Requirements for Enhanced Transparency: Emphasize Need for Sound Governance Practices

By Jane Hopkins-Gould, CPA, MBA, Forrest Frazier, CPA, and Jessica Dill, CIA

The Internal Revenue Service (IRS), the Senate Finance Committee, the Catholic Health Association (CHA), states' Attorneys General, and other interested stakeholders have placed much emphasis recently on transparency and accountability in the tax-exempt sector. That emphasis has manifested itself in many ways, including a redesigned IRS Form 990, state community benefit reporting requirements and charity care mandates and proposed federal legislation. Each of these initiatives emphasizes the importance of effective corporate governance practices.

Sound governance practices create a system of checks and balances to safeguard the organization's assets and ensure that exempt resources are used for charitable activities to further tax-exempt purposes. Most internal auditors have been advising for years that good governance practices are an integral part of an effective system of internal controls. This article outlines the areas within the revised Form 990 that focus on governance and discusses how an effective system of internal controls can be put in place at tax-exempt healthcare organizations to help them maintain and protect their tax-exempt status.

Proposed Changes to Form 990 Require Disclosure of Governance Polices and Procedures

The proposed revised Form 990, for use beginning with the 2008 tax return year, requires tax-exempt organizations to explicitly identify, explain and enumerate their governance policies and procedures in Part III of the Form. Interestingly, many of the items required to be disclosed are not required under IRS statute or other legislative or regulatory guidance, but rather, are simply good practices.

As part of the comment process to the IRS, which ended on Sept. 14, 2007, many organizations highlighted this fact and requested that the IRS either: a) make it clear these items are not, per se, a requirement of tax-exemption and/or; b) change the disclosure requirements. Based on comments made by Ronald Schultze, Esq. (Senior Technical Advisor to the Commissioner, Tax Exempt and Government Entities Division of the IRS) at the American Health Lawyers Tax Issues for Health Care Organizations annual conference on Oct. 8, 2007, the IRS is considering both sets of suggestions.

As the draft 2008 Form 990 is currently presented, organizations must disclose the following information within Part III, "Statements Regarding Governance, Management, and Financial Reporting":

- Board composition, including number of members of the governing body and number of independent members of the governing body.
- Changes to organizing or governing documents.
- Information regarding written policies and procedures, including whistle-blower, conflict-of-interest and document-retention and destruction policies and procedures related to contemporaneous documentation of governing body and committee meetings.
- Number of transactions reviewed under the conflict-of-interest policy.
- Whether the organization has local chapters, branches, affiliates and, if so, whether there are policies and procedures governing the activities of such entities.
- Whether the entity receives an independent audit, review, or compilation and who prepares the

[1] Internal Revenue Service, Draft Redesigned Form 990, Schedules, and Instructions. Available at http://www.irs.gov/charities/article/0,,id=171213,00.html.

financial statements (i.e., officer, director, trustee, or employee).

- Report whether the organization has an audit committee and if the organization's governing body reviews the Form 990 before it was filed.
- Explain the organization's practices regarding if/how the following documents are made available to the public:
  - Organizing and governing documents
  - Conflict-of-interest policy
  - Form 990
  - Form 990-T
  - Financial statements
  - Audit report

In addition, throughout the Form 990 and schedules, additional disclosures request the organization to provide:

- Audit committee charter.
- Policy on rebuttable presumption and compensation review.
- Policy on investments in disregarded entities, joint ventures and other affiliated entities.
- Policy on transactions and arrangements with related organizations to safeguard tax-exempt status.
- Community benefit report and charity care policy.
- Billing and collections policy.
- Travel and entertainment reimbursement policy.
- Investment policy.
- Disclosure of business relationships amongst officers, directors, trustees, key employees, independent contractors, substantial contributors and related family members and the organization or a related entity thereof.

Specific to healthcare organizations, the newly created "Schedule H—Hospitals" must be completed by organizations that operate at least one hospital facility that provides hospital or medical care, including as part of a hospital system or university. Schedule H requires organizations to report:

- Aggregate community benefit for all facilities.
- Certain information regarding billings, collections and joint ventures.
- A listing of facilities and description of type of services provided at each facility.
- Certain policies and activities to communities served by the organization.

Other Initiatives Emphasizing Sound Governance Practices

The Community Benefit Standard set forth within Revenue Ruling 69-545 expressly requires tax-exempt healthcare entities to maintain boards that are independent and representative of the community. The Form 1023, Application for Recognition of Exemption seeks information about specific governance practices. And a handful of tax court decisions and private letter rulings have set forth specific guidance on board governance. Most governance within tax-exempt organizations, including healthcare entities, however, is based on practices gleaned from the corporate sector and is "suggested" rather than required.

In February 2007, the IRS also issued a preliminary staff discussion draft, setting forth suggested good governance practices for charitable organizations. This draft document is also referenced in the IRS Form 1023, with respect to interrogatories related to corporate governance practices. While not statutorily required, the IRS continues to set forth informal guidance suggesting that it views good governance practices positively when reviewing tax-exempt organizations, whether under audit or as part of an initial application process. It seems that the IRS's view is that an entity which is well-run from an internal controls and governance perspective is more likely to be tax-compliant than one that is not.

Finally, on Oct. 18, 2007, the Independent Sector, a leadership forum for charities, foundations and corporate giving programs, issued a report entitled "Principles for Good Governance and Ethics Practices— A Guide for Charities and Foundations." The report details out 33 "sound practices" for charitable organizations to adopt related to their governance practices. The Independent Sector believes that good governance

	Organization has a documented policy?		Organization has a process for tracking exceptions to policy and changes to policy?	
	Yes	No	Yes	No
Whistle-blower policy	☐	☐	☐	☐
Conflict-of-interest policy	☐	☐	☐	☐
Document-retention and destruction policy	☐	☐	☐	☐
Procedures for documenting board of directors and audit committee meetings	☐	☐	☐	☐
Audit committee charter	☐	☐	☐	☐
Policy on rebuttable presumption and compensation review	☐	☐	☐	☐
Policy on investments in disregarded entities, joint ventures and other affiliated entities	☐	☐	☐	☐
Policy on transactions and arrangements with related organizations to safeguard tax-exempt status	☐	☐	☐	☐
Community benefit report and charity care policy	☐	☐	☐	☐
Billing and collections policy	☐	☐	☐	☐
Travel and entertainment Reimbursement policy	☐	☐	☐	☐
Investment policy	☐	☐	☐	☐

Table 1.1 Revised Form 990 Policy Checklist

practices strengthen accountability and effectiveness.

How to Enhance Your Governance Practices

As part of these initiatives, tax-exempt healthcare organizations are called now to clearly and consistently follow a set of governance practices that previously may have been less formal and sometimes inconsistently applied. The following are specific ways your organization's governance practices can be enhanced:

- Establishing, fostering, and living an effective code of ethics/conduct. Most organizations will have an existing code of ethics/conduct, but are there processes in place for updating the code, tracking changes and communicating changes to the organization's personnel? The revised Form 990 specifically requests the organization's whistle-blower hotline policy and conflict-of-interest policy, which is many times intertwined with the code of ethics.
- Establishing an effective confidential complaint mechanism (e.g., whistle-blower) for reporting violations of the code of ethics/conduct and other organization policies, legal and regulatory requirements, etc.

Good governance practices are an integral part of an effective system of internal controls.

- Evaluating the structure and responsibilities of the board of directors. The board should include independent directors and directors with financial expertise. The board's responsibilities should include approval of non-audit services.
- Evaluating the structure and responsibilities of the audit committee. Responsibilities should include oversight of external auditors.
- Enhancing corporate responsibility for financial reports through quarterly certifications of financial reporting by senior financial officers (e.g. chief financial officer and controller).
- Performing periodic management assessments of internal controls.
- Evaluating executive compensation for reasonableness.

Further, many organizations will need to reevaluate their governance policies and procedures to ensure that all entities within an integrated health system or other complex tax-exempt entity have consistent practices and regularly assess compliance therewith. Table 1.1 identifies the key policy areas that you should be evaluating within your organization.

In conclusion, good governance practices, while not, per se, required as a condition of tax-exempt status, are strongly suggested and highly regarded. If your organization has not recently reviewed the effectiveness and consistency of its corporate governance policies and procedures, now is the time to do so as it appears that requisite good governance practices will emerge from the various proposals and guidelines being put forth by federal, state and local authorities. **NP**

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You can always tell a real friend: when you've made a fool of yourself he doesn't feel you've done a permanent job.
~Laurence J. Peter