Henderson & Caverly Pum LLP

NONPROFIT ORGANIZATIONS NEWSLETTER

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CHARITIES AND RECORD KEEPING

Importance of Record Keeping

An exempt organization must keep books and records to show it complies with tax rules, and it must be able to document the sources of receipts and expenditures reported on IRS Form 990, Return of Organization Exempt From Income Tax. Even if 990-N (the electronic postcard) is filed, or no return is filed, records must be maintained showing activities conducted, income received and expenses incurred.

An effective record keeping system enables an organization to monitor the progress of programs and aid in the preparation of financial statements and returns.

Books and records must be available for inspection by the IRS. If the IRS examines an organization's returns, the organization must have records to explain items reported. Having a complete set of records will speed up the examination.

If an organization does not keep required records, it may be unable to show it qualifies for exemption. Thus, the organization may lose its tax-exempt status. In addition, an organization may be unable to complete its returns accurately and may be subject to penalties.

Monitor Programs

Records can show whether programs are improving, which programs are successful and what changes an organization may need to make. Good records management can contribute to the success of a program and an organization.

Prepare Financial Statements

It's important for organizations to maintain revenue and expense statements and balance sheets to prepare accurate financial statements. These statements can help an organization when working with banks, creditors, contributors and funding organizations.

Prepare Annual Returns and Tax Returns

Records must support income, expenses and credits as reported on the Form 990 series of federal returns and on state tax returns. These can often be the same records used to monitor programs and prepare financial statements. If the IRS examines an organization's returns, the organization may be asked to explain items reported. A complete set of records will speed up the examination.

Substantiation of Taxable Revenue and Expenses

Another reason for good record keeping is to substantiate revenues, expenses and deductions for unrelated business income tax ("UBIT") purposes. An organization must appropriately track the revenues and expenses subject to UBIT so that it can prepare its UBIT return on Form 990-T, Exempt Organization Business Income Tax Return. See our January 2019 article regarding recent IRS guidance related to UBIT.

Comply with Grant-Making Procedures

A charity that makes grants to individuals must keep adequate records to demonstrate that the grants serve charitable purposes. At a minimum, the records should show names and addresses of grantees, purpose of the grant, manner of selecting the grantees and relationship of the grantees to any members, officers, trustees or donors of the organization. A charity that makes grants to foreign organizations or individuals must also keep adequate records regarding those distributions.

Comply with Racial Nondiscrimination Requirements (Private Schools)

Private schools must keep records showing they have complied with requirements relating to racial nondiscrimination, including annual publication of a racially nondiscriminatory policy through newspaper or broadcast media to the community served by the school. For more information, see Schedule E, Schools, on the Form 990 and its accompanying instructions.

What Records Should be Kept?

Except in a few cases, the law does not specify mandatory record keeping processes. A corporation should keep records of board of directors' meetings.

An organization can choose any record keeping system, suited to its activities, that shows its income and expenses. If an organization has more than one program, it should ensure that records identify the income and expense items attributable to each program.

A record keeping system must include a summary of transactions. This is ordinarily written in the organization's books, such as accounting journals and ledgers. The books must show, among other things, gross receipts, purchases, other expenses, employment taxes and assets. For many small organizations, a checkbook may be the main source for entries in the books, while larger organizations need more sophisticated ledgers and records. All organizations must keep all documentation that supports the entries in the books.

Supporting Documents

Transactions such as contributions, purchases, sales and payroll will generate supporting documents (for example, grant applications and awards, sales slips, paid bills, invoices, receipts, deposit slips and canceled checks) that contain information to be recorded in accounting records. It's important to keep these documents because they support the entries in an organization's books and on its tax and information returns. They should be marked and stored in a safe location.

Donation records include a written agreement between the donor and the charity with regard to any contribution, an email communication or notes of or recordings of an oral discussion between the charity and the donor where the representative of the charity made representations to the donor with regard to the contribution on which the donor may have relied in making the gift. Donation records should be maintained for 10 years. Donation records of endowment funds and of significant restricted funds should be maintained permanently.

Records Management

Gross Receipts

Gross receipts are the amounts received from all sources, including contributions. An organization should keep supporting documents that show the amounts and sources of its gross receipts. Documents that show gross receipts include cash register tapes, bank deposit slips, receipt books, invoices and credit card charge slips.

Purchases, Including Accounting For Inventory

Purchases are items bought, including any items resold to customers. If an organization produces items, it must account for any items resold to customers. It must also account for the cost of all raw materials or parts purchased for manufacturing into finished products. Supporting documents should show the amount paid and verify the payment was for purchases. Documents for purchases include canceled checks, cash register receipts, credit card sales slips and invoices.

These records will help an organization determine the value of its inventory at the end of the year.

See IRS Publication 538, Accounting Periods and Methods, for general information on methods for valuing inventory.

Expenses

Expenses are the costs incurred by an organization to carry on its programs. Supporting documents should show the amount paid and the purpose of the expense. Documents for expenses include canceled checks, cash register tapes, contracts, account statements, credit card sales slips, invoices and petty cash slips for small cash payments.

Employment Taxes

Organizations with employees must keep records of compensation and specific employment tax records. See IRS Publication 15, (Circular E), Employer's Tax Guide, for details.

Records of Assets and Liabilities

An organization must keep records to verify information about its assets and liabilities. Assets are the property an organization owns and uses in conducting its activities, such as investments, buildings and furniture, and liabilities reflect the financial obligations of the organization. Records should show:

- When and how the asset was acquired
- Documents that support mortgages, notes, loans or other forms of debt
- Purchase price
- Cost of improvements
- Deductions taken for depreciation
- Deductions taken for casualty losses, such as losses resulting from fires or storms
- How the asset was used
- When and how the asset was disposed of
- Selling price
- Expenses of the sale

Typical Documents

Documents that show the above information include purchase and sales invoices, real estate closing statements, canceled checks and financing documents. If an organization does not have canceled checks, it may be able to get payment information from account statements prepared by financial institutions. These include account statements prepared for the financial institution by a third party. Account statements must be legible. The following table lists the contents of acceptable account statements:

If payment is by:

Check. Then account statement must show: Check number, amount, payee's name and date the check amount was posted to the account by the financial institution.

Electronic funds transfer. Then account statement must show: Amount transferred, payee's name and date the transfer was posted to the account by the financial institution.

Credit card. Then account statement must show: Amount charged, payee's name and transaction date.

How Long to Keep Records for Tax Purposes?

For federal tax purposes, an exempt organization must keep records that support an item of income or deduction on a return until the statute of limitations for that return runs. The statute of limitations has run when the organization can no longer amend its return and the IRS can no longer assess additional tax. The statute of limitations generally runs three years after the date the return is due or filed, whichever is later. An organization may be required to retain records longer for other legal purposes, such as for state or local tax purposes.

Additional Record Retention Periods

Other record retention periods vary depending on the type of record or return.

Permanent Records

Some records should be kept permanently. These include the application for recognition of tax-exempt status, the determination letter recognizing tax-exempt status, organizing documents (such as articles of incorporation and bylaws, with amendments) and board minutes.

Employment Tax Records

If an organization has employees, it must keep employment tax records for at least four years after the date the tax becomes due or is paid, whichever is later.

Records for Non-Tax Purposes

An organization should keep records until they are no longer needed for non-tax purposes. For example, a grantor, insurance company, creditor or state agency may require that records be kept longer than the IRS requires.

CALIFORNIA ATTORNEY GENERAL OVERSIGHT OF CHARITIES

The Attorney General regulates charities and the professional fundraisers who solicit on their behalf. The purpose of this oversight is to protect charitable assets for their intended use and ensure that the charitable donations contributed by Californians are not misapplied and squandered through fraud or other means. The main elements of the Attorney General's regulatory program are:

- The attorneys and auditors of the Charitable Trusts Section investigate and bring legal actions against charities and fundraising professionals that misuse charitable assets or engage in fraudulent fundraising practices.
- The Registry of Charitable Trusts administers the statutory registration program. All charitable trustees and fundraising professionals are required to register and file annual financial disclosure reports with the Registry. In addition, nonprofit organizations that conduct raffles for charitable purposes are required to register and file an annual financial report. Charitable trustees, see General Guide for Initial Registration. Commercial fundraisers, see Commercial Fundraiser Forms. Nonprofits seeking to hold raffles, see Nonprofit Raffle Program Forms.
- To help charities stay within the law, the Attorney General makes available various guides and publications, including the Attorney General's Guide for Charities. Additional guidance for charities is available on the Attorney General's Publications and Resources pages.
- The Attorney General also offers guidance to help Californians make important personal decisions on charitable giving. These resources include the Guide to Charitable Giving for Donors and a searchable database to learn about specific charities in the state. To search a charity, visit the Attorney General's Registry Search.

Charity Research Resources

The Registry Verification Search tool allows a registrant's public filings to be viewed and downloaded from the Registry database. These public filings include a copy of the annual informational return (Forms 990, 990-PF, and 990-EZ) filed with the Registry, as well as registration forms and documents that organizations are required to file with the Registry of Charitable Trusts.

Notice to Attorney General in Probate Matters

The Attorney General's office must be given notice of any matter involving a gift to charity, assets held in charitable trust, disposition or gifts of assets to an unnamed charitable beneficiary or property that may escheat to the State of California. For a summary of statutes that require notice to the Attorney General, please refer to the Notice Requirements.

Notice to or Request of Waiver from the Attorney General Before Taking Certain Actions

California law requires directors of charitable corporations to give notice or obtain consent from the Attorney General before taking certain actions. The following are transactions requiring notice or Attorney General approval:

- Voluntary dissolution. See Guide for Dissolving a California Nonprofit Corporation.
- Sale or disposal of all or substantially all corporate assets.
- Merger of a public benefit corporation.
- Conversion of a public benefit corporation to a mutual benefit or business corporation.
- Self-dealing transactions.
- Loans to directors/officers of a public benefit corporation.
- Sale or transfer of nonprofit health facilities.

The Nonprofit Transactions Requiring Notice or Attorney General Approval publication contains detailed information regarding each of the above-identified transactions and providing notice to the Attorney General's office.

If your nonprofit organization needs assistance in registering with or providing notice to or requesting a waiver from the Attorney General's office, please contact our office.

IRS - Latest Webcasts for Charities and Nonprofits

The IRS offers the following four new presentations for 501(c)(3) organizations:

- Charities and Nonprofits: A Quick Resource Guide
- Did you lose your tax exempt status? Why it happens and how to fix it
- Easy Form 1023-EZ
- File Error-Free Forms 990

Additional charities and nonprofits topics are available at IRSvideos.gov.

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