

# FORVIS

## 990 Tax Update & IRS Focus Areas

Noelle Alberto / December 2022

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## Presenters



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**Noelle Alberto** a Tax Senior Manager at FORVIS. She has over eight years of experience providing tax services to health care entities, colleges, universities, foundations, and other not-for-profit organizations as well as assisting taxable corporations and individuals with tax return preparation. In addition to tax services, her industry experience allows her to assist various organizations with tax compliance and consulting, including IRS applications for exemption and other correspondence. She also has presented on various tax topics to local and regional not-for-profit organizations. She is a member of the American Institute of CPAs and Texas Society of Certified Public Accountants.

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## Objective

- Legislative Updates
- IRS Focus Areas
- Compensation (Hot Topics & Section 4960)
- Employee Retention Credit
- Section 501(r) Compliance
- Other Enforcement Areas

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## Legislative Update - 2022

- Congress is currently in its lame duck session
- Working on a spending bill (omnibus or continuing resolution) to continue funding government for fiscal year 2023
  - Current CR funding government expires Dec. 16th
  - Would need 218 votes in the House and 60 votes in Senate to pass
- Key tax items being considered
  - Expansion of child tax credit
  - Deferring §174 capitalization requirement
  - Continuing to allow add-back to adjusted taxable income for depreciation, amortization and depletion for §163(j) purposes
  - Extending 100% bonus depreciation beyond 2022
- Expect some clarity on tax considerations the week of Dec. 12th

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## Some Changes & Considerations for 2022 & 2023

- §163(j) Business Interest Expense
- Bonus Depreciation
- §174 Capitalization
- Employee Retention Credit Considerations
- Corporate NOL
- Transportation Fringe Benefits –Remote Working
- Estate Exemption & Annual Gift Exclusion
- §1202 Reminders

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## Net Operating Loss Updates

- **NOL deduction limitations on utilization**
  - 80% of taxable income
  - Applies to losses generated in tax years beginning after December 31, 2017, & not utilized prior to 2021
- **No carryback**
  - Applies to losses arising in tax years beginning after December 31, 2020
  - Property/casualty insurance companies & certain farm losses have special carryback rules
- **Carried forward indefinitely**
  - Applies to losses arising in tax years beginning after December 31, 2017
- **NOL limitations for pre-2018 losses**
  - Rules remained the same, losses can be carried back two years & forward 20 years
  - No taxable income limit, can offset 100% of taxable income if NOL is large enough

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## Update on IRS Compliance Measures

- Accomplishments for Fiscal Year 2021
  - Exempt Organization Examinations Completed – 3,249
  - 82.3% of Exams resulted in a tax change
  - 94 entities received proposed revocations
- Common Themes Included
  - Hospitals with UBI operating at a loss
  - Missing filing requirements & forms
  - Unrelated Business Income
- Received 94,466 Determination Application
  - 81,589 Approvals – 76,852 of those were 501(c)(3)

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## Update on IRS Compliance Measures

- Priorities for Fiscal Year 2022
  - Increase access to public disclosure copies
  - Continue to expand data analytics to identify high-risk areas
  - Cross collaboration with other IRS teams on exams to identify emerging issues
  - Increase digital communication platforms to assist taxpayers

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## Recent IRS Enforcement

- Compliance Checks versus Examinations
- “Bad answers” on the Form 990
- Compensation over \$1,000,000 reported on Form 990 with no Form 4720
- Hospitals – continued focus on 501(r)
  - IRS is required to review internally every 3 years
  - Form 990 & organization website
  - Deeper look at documents on website
- Unrelated Business Income – losses & M&A expenses
- Employment tax & notices
- Employee Retention Credit
- Whistleblower trigger

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## Polling Question 1

Have you enjoyed watching the FIFA World Cup for the holidays?

- Definitely!
- Not since the US lost
- What's World Cup?
- It's alright

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## Compensation Areas of Focus

- Private Inurement
- Private Benefit
- Intermediate Sanctions – Excess Benefit Transaction
- Self-dealing for Private Foundations
- Section 4960 Excise Taxes

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## Penalties - Public Charities

- Intermediate Sanctions/Excess Benefit Transaction
  - Excise tax of 25% of the excess portion ON the disqualified person
  - Excise tax of 10% of the excess portion on any organization manager who participated in the compensation arrangement (unless not willful and due to reasonable cause)
  - If not corrected after notice, an additional excise tax of 200% of the excess portion on the disqualified person
- Private Inurement – Revocation of tax-exempt status of the Organization

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## Penalties - Private Foundations

- Self Dealing
  - Excise tax of 10% of self-dealing ON the disqualified person
  - Excise tax of 5% of self-dealing on a foundation manager who participated in the compensation arrangement (unless not willful and due to reasonable cause)
  - If not corrected after notice, an additional excise tax of 200% on self dealer
- Private Inurement – Revocation of tax-exempt status of the Organization

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## IRC Section 4960

- Added by the Tax Cuts and Jobs Act in 2017
- “Applicable tax-exempt organization” that pays to a “covered employee”
  - remuneration in excess of \$1 million for a taxable year; or
  - excess parachute payment
- Subject to an excise tax on amount of excess remuneration or any excess parachute payment at the corporate rate (currently 21%)
- Final regulations were issued January 2021

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## Compliance Check

For taxable years beginning after December 31, 2017, Internal Revenue Code (IRC) Section 4960 imposes a 21% excise tax on excess remuneration (over \$1 million per year) paid by you and any related organizations to your five highest paid employees. You and any related organizations that paid excess remuneration are liable for this tax.

Our records show you reported compensation to at least one employee for over \$1 million. However, we haven't received a Form 4720, Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code. Form 4720 is the form that is filed by the exempt organization to pay the IRC Section 4960 excise tax.

### What you need to do

#### If you're required to file a tax return

- Complete and send your signed Form 4720 using the instructions on the front page of this letter.

#### If you've already filed a return

- Send a signed copy of the Form 4720 using the instructions on the front page of this letter. Be sure to attach copies of all schedules and other documents you included with the original return.
- Provide the name and employer identification number (EIN) if you filed using a different EIN than that listed above.

#### If you're not required to file a Form 4720 (see Notice 2019-09 for exceptions)

- If you believe you are exempt from paying the IRC Section 4960 tax, please check the reason below, attach an explanation and send the information using the instructions on the front page of this letter:
  - ☐ Payments to a licensed medical professional and veterinarian to the extent that such payment is for the performance of medical or veterinary services by such professional.
  - ☐ Excess parachute payments under qualified plans as defined in IRC Section 280G(b)(6).
  - ☐ Excess parachute payments made under or to an annuity contract described in IRC Section 403(b) or a plan described in IRC Section 457(b).
  - ☐ Excess parachute payments to individuals who are not highly compensated employees as defined in IRC Section 414(g).
  - ☐ Other.

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## Covered Employees

- One of an applicable tax-exempt organization's (ATEO's) five highest-compensated employees for the current taxable year or anyone who was a covered employee of the ATEO for any preceding taxable year beginning after December 31, 2016
- No minimum threshold for an employee to be a covered employee (need not be paid excess remuneration or excess parachute payment)

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## Remuneration & Excess Remuneration

- Defined as wages, excluding designated Roth contributions
- Includes amounts required to be included in gross income under §457(f)
- Does not include certain retirement benefits, including payments from or contributions to qualified retirement plans
- Compensation for the performance of medical or veterinary services by a licensed medical professional (including a veterinarian) is excluded from remuneration & parachute payments under §4960(c)(3)(B) & (c)(5)(C)(iii) respectively
  - When a covered employee is compensated for both medical services & other services, the employer must allocate remuneration paid to such employee between medical services & such other services

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## Remuneration Example for 2021

Compensation Description	Dollar Amount
W-2, Box 5 (As reported on 990, Part VII)	\$985,000
- 403b Contributions	- \$26,000
+ Increase/- Decrease 457b Value	+ \$30,000 (Increase)
- 457b Contributions	- \$19,500
<u>+/- 457f/SERP Vested in Tax Year but paid in Different year</u>	<u>+ \$56,000 (Fiscal year end, vested in 2021 but paid 2022)</u>
Net Applicable Wages	\$1,025,500
<b>Compensation Applicable to Excise Tax</b>	<b>\$25,500</b>

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## Parachute Payments & Excess Parachute Payments

- A parachute payment is defined as any payment arising out of an employment relationship to a covered employee if:
  - Such payment is contingent on such employee's separation from employment and
  - The aggregate present value of the payments in the nature of compensation to such individual that are contingent on such separation equals or exceeds an amount equal to three times the base amount
- An anticipated reduction of the level of service of less than 50 percent is not treated as a separation from employment
- An excess parachute payment is the excess of the amount of any parachute payment made by an ATEO over the portion of the covered employee's base amount that is allocated to the payment
  - Note that this is the excess over one times the base amount and not the excess over three times the base amount

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## Parachute Payments Example

Payments Contingent on involuntary separation from Employment		800,000
Base Amount		200,000
Amount times Base		4
Is this Excess Parachute Payment		Yes
Amount Subject to Excise Tax		600,000
Amount of Excise Tax		126,000

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## Tips & Potential Mitigation Strategies

- Review employment agreements and severance policies to determine if they could generate excess parachute payments
- Shifting Income – specifically employee's bonus and severance
- Structuring of smaller payments made over time instead of a one-time payment upon termination
- Restructuring vesting dates
- Make sure considering related organizations

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## Polling Question 2

How confident are you that your compensation is being calculated accurately for Section 4960?

- Super confident
- Confident enough
- Not confident
- I don't know

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## Employee Retention Credit (ERC)

- Credit is allowed against the employer's share of Social Security tax
- Fully refundable credit
  - If the credit exceeds the employer's share of Social Security tax on all wages, the excess is treated as an overpayment & refunded
  - Claim on Form 941 or 941-X
  - May receive notice before receiving actual refund

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## ERC - Eligibility

- Experience one of the following:
  - Full or partial suspension of operations during any calendar quarter in 2020 due to orders from an appropriate government authority
  - A significant decline in gross receipt during the calendar quarter
- No limit on number of employees, more lucrative if under certain thresholds
- Trade or business requirement
- Government entities not eligible (for 2020, some are in 2021)
- Tax exempt organizations under Section 501(c) are eligible

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## ERC - Continued

- Partial Shutdowns
  - An employer may be considered to have a partial suspension of operations if more than a nominal portion of its business operations are suspended due to a government order despite the ability to work remotely.
- Revenue Decline
  - The evaluation of the decline is performed on a quarterly basis.
  - Income from forgiveness of the PPP loan in a quarter, that revenue may be excluded from the calculation of gross receipts.

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## ERC Summary

	2020 ERC	2021 ERC
Significant decline in gross receipts threshold	50%	20%
Applicable dates	3/13/20-12/31/20	1/1/21-09/30/21
Credit percentage applied to qualified wages	50%	70%
Per employee wage limit	\$10,000 for the year	\$10,000 per quarter
Maximum credit per employee	\$5,000	\$14,000
Maximum number of full-time employees allowed to claim credit on all wages paid	100	500
Certain government employers eligible?	No	Yes
Eligible if obtaining PPP loan?	Yes, retroactively	Yes

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## Polling Question 3

Has your organization considered utilizing the Employee Retention Credit?

- Yes, we have calculated and filed
- Yes, but it doesn't apply
- No
- I don't know

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## Section 501(r)

### History of 501(r)

- Part of the Patient Protection and Affordable Care Act (the ACA), enacted March 23, 2010
- Applies to all 501(c)(3) organizations that operate one or more hospital facilities
  - A hospital facility is a facility that is required by a state to be licensed, registered, or similarly recognized as a hospital
- Provisions of 501(r)(3)-(6) applied to taxable years beginning after March 23, 2012
- Final regulations were released on December 29, 2014 and apply to tax years beginning after December 29, 2015

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## Section 501(r)

### Key Provisions for IRS(& Public) Review

- Check website to ensure all required and most recently board-approved documents are listed in an easy-to-find area
  - Community Health Needs Assessment (CHNA)
  - Implementation Strategy (IS)
  - Financial Assistance Policy (FAP)
    - Include all attachments and references to the FAP
  - Plain Language Summary (PLS)
  - FAP Application
  - Billing & Collection Policy, if separate from FAP
  - All required translations for Limited English Proficiency (LEP) population
- Carefully review 990 (Schedule H in particular)

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## Section 501(r)

### Tips for the Website

- Easy to find
  - Links directly on the homepage or easily found on a drop down
  - All 501(r) related compliance items on same page
- CHNA & Implementation Strategy
  - Add statement about board review & adoption directly on the web page
  - **ex)** The CHNA and Implementation Plan report was presented to and approved by the Hospital Board on August 2, 2022. Medical Center Health System will utilize its 2022 plan as a guide over the next three years to offer programs that support the health of the community and the mission of the organization.

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## Section 501(r)

### CHNA & Implementation Strategy Focus Areas

3	During the tax year or either of the two immediately preceding tax years, did the hospital facility conduct a community health needs assessment (CHNA)? If "No," skip to line 12 . . . . .	3		1b
If "Yes," indicate what the CHNA report describes (check all that apply):				
a	<input type="checkbox"/> A definition of the community served by the hospital facility			
b	<input type="checkbox"/> Demographics of the community			
c	<input type="checkbox"/> Existing health care facilities and resources within the community that are available to respond to the health needs of the community			
d	<input type="checkbox"/> How data was obtained			
e	<input type="checkbox"/> The significant health needs of the community			
f	<input type="checkbox"/> Primary and chronic disease needs and other health issues of uninsured persons, low-income persons, and minority groups			
g	<input type="checkbox"/> The process for identifying and prioritizing community health needs and services to meet the community health needs			
h	<input type="checkbox"/> The process for consulting with persons representing the community's interests			
i	<input type="checkbox"/> The impact of any actions taken to address the significant health needs identified in the hospital facility's prior CHNA(s)			
j	<input type="checkbox"/> Other (describe in <u>Section C</u> )			

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## Section 501(r)

### CHNA & IS (continued)

8	Did the hospital facility adopt an implementation strategy to meet the significant community health needs identified through its most recently conducted CHNA? If "No," skip to line 11 . . . . .	8		1b
9	Indicate the tax year the hospital facility last adopted an implementation strategy: 20_____			
10	Is the hospital facility's most recently adopted implementation strategy posted on a website? . . . . .	10		
a	If "Yes," (list url): _____			
b	If "No," is the hospital facility's most recently adopted implementation strategy attached to this return? . . . . .	10b		1b
11	Describe in <u>Section C</u> how the hospital facility is addressing the significant needs identified in its most recently conducted CHNA and any such needs that are not being addressed together with the reasons why such needs are not being addressed.			
12 a	Did the organization incur an excise tax under section 4959 for the hospital facility's failure to conduct a CHNA as required by section 501(r)(3)? . . . . .	12a	1b	
b	If "Yes" to line 12a, did the organization file Form 4720 to report the section 4959 excise tax? . . . . .	12b		1b
c	If "Yes" to line 12b, what is the total amount of section 4959 excise tax the organization reported on Form 4720 for all of its hospital facilities? \$			

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## Section 501(r)

### Financial Assistance Policy & Summary

19	Did the hospital facility or other authorized party perform any of the following actions during the tax year before making reasonable efforts to determine the individual's eligibility under the facility's FAP? . . . . .	19		
If "Yes," check all actions in which the hospital facility or a third party engaged:				
a	<input type="checkbox"/> Reporting to credit agency(ies)			
b	<input type="checkbox"/> Selling an individual's debt to another party			
c	<input type="checkbox"/> Deferring, denying, or requiring a payment before providing medically necessary care due to nonpayment of a previous bill for care covered under the hospital facility's FAP			
d	<input type="checkbox"/> Actions that require a legal or judicial process			
e	<input type="checkbox"/> Other similar actions (describe in Section C)			
20	Indicate which efforts the hospital facility or other authorized party made before initiating any of the actions listed (whether or not checked) in line 19 (check all that apply):			
a	<input type="checkbox"/> Provided a written notice about upcoming ECAs (Extraordinary Collection Action) and a plain language summary of the FAP at least 30 days before initiating those ECAs (if not, describe in Section C)			
b	<input type="checkbox"/> Made a reasonable effort to orally notify individuals about the FAP and FAP application process (if not, describe in Section C)			
c	<input type="checkbox"/> Processed incomplete and complete FAP applications (if not, describe in Section C)			
d	<input type="checkbox"/> Made presumptive eligibility determinations (if not, describe in Section C)			
e	<input type="checkbox"/> Other (describe in Section C)			
f	<input type="checkbox"/> None of these efforts were made			

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## Section 501(r)

### Financial Assistance Policy & Summary

17	Did the hospital facility have in place during the tax year a separate billing and collections policy, or a written financial assistance policy (FAP) that explained all of the actions the hospital facility or other authorized party may take upon nonpayment? . . . . .	17		17
18	Check all of the following actions against an individual that were permitted under the hospital facility's policies during the tax year before making reasonable efforts to determine the individual's eligibility under the facility's FAP:			
a	<input checked="" type="checkbox"/> Reporting to credit agency(ies)			
b	<input type="checkbox"/> Selling an individual's debt to another party			
c	<input type="checkbox"/> Deferring, denying, or requiring a payment before providing medically necessary care due to nonpayment of a previous bill for care covered under the hospital facility's FAP			
d	<input type="checkbox"/> Actions that require a legal or judicial process			
e	<input type="checkbox"/> Other similar actions (describe in Section C)			
f	<input type="checkbox"/> None of these actions or other similar actions were permitted			

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## Section 501(r)

### FAP (continued)

		YES	NO
22	Indicate how the hospital facility determined, during the tax year, the maximum amounts that can be charged to FAP-eligible individuals for emergency or other medically necessary care.		
a	<input type="checkbox"/> The hospital facility used a look-back method based on claims allowed by Medicare fee-for-service during a prior 12-month period		
b	<input type="checkbox"/> The hospital facility used a look-back method based on claims allowed by Medicare fee-for-service and all private health insurers that pay claims to the hospital facility during a prior 12-month period		
c	<input type="checkbox"/> The hospital facility used a look-back method based on claims allowed by Medicaid, either alone or in combination with Medicare fee-for-service and all private health insurers that pay claims to the hospital facility during a prior 12-month period		
d	<input type="checkbox"/> The hospital facility used a prospective Medicare or Medicaid method		
23	During the tax year, did the hospital facility charge any FAP-eligible individual to whom the hospital facility provided emergency or other medically necessary services more than the amounts generally billed to individuals who had insurance covering such care? . . . . .	23	
If "Yes," explain in <u>Section C</u>			
24	During the tax year, did the hospital facility charge any FAP-eligible individual an amount equal to the gross charge for any service provided to that individual? . . . . .	24	
If "Yes," explain in <u>Section C</u>			

Schedule H (Form 990) 2016

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## Section 501(r)

### Final Thoughts on 501(r)

- Two policy changes that can simplify 501(r) compliance
  - Free care only discounts for FAP-eligible patients (typically see 200% FPG)
  - Eliminate Extraordinary Collection Activities (ECAs)
- Make sure your hospital is following through & implementing policy changes operationally
  - Conduct regular assessments
  - Update provider lists regularly and include updated versions on website
  - Internal audit procedures

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## Polling Question 4

Does your website have all required documents to be compliant under 501(r)?

- Yes
- No
- No, but we're working on it
- I don't know

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## Unrelated Business Income (UBI)

- UBI Criteria:
  - Activity must be a trade or business,
  - Activity must be regularly carried on, and
  - Activity is not substantially related to the organization's exempt purposes.
- **All three** criteria must be met for an activity to generate UBI.
- Identifying Potential UBI
  - Provide management or administrative services for a fee?
  - Provide lab services or pharmacy services to non-patients?
  - Operate a gift shop, bookstore, or restaurant?
  - Have ownership in a joint venture; i.e. partnership, S-Corp, etc.?
  - Rental activities on debt property?

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## UBI Siloing

- The sum of all unrelated business activities can't be less than \$0
- IRS Guidance – Issued Final Regulations under Section 512(a)(6)
- Final Regulations provide:
  - Exempt organization with more than one unrelated trade or business must compute UBTI separately with respect to each unrelated trade or business, without regard to the \$1K specific deduction, including determining any NOL deduction
  - **NAICS codes - first two digits**
  - Review unrelated business activities by NAICS codes and determine methodology for allocating the expenses

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## UBI Generated from Partnerships

- If partnership interest meets certain criteria under the de minimis test or the significant participation test, the UBI can be aggregated as investment activities versus breaking out the income into various business lines or activities
- De minimis test - applicable if the institution doesn't directly or indirectly hold more than 2% of a profit or capital interest in the partnership
- Significant Participation test (formerly Control Test) - applicable if the institution doesn't directly or indirectly hold more than 20% of a capital interest & doesn't have control or influence over the partnership based on facts and circumstances

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## UBI Generated from Partnerships

- K-1 Footnotes
  - Look closely at state reporting for potential state returns to prepare
    - States will come after what they are due
    - California, New York, Mississippi high enforcers
  - Foreign reporting
    - If partnership investment in foreign entities, additional form reporting to attach to 990-T
      - Form 926, 8865, etc.

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## UBI Siloing - continued

- Losses
  - The loss from one business activity can no longer be used to offset the gain from another
  - Follow the new corporate NOL carryover rules

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## Polling Question 5

Does your organization have more than one unrelated business activity?

- Yes
- No
- Definitely not
- I don't know

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## Other Areas of Focus

- Reporting Consistency
  - Data driven case selection
    - Mismatching information can lead to greater IRS focus on your reporting
    - Approximately 250 queries focusing on the risky areas of Form 990 & related schedules
      - Best practice questions
      - Spot inconsistencies
      - Identify missing items
    - Historically have had approx. 90% change rate
    - Many audits will be selected from this process

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## Other Areas of Focus

### ■ Data Reporting example

#### - 990, Part V

2a	Enter the number of employees reported on Form W-3, Transmittal of Wage and Tax Statements, filed for the calendar year ending with or within the year covered by this return	2a				
b	If at least one is reported on line 2a, did the organization file all required federal employment tax returns? . . . . .	2b				
Note. If the sum of lines 1a and 2a is greater than 250, you may be required to e-file (see instructions) . . . . .						

#### - 990, Part IX

9	Other employee benefits . . . . .				
10	Payroll taxes . . . . .				
11	Fees for services (non-employees):				

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## Other Areas of Focus

### ■ Data Reporting example

#### - 990, Part V

1a	Enter the number reported in Box 3 of Form 1096. Enter -0- if not applicable . . . . .	1a				Yes	No
b	Enter the number of Forms W-2G included in line 1a. Enter -0- if not applicable . . . . .	1b					
c	Did the organization comply with backup withholding rules for reportable payments to vendors and reportable gaming (gambling) winnings to prize winners? . . . . .	1c					

#### - 990, Part IX

11	Fees for services (non-employees):				
a	Management . . . . .				
b	Legal . . . . .				
c	Accounting . . . . .				
d	Lobbying . . . . .				
e	Professional fundraising services. See Part IV, line 17				
f	Investment management fees . . . . .				
g	Other. (If line 11g amount exceeds 10% of line 25, column (A) amount, list line 11g expenses on Schedule O.) . . . . .				

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## Other Areas of Focus

- Missing Answers or Schedules
  - Attaching information as an e-file attachment doesn't always show up on the "public disclosure copy"
    - Compensation, grants, related organizations, etc.
    - Audited Financial Statements
    - Can lead to reader confusion and notification to IRS
  - Missing items are considered filing an incomplete return

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## Other Areas of Focus

- Good Governance
  - Answering all the right questions on 990, Part VI
    - Written Conflict of Interest Policy
    - Written Whistleblower Policy
    - Written Document Retention & Destruction Policy
    - Documented process for compensation determination for officers & key employees

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# Questions?

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# Thank you!

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