Form 990 and your health care organization:
A comprehensive overview of Form 990 requirements and the implications to the internal audit function

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Agenda

- IRS Initiatives and 2010 Work Plan
- Legislative Update / Health Care Reform
- Community Benefit and Health care reform
  - Schedule H: Hospitals and Community Benefits
- Form 990
  - Governance and Policies
  - Schedule J: Compensation
  - Schedule L: Loans and Business Transactions
  - Schedule K: Tax-Exempt Bonds
  - Q&A
IRS Initiatives: 2009-2010
Work Plan

• Community Benefit
• 403(b) Plans
• Section 409(A) – Deferred Compensation
• Tax-Exempt Bond Compliance
• Electronic Health Records
• Governance Practices
• IRS Procedural Changes
• Medical Resident FICA
• Hospital/Physician Relationships
• Compensation
Recent Legislative Activity: 403(b) Plans

- Final regs issued on July 26, 2007 regarding IRC Section 403(b) plans for IRC Section 501(c)(3) organizations.
- Audit requirement for 2009 year:
  - Requires written plan
  - Tax-exempt entities aggregated as single employer
  - Nondiscrimination rules changed and universal availability requirement adopted for deferrals
- Relief provisions issued for certain existing contacts
Recent Legislative Activity: Stark II, Phase III Final Regulations

- Issued September 5, 2007, effective December 4, 2007
- Final Stark Changes: Effective October 2009
- "Stand in the Shoes" rule – Rules "look through physician organization" to the individual physicians
  - Must rely on direct compensation exceptions
- Recruitment Provisions
- Retention Payments
- Limitations on "per click" arrangements
- Most provisions have Fair Market Value exceptions and must be “set in advance”
Recent Legislative Activity: “Red Flags” Legislation

- Legislation enacted in 2007
- Effective January 1, 2011
- Identity Theft Monitoring and Reporting
- Task Force Recommended
- Senior Executive or Board Member to oversee hospital’s efforts.
- Privacy/Protection Policies could save hospitals millions
Health Care Reform
Patient Protection and Affordable Care Act

- W-2 Reporting
- 1099 Reporting
- Accountable Care Organizations
Health Care as a Tax Exempt Activity

- Health care *per se* is not explicitly listed as a charitable activity in §501 of the Internal Revenue Code (IRC)
- **Community benefit** guidelines allow health care entities to apply for and obtain tax-exempt status
  - Revenue Ruling 69-545
Health Care as a tax-exempt activity hinges on Community Benefit

Historical Perspective

Community Benefit Mandates:

• Maintaining a **board** comprised of **community members**
• Offering medical staff privileges to all qualified physicians in the area
• Operating a full-time **emergency room** that provides service to all, regardless of ability to pay
• Using surplus funds to:
  o improve quality of care
  o expand facilities
  o advance medical training, education and research
• **Charity Care** - admitting non-emergency patients unable to pay for care, including Medicare and Medicaid
Problems with Community Benefit Standard
Historical Perspective

- Not Clear, Objective or Measurable
- Difficult to Enforce and Monitor
- "Charity care" not specifically set out
- No federal level of "acceptable" Community Benefit
- Many states (20+) request some type of community benefit report from health care entities – not consistent with 990
- Lots of debate in Senate and House of Representatives about legislation mandating levels of community benefits.
- Tax-Exempt Hospitals: How to quantify, measure and report?
- Should benefits be required to equal the value of a hospital’s tax-exempt status?
Two new Internal Revenue Code sections – specific to hospitals

• §501(r) - Additional Requirements for certain hospitals
  - Community needs assessment
  - Financial assistance policy
  - Limitation on charges
  - Billing and collection requirements
• §4959 – Taxes on failures by hospital organizations
  - Failure to comply with §501(r)
    - $50,000 penalty
    - Loss of exemption?
Community Benefit and Health Care Reform
Patient Protection and Affordable Care Act

Community Needs Assessment
Effective for years beginning after 3/23/2012

- Community needs health assessment - every three years
- Implementation strategy to meet needs identified
- Explain how you met needs, or why you didn’t fulfill them
- Must be publicly available
- Who may gather the data:
  - Public health agency,
  - Other non-profit, or
  - Two or more hospitals jointly
Community Benefit and Health Care Reform
Patient Protection and Affordable Care Act

Effective for years beginning after 3/23/2010

Financial Assistance Policy
• Must be Written, Publicized and must Contain:
  o Eligibility criteria for free or discounted care
  o Basis for calculating amounts charged
  o How to apply for assistance

Emergency Medical Care Policy
• Must be written
• Must provide emergency care regardless of criteria in Financial Assistance Policy
Effective for years beginning after 3/23/2010

Limitation on Charges

• Prohibits use of gross charges
• For indigent patients eligible under Financial Assistance - charges cannot exceed those generally billed to those patients covered by insurance

Billing and Collection requirements

• No extraordinary collection actions permitted without reasonable effort to determine eligibility for Financial Assistance
Treasury must review a hospital’s community benefit activities every three years
  • How? Presumably scrutiny of schedule H

Guidance is coming
  • Notice 2010-39 issued in May asks for comments
Community Benefit Reporting
What Internal Audit can do now

- Review and update financial assistance policies
  - How will your organization publicize the policy?
- Develop appropriate billing and collection policies that ensure fair collection practices
- Consider creation of Community Benefits Policy
- Review Quantification of Community Benefits
- Consider Valuing Tax Exempt status
- Strategize on plan to fulfill needs assessment
  - Who will you partner with?
- Start Now!
Schedule H

Hospitals: For 2009 all parts are required!
(Refer to Hand Out)

Required if you operate one or more state licensed, registered or similarly recognized hospitals (defined by EIN).

- Definition of Hospital – specific to use for Schedule H only
- U.S. entities only
- Direct and Indirect ownership (SMLLCs, Partnerships)
  - Part I, Charity care and Certain Other community benefits at cost
  - Part II, Community Building Activities
  - Part III, Bad Debt, Medicare, and Collection Practices
  - Part IV, Management Companies and Joint Ventures
  - Part V, Facility Information (required in 2008)
  - Part VI, Supplemental Information

Instructions for Schedule H are 24 pages, plus 8 worksheets
Schedule H
Action items and best practices

• Begin gathering the information **now**.
• Forms and Instructions available at
  www.irs.gov/charities
• Review the information and assess how it will be viewed by the public.
• Develop internal processes to gather complete and accurate data.
  o Consider assigning responsibility to a management member.
  o Consider assigning responsibility to a board member.
Focus on:

- Governance
- Charity Care
- Policies
Who is looking at your Form 990?

- Congress
- Internal Revenue Service
- General public (including those who don't like you)
- Your competitors and the media
- Donors and potential donors
- Vendors
- State Attorneys General
- Consumer groups and watchdog organizations
- Labor unions
  - Check out your organization’s Form 990 at www.guidestar.org
Why Form 990 Is Important – The IRS

Retaining tax-exempt status

Form 990 states your case for retaining tax-exempt status and demonstrates your compliance with the tax rules on an annual basis:

• Still organized as a tax-exempt entity?
• Still operated as a tax-exempt entity?
• Is there a liability for income or excise taxes?
• Have you started the statute of limitations?

→ Does your Form 990 support your case?
→ Does your Form 990 confirm your tax-exempt mission?
Why Form 990 Is Important – The Public

*Maintaining your reputation, credibility and goodwill*

Transparency, disclosure and accuracy:

• Form 990 is an “information return” not a “tax return”
  o Form 990 must be complete and accurate – you sign under penalties of perjury!
  o Form 990 must be available for public inspection.
  o Where is your revenue coming from?
  o What public good are you accomplishing?
  o Where is the rest of the money going?

→ Form 990-T must be made available for public inspection
Electronic Filing Will Also Drive Accuracy
Substantial Penalties for Noncompliance

- Against the organization
  - Filing an incomplete or inaccurate Form 990
  - $100 per day, limited to $50,000 per return
- Against responsible persons – you?
  - Upon notification of an incomplete or inaccurate return
  - Failure to provide information within the time allotted
- $10 per day, limited to $5,000 per return
- Fines and imprisonment (egregious cases)
  - Willfully not filing returns
  - Filing fraudulent returns and statements with the IRS
Preparing Form 990 now and in the future

The stakes are higher than ever

• Understand Form 990 from both the organizational and operational perspective
• Remember accuracy, disclosure and transparency are keys for preparing an “information” return
• Ensure that you are complying with all applicable tax regulations
• Put policies in place to ensure accuracy and completeness
→ Be proactive. Completing Form 990 requires more research and documentation than ever before. It takes coordination of tax accountants working together with operations personnel to ensure compliance
Part VI – Governance, Management and Disclosure

• Number of voting board members and how many are independent
  – Does your organization have a different definition of independence? Can lead to confusion

• Family and Business relationships (Officers, Directors, Trustees, Key Employees)

• Is there delegation of control over management to outside persons or organizations?
Governance

Did you become aware of a **material** diversion of the organizations assets during the year?

Embezzlement, theft or any other unauthorized diversion of organization assets
- New for 2009 – ‘material’ defined
- Lesser of:
  - 5% of Organization’s assets
  - 5% of Organization’s gross receipts
  - $250,000

• Consequences: Excess benefits / Inurement
Governance

Part VI – Governance, Management and Disclosure

• Who elects the governing body?
• Who approves decisions made by the governing body?
• Are meetings and actions undertaken by the governing body and committees documented?
• What process was followed to review the 990 and was the governing body provided a copy before filing?
Part VI – **Policies**

- Written **conflict of interest** policy?
  
  - Are potential conflicts required to be disclosed annually?
  
  - Does the organization regularly and consistently monitor and enforce compliance?
  
  - Is it available to the public? How?

- Written **whistleblower** policy?

- Written **document retention** and destruction policy?
Part VI – Policies

Rebuttable Presumption of Reasonableness:

- "Did process for determining compensation of the following persons include a review and approval by independent persons, comparability data, contemporaneous substantiation of the deliberation and decision?"
  - Top Management, Officers, Key Employees
  - Describe the process
Part VI – **Policies**

- **Joint Ventures**
  - Written policy to evaluate participation to ensure tax-exempt status is protected?
Governance and Policies

*What the IRS has said about the responses you give*

“We’re not looking to play *gotcha*” *
(at least not yet)

- Expectation is for a transition period – couple of years
- Governance responses will be taken into account for determining greater risk of noncompliance
- No immediate plans to audit based on answers – but Watch Out!
- Expecting boards to take more responsibility for accuracy of the 990

*Stephen Clarke – IRS*
Governance and Policies
Organizations responses in a Survey Conducted by Grant Thornton

Organizations are taking a new look at Policies and Governance practices

• More than one fifth of respondents modified their Conflict of Interest Policies in 2009 (up from 8% the year before)
• A 32% increase in changes to record retention polices (up from 15%)
• 55% adopted policies to have the board review the 990 (up from 22%)
Schedule J
When is it required?

• Schedule J is required if there is **reportable & other compensation** provided to:
  o A former officer, key executive or highly compensated executive of more than $100,000 from you and all related organizations.
  o A former director or trustee of more than $10,000, in that capacity, from you and all related organizations.

• Schedule J is required if there is **reportable compensation and other compensation** provided to:
  o Any individual listed in Part VII, Section A, or more than **$150,000** from you and all related organizations.
For those disclosed on Schedule J, the following must be disclosed and described:

- First-class or charter travel
- Travel for companions (non-business purpose)
- Tax indemnification and gross-up payments
- Discretionary spending accounts (credit cards?)
- Housing allowance or personal residence
- Health or social club dues or initiation fees
- Personal services (e.g., chauffeur, maid, financial planner, nanny, physician, tax preparation, legal services)
Compensation disclosure must show: Base Comp, Bonuses, Deferred Comp, Other Reportable and Non-Reportable Comp and must also:

- Include actuarial Increases in deferred comp
- Indicate whether severance or change in control payments are provided
- Include supplemental nonqualified retirement benefits
- Include equity-based compensation arrangements
- Identify compensation contingent upon revenues or net earnings
- Provide a description of any non-fixed payments
• Organizations must **describe the process** for determining the compensation of the CEO, executive director or other officers and key employees

• While the classification of officer is determined by reference to state law, it always includes the **organization’s top management official**

• If an organization is required to attach Schedule J, **disclosing the base compensation, bonus amount and other compensation for insiders** is required, as well as the process for determining incentive compensation
If an organization satisfies the following criteria, a transaction should be considered reasonable:

**Rebuttable Presumption of Reasonableness**

- A board of directors or trustees composed of individuals unrelated to the disqualified persons involved in the transaction approves the transaction.
- The board or committee obtains and relies upon appropriate data as to comparability.
- The board or committee documents the basis for the decision.
Compensation - Action Items

- Determine Related Organizations/Disregarded Entities to identify universe of individuals that must be considered
- Prepare/review explanations of current compensation arrangements
  - Determine whether arrangements currently include any of the compensation items that require specific disclosure
  - Educate board/management regarding new expanded disclosures and identify any desired changes to arrangements
Compensation - Action Items

- Determine/modify written policies regarding expense reimbursements and consider requiring substantiation prior to reimbursing or allowing the listed expenses.
- Review process and data utilized to set CEO/Executive Director compensation to determine whether modifications should be adopted (consider complying with “presumption requirements” where possible).
- Review severance agreements as they must be reported by individual – may present legal issues unless addressed at time of separation.
What should organizations do now?

• The board charters an independent committee with executive compensation oversight
• The committee hires a compensation consultant directly
• The committee supervises the work of the consultant
• The committee has a total compensation philosophy (pay and benefits)
• The consultant utilizes appropriate data for analysis
• The committee makes determinations in executive session
• The committee minutes reflect the decision-making process
• All of the appropriate tax forms are fully completed
Loans
To and from certain persons require disclosure

Disclosure on Balance Sheet and Schedule L:

• If loan is outstanding at year end
• Interested persons included: Disqualified Persons, Current and Former Directors, Trustees, Officers, Key Employees and 5 highest compensated employees, Substantial Contributors, Family members, more than 35% controlled entities
  • Example: Physician loans
  • There are some exceptions – Ordinary course of business
• How originated appears not to be important, but ultimately whether there is any debt outstanding between the interested person and the organization
• Detail includes whether the loan is in default, had board approval, whether there is a written agreement
Loans – Action Items

- View all loans to determine reporting requirements and modifications, if any, that should be considered:
  - Ensure arrangements are in writing
  - Consider requiring Board approval of all existing loans to/from interested persons
  - Consider adding Board approval as a condition for future loan transactions with interested persons
- Monitor any loans/advance balances to determine whether they can be eliminated prior to year-end
- Communicate with interested persons regarding disclosures that will be required
Business Transactions

Involving Interested Persons

Business transactions

– sales, exchanges, leases, furnishing goods or services, or transfers of income or assets, compensation paid to a family member, joint ventures
– ordinary course of business exception does not apply

Reporting threshold:

– Total payments exceed greater of: $100,000, or single transactions exceeding $10,000 or 1% of the organization’s revenues, or
– Compensation paid to a family member of the interested person exceeded $10,000, or
– If a Joint Venture: $10,000 or greater than 10% investment
Interested persons include:

- Directors, Trustees, Officers, Key Employees (current and former),
- Entities >35% controlled by aforementioned persons (directly or indirectly, individually or collectively)
  - Or >50% controlled in the case of another Non-profit organization
- For-profit entities where Directors, Trustees, Officers, Key Employees (current and former) served as Directors, Officer, Trustee, Key Employee, or a >5%
  partner / shareholder
- Family members of all above persons and entities
- Management companies of former Officers, Directors, Trustees, Key Employees

Impacts Board Member Independence!

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Business Transactions – Action Items

- **Compare** internal definition of board independence vs. IRS definition
- Prepare internal **questionnaire** for Officers, Directors, Key Employees
- Identify **related** organizations
- Identify **employees** related to Officers, Directors, Key Employees
- Identify **who** you do business with
Schedule K

*Increased IRS focus on post-issuance compliance if you file a Form 990 and issue tax-exempt bonds*

All parts of schedule K are required for 2009

The Schedule K is divided into four parts:

- Part I - Bond Issues
- Part II - Proceeds
- Part III - Private Business Use
- Part IV - Arbitrage
Part I - Bond Issues: Provide general information for each outstanding tax-exempt bond issue which, both had an outstanding principal amount in excess of $100,000 as of the last day of the tax year (or other selected 12 month period) and was issued after December 31, 2002

Part II - Proceeds: Provide more specific information for the bonds listed in Part I such as total proceeds, the use of those proceeds, and the allocation of those proceeds
Part III - Private Business Use: Provide information related to the private business use of the bond issues listed in Part I such as lease arrangements, management and service contracts, research agreements, percentage of the property used in a private business use and record retention policies

Part IV - Arbitrage: Provide information with respect to arbitrage such as arbitrage rebate and yield reduction payments made, hedge contracts and guaranteed investment contracts
Schedule K

Why is the IRS Making all these Changes?

• Previous version did not keep pace with changes in the law and the increasing size, diversity and complexity of the tax-exempt sector

• IRS believes there is “significant noncompliance with recordkeeping and record retention requirements relating to tax-exempt bonds issued by or for the benefit of section 501(c)3 organizations”

• Represents an expansion of the IRS oversight in the tax-exempt bond area

• IRS wants to know if tax rules are being followed after the issuance of tax-exempt bonds
Schedule K
Why is the IRS Making all these Changes?

• Previously, focus was on the time period leading up to and including the issuance of tax-exempt bonds
• Encourages tax-exempt organizations to set up post issuance compliance policies and procedures to ensure compliance with bond related tax requirements
• Detailed reporting requirements provide incentive for borrowers to be more rigorous in record keeping and post issuance compliance monitoring
• This process is expected to be time consuming and burdensome
• Some believe Schedule K was designed to obtain information for IRS audits
What should organizations do now?

- Create post-issuance compliance practices and procedures for tax-exempt bond issues
- Define facilities and equipment financed by tax-exempt bond proceeds
- Trace and allocate your tax-exempt bond proceeds
- Identify and review documents related to your tax-exempt bonds such as arbitrage certificates, management and service contracts, research agreements, etc.
- Confirm you are in compliance with arbitrage rebate and yield restriction regulations
Contributions and Grant Making

- Core Reporting – Where are the questions hiding?
- Supplemental Schedules – Thresholds and disclosures
- Compliance – Series of Y/N questions – “Correct” answers
- Governance – Policies and procedures disclosures
  - Contributions of Cash
  - Contributions in-kind
  - Domestic Grants
  - Foreign Grants
Fundraising & Special Events

- Compliance with donor acknowledgement
- Understand what is and isn’t in this category
- Understand timing and reporting
- Set up procedures for gathering information contemporaneously
- Ensure quid pro quo donor receipts are issued

**Gaming:**
- Compliance with state regulatory agencies
- Compliance with federal reporting requirements
Written Substantiation

- Pre-PPA > $250 cash contribution
- Post – PPA all cash contributions
  - Less than $250 donor can use bank records but donors may no longer use detailed written logs
- Quid Pro Quo > $75 with value
What is Written Substantiation?

- Document from charity
- Name of EO and Donor
- Date of donation (Date of postmark)
- Exact amount of cash or description of property – Do Not provide value
- Quid pro quo – Do provide value
Expenses - Reporting Requirements

• Must use the categories provided first!
• Fees for services (line 11, several categories)
  • All contractor fees, including health care professionals

Other Expenses (line 24):
• List the top five by dollar amount
  • Unrelated business income taxes – always listed
• Avoid terms: “other” and “miscellaneous”
  • Cannot exceed 5% of line 25
• Schedule I, Part III – Complete if aggregate is > $5,000
  o Group by type of grant or assistance
  o Number of individuals in group
  o Total amount of cash grants in grouping
  o Total amount of non-cash assistance in grouping
  o Method of non-cash valuation
  o Description of non-cash assistance
  o Cash assistance only described in column (a) Type
  o Examples: Scholarship, tuition assistance, medical payments for a particular person
Other Issues

• Organizational structure
• Supporting organizations
• Physician hospital arrangements
• Tax preparation process
• State and local tax matters
• Medical Residence FICA refunds
Closing remarks

Key action items

• Create a strategy to ensure Form 990 compliance involving the right people and process

• Ensure that your Form 990 return is accurate and reflects positively on your organization since it is a public document

• Involve management, your board and audit committees appropriately
QUESTIONS?

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