trustees, officers, and other employees.

The Internal Revenue Service encourages a charity's board of directors to adopt and regularly evaluate a written conflict of interest policy that requires directors and staff to act solely in the interests of the charity without regard for personal interests; includes written procedures for determining whether a relationship, financial interest, or business affiliation results in a conflict of interest; and prescribes a course of action in the event a conflict of interest is identified.

The Internal Revenue Service encourages organizations to require its directors, trustees, officers and others covered by the policy to disclose, in writing, on a periodic basis any known financial interest that the individual, or a member of the individual's family, has in any business entity that transacts business with the charity. The organization should regularly and consistently monitor and enforce compliance with the conflict of interest policy. Instructions to Form 1023 contain a sample conflict of interest policy. Organizations are urged to tailor the sample policy to their own particular situations and needs, with the help of competent counsel if necessary. Organizations that file Form 990 will find that Part VI, Section B, Line 12 asks whether an organization has a written conflict of interest policy, and whether it regularly and consistently monitors and enforces compliance with the policy.

C. *Investments.* The governing body or certain other persons may be required either by state law or by the organizational documents to oversee or approve major investments made by the organization. Increasingly, charities are investing in joint ventures, for-profit entities, and complicated and sophisticated financial products or investments that require financial and investment expertise and, in some cases, the advice of outside investment advisors.

The Internal Revenue Service encourages charities that make such investments to adopt written policies and procedures requiring the charity to evaluate its participation in these investments and to take steps to safeguard the organization's assets and exempt status if they could be affected by the investment arrangement. The Internal Revenue Service reviews compensation arrangements with investment advisors to see that they comply with federal tax law. Organizations that file Form 990 will find that Part VI, Section B, Line 16 asks whether an organization has adopted procedures and policies regarding participation in a joint venture or similar arrangement with a taxable entity. In addition, Form 990, Schedule D, asks detailed information about certain investments.

D. *Fundraising.* Charitable fundraising is an important source of financial support for many charities. The Internal Revenue Service encourages charities to adopt and monitor policies to ensure that fundraising solicitations meet federal and state law requirements and solicitation materials are accurate, truthful, and candid. Charities are encouraged to keep their fundraising costs reasonable and to provide information about fundraising costs and practices to donors and the public. Organizations that file Form 990 will find that Schedules G and M solicit information about fundraising activities, revenues and expenses.

E. *Governing body minutes and records.* The Internal Revenue Service encourages the governing bodies and authorized sub-committees to take steps to ensure that minutes of their meetings, and actions taken by written action or outside of meetings, are contemporaneously documented. Organizations that file Form 990 will find that Part VI, Line 8 asks whether an organization contemporaneously documents meetings or written actions undertaken during the year by its governing body and each committee with authority to act on behalf of the governing body.

F. *Document retention and destruction.* The Internal Revenue Service encourages charities to adopt a written policy establishing standards for document integrity, retention, and destruction. The document retention policy should include guidelines for handling electronic files. The policy should cover backup procedures, archiving of documents, and regular check-ups of the reliability of the system. For more information, see IRS Publication 4221, *Compliance Guide for 501(c)(3) Tax-Exempt Organizations*, available on the IRS website. Charities are required by the Internal Revenue Code to keep books and records that are relevant to its tax exemption and its filings with the Internal Revenue Service. Organizations that file Form 990 will find that Part VI, Section B, Line 14, asks about whether an organization has a written document retention and destruction policy.

G. *Ethics and whistleblower policy.* The public expects a charity to abide by ethical standards that promote the public good. The organization's governing body bears the ultimate responsibility for setting ethical standards and ensuring they permeate the organization and inform its practices. The Internal Revenue Service encourages a charity's board or trustees to consider adopting and regularly evaluating a code of ethics that describes behavior it wants to encourage and behavior it wants to discourage. A code of ethics will serve to communicate and further a strong culture of legal compliance and ethical integrity to all persons associated with the organization.

The Internal Revenue Service encourages the board of directors to adopt an effective policy for handling employee complaints and to establish procedures for employees to report in confidence any suspected financial impropriety or misuse of the charity's resources. Such policies are sometimes referred to as *whistleblower* policies. The Internal Revenue Service will review an organization to determine whether insiders or others associated with the organization have materially diverted organizational assets. Organizations that file Form 990 will find that Part VI, Section B, Lines 5 and 13 ask whether the organization became aware during the year of a material diversion of its assets, and whether an organization has a written whistleblower policy.

[Back to list](#)

5. Financial Statements and Form 990 Reporting

Directors are stewards of a charity's financial and other resources. The Internal Revenue Service encourages the board, either directly or through a board-authorized committee, to ensure that financial resources are used to further charitable purposes and that the organization's funds are appropriately accounted for by regularly receiving and reviewing up-to-date financial statements and any auditor's letters or finance and audit committee reports.

A. *Financial Statements.* Some organizations prepare financial statements without any involvement of outside accountants or auditors. Others use outside accountants to prepare compiled or reviewed financial statements, while others obtain audited financial statements. State law may impose audit requirements on certain

charities, and a charity must ensure that it abides by the requirements of state law. Many organizations that receive federal funds are required to undergo one or more audits as set forth in the Single Audit Act and OMB Circular A-133. However, even if an audit is not required, a charity with substantial assets or revenue should consider obtaining an audit of its financial statements by an independent auditor.

The board may establish an independent audit committee to select and oversee an independent auditor. An audit committee generally is responsible for selecting the independent auditor and reviewing its performance, with a focus on whether the auditor has the competence and independence necessary to conduct the audit engagement, the overall quality of the audit, and, in particular, the independence and competence of the key personnel on the audit engagement teams. The Internal Revenue Service encourages all charities to take steps to ensure the continuing independence of any auditor that conducts an audit of the organization. Organizations that file Form 990, will find that Part XI, Line 2, asks whether the organization's financial statements were compiled or reviewed by an independent accountant, audited by an independent accountant, and subject to oversight by a committee within the organization. And, Part XI, Line 3 asks whether, as a result of a federal award, the organization was required to undergo an audit as set forth in the Single Audit Act and OMB Circular A-133.

B. *Form 990*. Although not required to do so by the Internal Revenue Code, some organizations provide copies of the IRS Form 990 to its governing body and other internal governance or management officials, either prior to or after it is filed with the Internal Revenue Service. Practices differ widely as to who sees the form, when they see it, and the extent of their input, review, or approval. Some, especially smaller organizations, may provide a copy of the Form 990 to the full board for review or approval before it is filed. Others provide a copy of the form to a portion of the governing body, or to a committee or top management officials, before it is filed. Still others provide a copy to the board, a committee or top management officials, but not until after it is filed. Organizations that file Form 990 will find that Part VI, Section A, Line 10 asks whether the organization provides a copy of Form 990 to its governing body, and requires the organization to explain any process of review by its directors or management.

[Back to list](#)

6. Transparency and Accountability

By making full and accurate information about its mission, activities, finance, and governance publicly available, a charity encourages transparency and accountability to its constituents. The Internal Revenue Code requires a charity to make its Form 1023 exemption application, Form 990, and Form 990-T, available for public inspection. The Internal Revenue Service encourages every charity to adopt and monitor procedures to ensure that its Form 1023, Form 990, Form 990-T, annual reports, and financial statements, are complete and accurate, are posted on its public website, and are made

available to the public upon request. Organizations that file Form 990 will find that Part VI, Section C, Lines 18 and 19, ask whether and how an organization makes its Form 1023, Form 990 and Form 990-T, governing documents, conflict of interest policy, and financial statements available to the public.

[Back to list](#)

Date posted: February 4, 2008

Indiana Charity Gaming Outline

1. **First rule - Games of chance are illegal in the State of Indiana**
 - a. 3 Exceptions:
 - i. State of Indiana gaming (lottery)
 - ii. Licensed Gambling (Riverboat and parimutuel horse betting)
 - iii. Licensed Charity Gaming

2. **What is Charity Gaming?** – Anything that involves “pay to play” games of chance.
 - a. Examples: Raffles, Bingo, Drawings/Door prizes, “Game Night,” festivals, pull tabs
 - b. Primary purpose is to raise funds for charitable organization by selling “chances” to win a prize
 - c. What is NOT Charity Gaming for charity fund raising purposes – Games of Skill where there is not a “chance” element to participation
 - i. Buy a ticket, shoot a basket, win a prize
 - ii. Buy a guess of M&Ms in a jar
 - iii. Random prize for attendance - cannot be a “drawing,” but can be a “marked program” – cannot pay “extra” for chance at a prize (limit on value of prize, however)
 - iv. These do NOT require a license and are not regulated

3. **Who can conduct (legal) charity gaming?**
 - a. Nonprofit organizations - “official” existence for more than 5 years, including schools and school support organizations
 - b. Must have filed for gaming permit with State of Indiana - annual requirement
 - c. Must file gaming report with State of Indiana
 - d. Must have written permission to use location where event occurs
 - e. Must apply for and receive charity gaming license from the Gaming Commission

4. **Limits to Charity Licenses**
 - a. Bingo – \$1,000 prize per game, \$6,000 per event for annual licenses (limit, 2 events per year)
 - b. Each type of event has a different limit matrix, and special permission is required for “big” prizes

5. **Who can play (Who cannot play)**
 - a. Adults can play and participate (organize, handle money, file reports, sell tickets)
 - b. Minors under 18 year can ONLY sell raffle tickets - cannot otherwise buy raffle tickets, organize an event, handle money or file reports.
 - c. Only members of the sponsoring organization can participate in organizing and conducting a charity gaming event. Strict rules apply.

6. **Penalties for violations**
 - a. Penalties for unlicensed gaming and for inaccurate reporting
 - b. Up to \$5,000 *per violation* and permanent revocation of gaming permit. Criminal charges may also apply.

7. **Who Governs Indiana Charity Gaming?**
 - a. Indiana Gaming Commission – Charity Gaming Division
 - i. <http://www.in.gov/igc/2339.htm>
 - ii. Find forms, publications, additional information here

Independent Contractor or Employee?
IRS Summertime Tax Tip 2010-20

As a small business owner you may hire people as independent contractors or as employees. There are rules that will help you determine how to classify the people you hire. This will affect how much you pay in taxes, whether you need to withhold from your workers paychecks and what tax documents you need to file.

Here are seven things every business owner should know about hiring people as independent contractors versus hiring them as employees.

1. ***IC-Employee Characteristics.*** The IRS uses three characteristics to determine the relationship between businesses and workers:
 - ***Behavioral Control*** covers facts that show whether the business has a right to direct or control how the work is done through instructions, training or other means.
 - ***Financial Control*** covers facts that show whether the business has a right to direct or control the financial and business aspects of the worker's job.
 - ***Type of Relationship*** factor relates to how the workers and the business owner perceive their relationship.
2. ***What-When-How.*** If you have the right to control or direct not only what is to be done, but also how it is to be done, then your workers are most likely employees.
3. ***“Deliverables” Only.*** If you can direct or control only the result of the work done -- and not the means and methods of accomplishing the result -- then your workers are probably independent contractors.
4. ***Consequences of Error.*** Employers who misclassify workers as independent contractors can end up with substantial tax bills. Additionally, they can face penalties for failing to pay employment taxes and for failing to file required tax forms.
5. ***Benefits of Accuracy.*** Workers can avoid higher tax bills and lost benefits if they know their proper status.
6. ***Request for Guidance.*** Both employers and workers can ask the IRS to make a determination on whether a specific individual is an independent contractor or an employee by filing a Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding, with the IRS.
7. ***For More Information.*** You can learn more about the critical determination of a worker's status as an Independent Contractor or Employee at IRS.gov by selecting the Small Business link. Additional resources include IRS Publication 15-A, Employer's Supplemental Tax Guide, Publication 1779, Independent Contractor or Employee, and Publication 1976, Do You Qualify for Relief under Section 530? These publications and Form SS-8 are available on the IRS website or by calling the IRS at 800-829-3676 (800-TAX-FORM).

<http://www.irs.gov/newsroom/article/0,,id=173423,00.html>