

HCCA 2021 COMPLIANCE INSTITUTE ROLE OF IRS 990 RETURNS FOR COMPLIANCE AND ENFORCEMENT

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Today's Speaker – Jim Sheehan



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WHAT YOU SHOULD PRINT OUT TO REVIEW THIS PRESENTATION

- 2020 IRS 990 (blank form)
- 2020 IRS 990 Schedule H-(Hospital)
- 2020 IRS 990 Schedule I-(grants)
- 2020- IRS 990 Schedule J-(compensation to officers)
- 2020- IRS 990 Schedule L-(transactions with interested persons)
- 2020 – IRS 990 Schedule O
- Available: <https://www.irs.gov/forms-pubs/about-form-990>

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Why Compliance Officers Need to be Involved in Review of IRS 990s

- Your virtual front door-30 pages about your mission, governance, leadership, finances, governance and compliance
- Available publicly to anyone on GuideStar
- Factual representations about compliance and governance
- Extensive text discussion
- Opportunity for leadership review of compliance

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The IRS 990 is an Annual “Information Return” for Public Charitable Nonprofits

- Primary purpose not tax collection but public disclosure and reporting.
- IRS requires it to be made available to the public.
- Parts I-XII of the form must be completed by **all filing organizations except organizations eligible for 990 EZ (under \$200K gross receipts)**.
- Schedules A-R vary depending on the nature and disclosures of the organization.
- IRS Instruction book Cat. No. 11283J (102 pages) (just for the 990).
<https://www.irs.gov/pub/irs-pdf/i990.pdf>
- Each Schedule (A-R) has its own instructions.
- IRS newsletter subscription.
<https://service.govdelivery.com/accounts/USIRS/subscriber/topics>

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990 VALUE AS GOVERNANCE TOOL

- Signed and sworn to by officer and (usually) independent professional.
- Usually reviewed by Board or board committee prior to filing (and failure to review must be disclosed)
- Detailed financials
- ID of Officers, directors, largest contractors
- Governance reporting
- Compensation reporting for managers, five highest paid non-managerial employees (includes both W-2 and 1099)
- Annual - how things have changed this year.

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The IRS 990 for 2020 (Calendar Year) is Due July 15, 2021 (Notice 2020-23) BUT . . .

- Ordinary year-due May 15; 6 month extension available
- **2020 return Automatic extension available to November 15** (must file form 8868) prior to July 15, 2021.
- Automatic revocation occurs when an exempt organization that is required to file an annual Form 990 does not do so for three consecutive years. Under the law, the organization automatically loses its federal tax exemption.
- Effective for tax years beginning after July 1, 2019, the Taxpayer First Act, Pub. L. No. 116-25 Section 2301, requires organizations exempt from taxation to file their annual Form 990 electronically.

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THE NEW AND IMPROVED IRS 990

- Behind every government form there was a scandal-the Smithsonian
- 2008 990 Revisions-(“Sarbanes-Oxley for nonprofits”)
- Money
- Mission
- Management (Who is running the organization? How much are they paid?)
- Governance - are they following the rules? (Part VI)
- What state has primary regulatory authority? (Every nonprofit is created under both federal (Internal Revenue Code and state charities law.) (State of domicile question M on first page.)

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State of Domicile (Part 1, question M)

- Question M identifies State with Primary Authority over “internal affairs”
- “Internal Affairs” = Governance
- Corporations are creatures of state law-have only the powers granted by state law, and are subject to state requirements
- Example: states which prohibit loans to officers and directors (IL)
- Example: states which require conflict of interest policies (NY)
- Example: states which require independent audits of nonprofits (FL.)
- Example: states which require formal reporting of embezzlements (Ca.)
- Example: states which require nothing (De.)

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990 ADVERSE EVENTS

- University of Maryland Medical System
- Hacienda Health Care

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University of Maryland Medical System

- UMMS spent \$500,000 to purchase 100,000 copies of “Healthy Holly” (a book series self-published by Baltimore’s now ex-Mayor Catherine Pugh) to donate to Baltimore school children, while she was a trustee of UMMS, a private, not-for-profit health system with 11 hospitals and \$2 billion in annual revenues.
- UMMS’s 2015 IRS 990— yes on line 12 Schedule O monitoring and enforcement policy: the general counsel “reviews the responses...” to determine whether a conflict exists and consults with the audit committee in appropriate cases. In addition, there is a requirement that in all invitations for bids, proposals, or solicitations for offers, the vendor, supplier, or contractor must disclose any “actual or potential transaction with any organization officer, director, or employee.”
- The Baltimore Sun reported on March 13, 2019 that a third of the UMMS’s board received payments from the system “through contracts with their businesses.”
- The CEO, COO, chief compliance officer, and general counsel “left” their positions in June 2019 and UMMS announced a new conflict of interest policy on May 31, as required by a new Maryland state law passed after the Baltimore Sun stories. The policy lays out specific responsibilities for the new chief compliance officer.
- July 2019-new Corporation Conflicts of Interest Policy
- Red Flag-CEO, COO, chief compliance officer, and general counsel “left” at same time

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Baltimore Sun March 2019

- “The University of Maryland Medical System classified its two most recent purchases of books from Baltimore Mayor Catherine Pugh as “grants” in federal tax filings — one to the city public school system in 2017 and one to the Democrat’s Healthy Holly company in 2015.”
- Schedule I “Grants and other Assistance to Organizations, Governments, and Individuals”

baltimore city public schools 603 DENNLY ROAD BALTIMORE, MD 21215	52-2064235	govt	100
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Describe in Part IV the organization’s procedures for monitoring the use of grant funds in the United States

- RED FLAG-NO RESPONSE TO PART IV-monitoring
- RED FLAG-Schedule L, Business Transactions with Interested Persons-no disclosure of Pugh transaction

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Hacienda Health Care (2019) Arizona Republic Story

- Hacienda Board members who oversee the Phoenix care facility where an incapacitated patient was raped “have a long record of self-dealing and nepotism.”
- Hacienda HealthCare board members and their relatives benefited financially from their positions.
- Some board members do business directly with Hacienda, and some board members have business dealings with each other. Some of their children were hired at Hacienda.
- Hacienda's board chairman, Tom Pomeroy, brokered health insurance for roughly 800 Hacienda employees through his private company for decades, reaping lucrative commissions (4-7%) on the contracts.
- **Red Flag-no disclosure in 2017 on Schedule L, Part V-Business Transactions with Interested Persons**

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Hacienda Health Care IRS 990 for Year Ending 6/30/18 (filed 5/22/19)

- FORM 990, PART VI, SECTION B, LINE IIB:
- THE ORGANIZATION'S CEO, TREASURER AND CFO WILL REVIEW AND APPROVE THE FORM 990 PRIOR TO FILING. THE ORGANIZATION'S CEO HAS BEEN AUTHORIZED BY THE BOARD OF DIRECTORS TO SIGN THE FINAL FORM 990.
- **Red Flag-No review by Board or Board Committee**

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HACIENDA HEALTH CARE 2018 IRS 990 Schedule L

- (A) NAME OF PERSON: _____
- (B) RELATIONSHIP BETWEEN INTERESTED PERSON AND ORGANIZATION:
DAUGHTER OF BOARD MEMBER
- (D) DESCRIPTION OF TRANSACTION: COMPENSATION AS VP OF
MARKETING & PUBLIC RELATIONS
- (A) NAME OF PERSON: TOM POMEROY
- (D) DESCRIPTION OF TRANSACTION: COMMISSIONS PAID BY INSURANCE
COMPANY
- FOR BROKERING THE INSURANCE CONTRACTS OF THE FILING ENTITY AND
AFFILIATES
- Red Flag-first year reporting of Pomeroy contracts

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Hacienda Health Care 2018 IRS 990

- Part VI, Section B-the Compliance Officer's Section
- Question 12a-Did the organization have a written conflict of interest **policy**?
- 12b-Were officers, directors, or trustees and key employees required to **disclose annually** interests that could give rise to conflicts?
- 12c-Did the organization **regularly** and **consistently monitor** and **enforce** compliance with the policy? If yes, describe in Schedule O how this was done.

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Hacienda Health Care 2018 IRS 990, Schedule O

- THE ORGANIZATION HAS A CONFLICT OF INTEREST POLICY THAT ADDRESSES THE CONSIDERATION OF POTENTIAL CONFLICTS OF INTEREST BY THE BOARD OF DIRECTORS, COMMITTEE MEMBERS, KEY EMPLOYEES, AND THEIR RELATIVES.
- AS PER THE POLICY, SUCH PERSONS MUST MAKE DISCLOSURE OF ANY POTENTIAL CONFLICTS OF INTEREST AND MUST ABSTAIN FROM VOTING ON ANY ACTION IN WHICH THEY MAY HAVE AN INTEREST. ON AN ANNUAL BASIS, ALL BOARD MEMBERS ARE REQUIRED TO SIGN OFF ON AN ANNUAL CONFLICT OF INTEREST FORM, EITHER STATING ANY KNOWN CONFLICTS, OR STATING THAT THERE ARE NONE
- **Red Flag-no discussion of “regularly and consistently monitor and enforce compliance”-who did the monitoring? The enforcement?**

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What Does the IRS Do With 990s?

- Check to see if filed and complete.
- Check to see if some numbers add up.
- Review a very small number of returns for wage reporting (to collect employment taxes), Unrelated Business Income Tax (UBIT), Schedule L (payments to related persons).
- IRS is a tax collecting agency - they determine if an organization is tax exempt.
- Not much IRS interest in reporting or governance (after 2013 IRS exempt organization targeting controversy. (See 2015 Senate Report.)
<https://www.finance.senate.gov/imo/media/doc/CRPT-114srpt119->

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What Can Regulators, Media, Employees, Donors, Competitors Do With IRS 990?

- Assisting and assuring compliance with filing and reporting requirements.
- Assessing finances, performance, and risks of individual entities and charitable sectors.
- Identifying key personnel, contractors, and relationships (p.7, Part VII).
- Identifying golden parachutes to former executives
- Assessing complaints and media reports.
- Evaluating transactions and dissolutions.
- Obtaining admissions by entities and individuals.

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Heroic Volunteer Firefighter Michael Klein Saves Cat (photo from Putnam Daily Voice)



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Michael Klein, New York's 2d Largest Nonprofit Thief - Guilty Plea

- 13 years of embezzlement by Mahopac Volunteer Fire Department treasurer (2002-2015).
- Treasurer wrote 275 checks for more than \$5.7 million to his two businesses, Abbie Graphic Services and Buckshollow Emergency Equipment Corp \$5.6 million.
- 55-foot yacht, jewelry, home in Florida, antique fire truck.
- Sentenced 2017 to 6 years, 5 months.

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Mahopac Volunteer Fire Department IRS 990

No review was or will be conducted

No documents available to the public

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TEN ISSUES FOR REVIEW

#1 Schedule H-the hospital schedule

For hospitals, the most important schedule-detailed reporting requirements, likely state and federal regulator review

Particular interests-

- bad debt, Medicare, and Collections Policies
- financial assistance policy
- community health needs assessment
- detailed discussion beyond scope of this overview

<https://www.irs.gov/pub/irs-pdf/i990sh.pdf>

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TEN ISSUES FOR REVIEW

#2 Page 1, Signature blocks.

- 1 officer from charity.
- Paid preparer (usually an accounting firm) (990 usually prepared by a tax partner, not an audit partner).
- Bad accountants attract problem clients.
- Problem clients seek out bad (or distant) accountants.

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TEN ISSUES FOR REVIEW

3 “Diversions”

- “A diversion of assets includes any unauthorized conversion or use of the organization's assets other than for the organization's authorized purposes, including but not limited to embezzlement or theft.”
<https://www.irs.gov/pub/irs-pdf/i990.pdf>
- Question 5 on Part VI - Did the organization become aware during the year of a significant diversion of the organization's assets?.....Yes/No
- Yes - must explain on Schedule O.
- **POTENTIAL RED FLAG**

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IRS 990 Instructions- #3 - Diversions

- Note. A diversion of assets can in some cases be inurement of the organization's net earnings. In the case of section 501(c)(3), 501(c)(4), and 501(c)(29) organizations, it also can be an excess benefit transaction taxable under section 4958 and reportable on Schedule L (Form 990 or 990-EZ).
- <https://www.irs.gov/pub/irs-pdf/i990.pdf>

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DOING DIVERSIONS REPORTING RIGHT- Part VI, Question 5, Schedule O Explanation

- IN JULY 2017, MANAGEMENT OF _____ HEALTHCARE PROVIDERS D/B/A _____ MEMORIAL HOSPITAL DISCOVERED THAT A DISQUALIFIED PERSON VIS-A-VIS THE HOSPITAL, WITHIN THE MEANING OF SECTION 4958 OF THE INTERNAL REVENUE CODE, WAS EMBEZZLING FUNDS OVER A MULTI-YEAR PERIOD.
- MANAGEMENT TOOK ALL APPROPRIATE STEPS, INCLUDING TERMINATING THE EMPLOYEE, REPORTING THE EMBEZZLEMENT TO THE APPROPRIATE STATE AND FEDERAL AUTHORITIES, SEEKING REDRESS FROM THE DISQUALIFIED PERSON EMPLOYEE (INCLUDING AN AGREEMENT TO RECOUP ADDITIONAL FUNDS UPON THE VESTING OF A QUALIFIED PLAN), OBTAINING INSURANCE PROCEEDS UP TO THE POLICY LIMIT, AND INSTITUTING NEW POLICIES AND PROCEDURES TO MITIGATE THE RISK OF SUCH ACTIONS IN THE FUTURE THE UNAUTHORIZED TRANSACTIONS HAVE BEEN REPORTED ON SCHEDULE L AND OTHER APPROPRIATE FORMS

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RESPONSE TO DIVERSIONS

- Washington Post (2013):" Progressive Policy Institute realized that a senior manager had quietly used unauthorized checks, credit-card charges, and cash withdrawals to drain about \$100,000. . . ."
- "Officials at the institute didn't call police and didn't alert donors, said Lindsay Mark Lewis, now executive director of the Washington-based organization."
- "We had an agreement that as long as the payments were made, that we would not pursue anything else," Lewis said."

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RESPONSE TO DIVERSIONS

- “Since leaving the Progressive Policy Institute [the former executive director] has gone on to work for nonprofit and political groups in Florida, serving as finance director at one, documents and interviews show.”
- Finance director of a Congressional campaign.
- Compliance director of a nonprofit.

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Regulators’ Response to Diversions California Reporting Requirements

- Upon learning that an employee has embezzled funds from the charity, the directors have a legal duty to take reasonable steps to try to recover the funds and to refer the matter to the local District Attorney for possible criminal prosecution. The directors may have to hire a private attorney to file a civil suit for restitution against the employee. Directors must evaluate whether the prospect of recovery outweighs the probable costs of suit. The loss to charity should be reported on the Form RRF-1 filed with the Attorney General, with an attached explanation of the action taken by the directors to recover the loss.
- That Form RRF-1 includes this question: “2. During this reporting period, was there any theft, embezzlement, diversion or misuse of the organization’s charitable property or funds?”

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Regulators' Response to Diversions

- California Reporting Requirements-RRF1
- 1) Nature, date, amount of the loss.
- 2) Description of the steps the organization took to recover the loss. Attach a copy of any police and/or insurance report.
- 3) Description of the procedures the organization implemented to prevent a recurrence of the situation.
- **Don't let your regulator learn about diversion first from media or whistleblower**

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TEN ISSUES FOR REVIEW

#4 IRS 990 Schedule L

- Transactions with interested persons must be reported on Schedule L
- "Interested persons" = current or former officer, director, trustee, or key employee, creator or founder, substantial contributor, and their family members.
- Excess benefit transactions.
- Loans, grants, other benefits, business transactions.
- Part IV, Lines 26-28 of the 990 - loans and other receivables between the charity and interested persons.
- If yes, must complete and attach Schedule L.

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TEN ISSUES FOR REVIEW

#5 Part VI of IRS 990-Governance, Management, and Disclosure

- 11b-describe on Schedule O the process for reviewing the 990 by directors. If none, Schedule O must include the statement “No review was or will be conducted.”
- **RED FLAG!**

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TEN ISSUES FOR REVIEW

#6 Conflicts of Interest Management

- Part VI, Line 12 a-c - conflict of interest. Is there a policy (Yes/No)? Are board members required to report annually(Yes/No)? Is the policy regularly and consistently enforced? (Yes/No)
- Must be described on Schedule O.

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Memorial Sloan Kettering - Conflict of Interest

- Chief Medical Officer Dr. Jose Basalga failed to disclose millions of dollars in payments from drug and healthcare companies.
- After internal investigation - NY Times reports statement by outside counsel investigator that plans to manage conflicts of interest “were not implemented because it was felt to be unnecessary or because there was a failure to realize that a management plan was needed.”
- Beginning in 2014, senior executives were no longer required to vet financial relationships with a conflict of interest advisory committee because the hospital felt the committee should not be asked to make decisions about executives to whom they reported.
- 2016 Part VI, question 12a-c – Yes.
- 2016 Schedule O “The **Compliance Officer and staff** are responsible for administering the conflict of interest program. . . .”

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The Link Between Governance and Diversions in Public Charities

- Likelihood of a fraud is negatively associated with a board review of the Form 990, the existence of a conflict of interest policy, and the presence of restricted donations. In addition, we document that the likelihood of an asset diversion is negatively associated with program efficiency and positively associated with growth and organizational complexity.
- [“Maintaining Public Trust: The Influence of Transparency and Accountability on Donor Response to Fraud”](#) Harris, Petrovits, Yetman (2017.)

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TEN ISSUES FOR REVIEW

7 Compensation to “Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees” - Schedule J.

- Policies for establishing compensation.
- Documentation of expenses.
- Severance/change of control payments.
- Total compensation (\$).
- Watch for accurate reporting-IRS expense requires “accountable plan.”

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TEN ISSUES FOR REVIEW

#8 Tax Compliance (Part IX, Line 10; Part V, page 5).

- Part IX, Line 10 payroll taxes - if there are employees, (see page one) this line should not be blank or 0.
- Number of employees reported on Form W-3 (transmittal of wage and tax statements) Exhibit 4 (compare with page 1, question 5 - total number of employees during year).
- **Note: Sometimes accountants include payroll taxes in Part IX Line 7 (wages).**
- Responsible person penalty-100% .

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TEN ISSUES FOR REVIEW

#9 Schedule I - grants to organizations, governments, individuals

- Part 1-Maintain records to substantiate amounts of grants, etc.?
- “No” is red flag.
- Part II - List all grants to organizations over \$5000 - must complete all lines, including address-no general descriptors. If answered yes to Form 990, Part IV, Line 21.
- Part III - Grants and other assistance to individuals - no names, but categories (if answered yes to Form 990, Part IV, Line 22.
- Some organizations will try to avoid listing grantee organizations.
- Part IV - How monitor use of funds? (required field; organizations must monitor.)

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TEN ISSUES FOR REVIEW-

#10 SCHEDULE O - free text

- Conflict of interest monitoring and enforcement
- Diversions
- Amendments/disclosures since prior year

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BONUS ISSUE: FORM 4720- Return of Excise Taxes

- Reporting and Excise taxes on compensation over \$1 million
- Reporting and Excise taxes on excess political, lobbying expenditures
- Reporting and Excise taxes on “Excess Benefit Transactions” See 990 question 25 a and b in Part IV
- EBT Tax owed by managers and disqualified persons, but must be reported by entity
- No state requires 4720 to be filed; not public; can be subpoenaed
- Important document in fraud cases by CEOs, board members

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Where to Find Filed IRS 990s

- GuideStar (must register) <https://www.guidestar.org/search>.
- Nonprofit Explorer from Pro Publica <https://projects.propublica.org/nonprofits/>.
- IRS: <https://apps.irs.gov/app/eos/>.
- CauseIQ (subscription service) <https://www.causeiq.com/>.
- CitizenAudit (some free, some subscription-helpful to state regulators) CitizenAudit.Org

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Questions?

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