

FORM 990 ACCOUNTING AND REPORTING**ISSUES FOR DISCUSSION -- 2003****Background**

For the past twelve years the Internal Revenue Service, state charity officials, and the nonprofit sector have been meeting to discuss Form 990 accounting and reporting issues. The National Center for Charitable Statistics (NCCS) at the Urban Institute maintains an on-going list and adds issues suggested by the many national and subsector organizations, nonprofit managers, attorneys, accountants, and other interested individuals who are part of the NCCS Data Quality Network. NCCS hosts an annual meeting to discuss these issues.

There have been several important developments on the Form 990 and issues related to quality of data in the nonprofit sector over the past year.

- The IRS plans to enable electronic filing for Form 990 and Form 990-EZ in January 2004 (for organizational year 2003), with Form 990-PF and Form 990-T following in 2005.
- NCCS has developed free *Desktop 990* software to help charities complete their forms. The software can be downloaded at <http://www.form990.org>.
- Using *Desktop 990*, charities in Pennsylvania and Colorado can already complete their Forms 990 and all information required for state registration. Several other states will have the same capability by 2004, when the federal e-filing system becomes operative.
- The General Accounting Office has published a report entitled "Tax-Exempt Organizations: Improvements Possible in Public, IRS and State Oversight of Charities," (April 30, 2002) available at <http://www.gao.gov/new.items/d02526.pdf>.
- As the sector moves more and more to electronic reporting for Form 990, there is also a major effort to streamline the federal grants process. NCCS, OMB-Watch, NCNA, and GuideStar have a project underway to ensure that nonprofit needs are heard at the federal level and are also working with other funders (states, foundations) to help coordinate the development of standards for applying and reporting on grants.

We hope you will review the issues in this paper, submit comments, recommendations, and additions to Bill Levis at qrlevis@aol.com and Linda Lampkin at llampkin@ui.urban.org, and track progress at www.qual990.org.

Formatting, Design, and Space Issues

Issue #1 — Improve Narrative Information on Program Service Accomplishments, Part III

Review of Issues: Although organizations are required to disclose their primary exempt purpose in Part III, many do not. The space constraint is one obvious problem. Also, while most nonprofits list at most two program service activities on Part III, there is not enough space to provide a complete description of the activities, including clients served, publications issued, etc., as stated on the form.

Recommendations:

- 1) Add “mission statement” in parentheses after the "primary exempt purpose" line in Form 990, Part III.
 - 2) Add a reminder in the instructions that program service information will be posted on the Internet.
 - 3) Eliminating Lines c and d of Form 990, Part III and expand primary exempt purpose and lines a and b.
 - 4) Add examples in the instructions for the language and specificity of reporting on activities, especially those that will guide numerical examples of service provision.
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Issue #2 — Structure Requirements for Attachments and Require Filling in Blanks

Review of Issues: Attachments to Form 990 often fail to include adequate information, do so in a confusing manner, or contain extraneous information. The instructions for Line 50 (Receivables from officers, directors, trustees and key employees) are a good model for specifying attachment formats. These instructions have a bold heading “Specified format,” and a numbered checklist of items that an attachment must contain.

There are also a number of Form 990 lines (compensation, number of hours worked, for example) that are often left blank, so it is difficult to tell when the preparer meant “zero” or just did not respond.

Recommendations:

- 1) Highlight (put in bold type) the requirement to include compensation information in the Part V instructions.
 - 2) Create an IRS specified format for attachments, using the instructions for Line 50 as a model.
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Issue #3 — Reduce Disclosure of Extraneous and/or Non-disclosable Data

Review of Issue: Completed forms occasionally contain sensitive data not required. Social security numbers of board members, bank account numbers, and private information about service recipients are among the most common inclusions.

Recommendations:

- 1) Ask Form 990 software developers to include warnings about non-disclosable information.
 - 2) Add IRS ruling stating if confidential data is placed on the form (i.e., not on Schedule B), the filing entity is solely responsible for accidental disclosure by other parties. Such an approach would require new or revised regulations.
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Issue #4 — Account for Organizations Below the Filing Threshold

Review of Issue: The Business Master File is full of defunct organizations and bad addresses. One reason is because once organizations are listed on the BMF, they are not required to file information with the IRS unless they are above the filing threshold of \$25,000 in annual gross receipts. The Joint Committee on Taxation recommended that filings be required of smaller nonprofits.

Recommendation:

Create a "Super" EZ form for tax-exempt organizations currently below the filing threshold. The reporting requirements would be: EIN, public name, telephone number, email and URL (if any), a certification that gross receipts and total assets are below the statutory limits for filing 990-EZ, and the signature of an officer.

Issue # 5 — Add lines to separate key sources of nonprofit income

Review of Issue: With electronic filing, organizations would probably be able to separate their income into categories that would be useful for regulators, policymakers, and researchers, such as direct public support by individuals, foundations, and corporations, and government contributions by source at the federal, state, or local levels.

Recommendations:

- 1) Require division of "Direct public support" into support received from Individuals, Foundations (private and community), and Business (commonly referred to as "corporate giving").
 - 2) Require division of "Government contributions" by level -- Federal, State, and Local.
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Issue #6 — Require self coding of each program in Part III

Review of Issue: The NCCS classification system for programs, activities, and services of nonprofits and their beneficiaries can be used by organizations to self-code their activities on the form. This information again would be of use to regulators, policymakers, and researchers. An easy transition to this system could be made with electronic filing.

Recommendation:

Provide space in Form 990 Part III for a program service code for each program (or incorporate drop down menus with keyword search to find correct codes in software).

Issue #7 – Limit use of Part II, Line 43 – Other expenses.

Review of Issue: Some Form 990 filers do not use divide their expenses into the categories listed in Part II (lines 22-42) but group them on Line 43 and add an attachment with the category names used in the organizations’ accounting systems. Thus, if relevant comparisons are to be made among organizations, it is necessary to review the forms and enter the information from the attachment in the correct categories, assuming that there is enough information to make assumptions about the correct categories.

Recommendation:

Detailed recommendations need to be created.

Issue #8 – Improve compliance with attachment for Schedule A, Part III, line 2e

Review of Issue: In Part III of Schedule A, Lines 2a – 2e require the disclosure of related party transactions. Under Line 2e, it states that a detailed statement needs to be attached, but often filers do not attach the statement. This requirement needs to be emphasized.

Recommendation:

Highlight (make bold) “Attach a detailed statement” in the descriptor for Line 2 on Form 990.
[need additional recommendations]

Accounting and Public Support Test Issues

Issue #9 — Report “other professional fees” in Line 30 rather than in Line 43 – Other expenses.

Review of Issue: Reporting other professional fees in Line 43 makes it almost impossible to determine total professional fees in any given Form 990 or to develop statistics on professional fees. Reporting all professional fees in a separate line item is required for GAAP functional reporting and government grant reporting, for example.

Recommendation:

Broaden the scope of Line 30 from just “Professional fundraising fees” to “Professional fees” in general where **all** Professional fundraising fees would be required to be reported in Col. D and what are now reported in Line 43 as Other Professional fees would be reported in Cols. B & C.

Issue #10 — Clarify instructions for reporting fundraising expenses when the organization is soliciting contributions for other organizations.

Review of Issue: Instructions for Part II have been revised to emphasize that fundraising expenses should not be reported as program related even when one of the functions of the organization is soliciting contributions for other organizations.

Recommendation:

Revise instructions to state that (a) the related GROSS contributions raised are to be reported in line 1a and (b) the amount of related NET contributions distributed to those other organizations should be reported as program related expenses in Line 22 under Column B of Part II and reflected in Line 13, Program services, of Part I.

Issue #11 — Require organizations to complete Part II in accordance with SOP 98-2.

Review of Issue: AICPA Statement of Position 98-2 was released over 4 years ago, and provides practical guidance on allocating joint costs. SOP 98-2 is the only authoritative accounting literature on this issue, so, there is no reason for any nonprofit that engages in joint cost activities to use a different method.

Recommendations :

- 1) Require organizations to report joint cost allocations in accordance with SOP 98-2.
 - 2) Revise instructions on the Joint Costs section of Part II to require that reporting of joint costs in Form 990 must be the same as and consistent with such reporting in the organization's audited financial statements, if one is prepared.
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Issue #12 — Improve reporting for IRC 527 Political Organizations .

Review of Issue: The introduction of these 572 organizations as Form 990 filers introduces a number of new issues.

Recommendation:

More study is needed to detail recommendations.

Issue #13 — Add a separate schedule for grants to foreign organizations .

Review of Issue: In IRS Announcement 2002-87, the question “should a separate schedule of grants to foreign organizations be required?” was raised. The extent of the burden that this would add to filers has not been researched, but the information would be useful to regulators, and other Form 990 data users.

Recommendation:

Further study is required before recommendations are finalized.

Issue #14 — Clarify Medicare and Medicaid Payments (Grants) (Lines 2 and 93f)

Review of Issue: Organizations should report Medicare/Medicaid payments as program service revenue in Part I, line 2 and Part VII, line 93f, and NOT as government contributions in Part I, line 1c. Current instructions for line 1c make no reference to Medicare/Medicaid payments.

Recommendation:

Change instructions for line 1c to specifically mention the correct placement of Medicare and Medicaid revenue.

Issue #15 — Add Options for Alternative Public Support Test (Part IV-A)

Review of Issue: It is difficult and a heavy record-keeping burden on nonprofits to accurately calculate Lines 15 to 25 of Form 990 Schedule A Part IV-A (i.e., “Support Schedule use cash method of accounting”). It is especially difficult for nonprofits that use accrual accounting and have to translate their general ledgers into a cash system for the purposes of the Public Support Test.

A worksheet has been developed that uses Form 990 line-item entries to calculate most, and for 90 percent of all Form 990 filers, *all* of next year’s entries for Column (A), Lines 15 to 25, of Schedule A, Part IV-A. This “simplified method,” now under review by practitioners, is available from Bill Levis at qrlevis@aol.com.

Recommendations :

- 1) Complete review of “Simplified Method” for calculating Lines 15 to 25 of Part IVA of Schedule A, by nonprofit organizations and from nonprofit accounting professionals.
- 2) Incorporate in IRS specifications for Form 990 eFiling software.

Reporting, Definitions, and Instructions**Issue #16 — Separate Requirements and Examples in Instructions**

Review of Issue: Examples are often interspersed among the line item requirements in the text of the instructions, making it difficult to tell where the example ends and the requirements resume.

Recommendation:

Set examples off (by margin, font, font size, in a box, or spatial separation) from requirements.

Issue #17 — Require Better Contact Information

Review of Issue: It is often difficult to contact nonprofit organizations based on the information contained on the Form 990. For the 2001 Form 990, IRS added Line G, Website, for the URL. However, an e-mail address would help in contacting the organization.

Recommendation:

Expand Line G to include both the URL and email address or add a line for an email address for contacting the organization.

Miscellaneous

Issue #18 — Separate Temporarily and Permanently Restricted Amounts from Unrestricted Contributions (Line 1d)

Review of Issue: Temporarily and permanently restricted contributions are combined with unrestricted contributions on the Form 990 on Line 1d and Line 12.

Recommendation:

Need additional recommendations from the accounting profession

Issue #19 — Improve Reporting of Lobbying Expenditures and Inform Selection of the 501(h) Election (Schedule A, Part III, Part VI-A, Part VI-B)

Review of Issue: Many organizations do not know how to decide if they should take the 501(h) election and IRS documents do not provide enough information.

Recommendations:

- 1) State in the instructions that it is acceptable to take the election even if the organization has no plans to lobby in the coming year.
- 2) In the instructions, provide referrals to sources of additional information on which to base the decision of whether to take the election.

[need additional recommendations]

Issue #20 — Improve Reporting on Lobbying Activities (Schedule A, Part III, Part VI-A, Part VI-B)

Review of Issue: Many organizations check “Yes” on Schedule A, Part III, line 1 but may leave the line for total expenses blank. Often the total of lobbying expenditures reported on line 38 (grassroots expenditures in line 36 plus the direct lobbying expenditures in line 37) does not equal the amount reported in Part III under line 1. Further study is required on the appropriate allocation of expenditures on lobbying. It is difficult to make specific recommendations before more detail is available on current reporting by nonprofits.

Recommendation:

[need recommendations]

Issue #21 -- Require Part VII to link related or exempt function income with the Business Code

Review of Issue: Part VII was designed to illuminate the sources, levels and taxability of business-related gross income. Filers are required to categorize gross income by the business activity that produced the income, using business codes (BCs). Further, the income

corresponding to each BC must be disaggregated into taxable and “unrelated” (column ‘B’) or nontaxable because it falls within a statutory exclusion (column ‘C’) or is substantially “related” (Column ‘E’). However, few organizations assign a BC to nontaxable sources of business-related gross income, or specify the gross receipts earned based on the reason claimed for exemption. Because the BC taxonomy is found only as an attachment to the Form 990T Instructions, and because of flaws in Part VII’s matrix design and the lack of specific instructions, it may appear that organizations need only report the BC with respect to unrelated business income, but need not disclose the BC by category of nontaxable business income.

Recommendations:

- 1) Correct existing design errors to Part VII by ensuring Column A’s ‘Business Code’ is understood to be applicable to the information reported in Columns B, C, D and E. This can be accomplished by allowing the second vertical line (separating Columns A and B to ascend to the second horizontal line (the join the line below the bold “PART VII, ANALYSIS OF INCOME-PRODUCING ...”, by abbreviating “Unrelated business income” currently above Columns A and B to ‘UBI’, and by moving the new abbreviation ‘UBI’ to Column B’s descriptor box (so that the heading to the column which presently reads “(B) Amount” becomes “(B) UBI Amount.”
- 2) Change the language in the heading for Column E to read “(E) Related/exempt function income Amount.”
- 3) Change the language in the heading above Columns C and D to read “Income exc. by §512, 513 or 514.”
- 4) Add language to the instructions for Part VII that clarifies filers must report the BC with respect to income that is nontaxable and reportable on Columns C, D and E, and provide sample filled out Part VII, Line 93 matrix.
- 5) Move the BC taxonomy from Form 990T to the Form 990 Instructions.
- 6) Develop and post on the Qual990 website a properly completed Part VII.

Issue #22 -- Improve Narrative Instructional Information for Part VIII’s Substantiation Requirements

Review of Issue: Part VIII requires organizations with “Substantially related” (and therefore disclosed in Column E (Part VII)) income to explain in a narrative why that income is so related. Part VIII was meant to provide a plenary audit function so researchers could more immediately determine the nexus between the activity generating income and the organization’s exempt mission. However, many organizations do not fill out Part VIII, write “not applicable” in the space, or provide a cursory explanation that the income is not taxable, for example, because “it is program service revenue.” As a consequence, Part VIII is not providing useful information to policymakers, enforcement officials, or donors.

Recommendations:

1. Add examples in Part VIII instructions to illustrate the level of specificity required to properly complete Part VIII, and shows that all income reported on Lines 93, 101, 102 and 103 of Part VII is separately accounted for in Part VIII.
2. Develop and post on the Qual990 website a properly completed Part VIII.

3. Develop a format for a “Supplemental Sheet” to Part VIII for the required narrative.

Issue #23 — Disclose on Form 990 whether organizations have adopted conflict of interest policies or have independent audit committees

Review of Issue: In IRS Announcement 2002-87, IRS raised the question “should exempt organizations be required to disclose on Form 990 whether they have adopted conflict of interest policies or have independent audit committees?” Requiring disclosure of these two facts could be useful as a way of encouraging NPOs to adopt conflict of interest policies and have Board audit committees.

Recommendation:

Require disclosure on Form 990 of adoption of conflict of interest policies and existence of audit committees (consisting of Board members, not independent outsiders).

Issue #24 — Disclose on Form 990 whether organizations have presented the completed Form 990 to their boards of directors for review and approval.

Review of Issue: It is likely that most, if not virtually all nonprofit organizations never even think about distributing copies of their Forms 990 to their boards. Having Form 990 ask the question “Has the completed Form 990 been presented to and approved by the board of the organization?” would be useful as a way of encouraging NPOs to adopt policies of getting Board approval of Form 990. This action would be recorded in the board meeting minutes. IRS could also consider whether to make board approval of the 990 a requirement. Either way, the question remains the same.

Recommendation:

That a question be added to Part VI of Form 990: “Has the completed Form 990 been presented to and approved by the board of the organization?”

Issue #25 — Create IRS business rules and diagnostics for use in Form 990 software to eliminate errors during preparation.

Review of Issue: One of the advantages to having electronic filing of Forms 990 is that the 990 preparation software can have a comprehensive set of business rules and diagnostics which will alert the software users of actual and possible reporting errors during the preparation process, before the forms are filed.

Recommendations:

That IRS publish a comprehensive set of business rules and diagnostics that would be required in Form 990 preparation software, including:

- 1) Total of Part V should be less than total compensation for key employees in Part II.
- 2) Total for Schedule A, Part I should be less than total for Part II Other wages.

- 3) Other Expenses should be limited to, say, less than 20% of total expenses without explicit override.
 - 4) Medicare/Medicaid should explicitly be excluded from "Other program service revenue"
 - 5) No negatives in Part VII.
 - 6) No negative expenses in Part 1 expenses deducted from gross amounts.
 - 7) If direct contributions reported, require explicit override/verification warning if no fundraising expenses reported.
 - 8) If functional expense item for compensation in Part II, then must have entry on 90b -- add to software and in instructions.
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Issue #26 — Disclose related directors.

Review of Issue: Although disclosure of family and/or business relationships among officers, directors, and trustees is obtained when an organization first applies for recognition as a tax exempt entity on Form 1023, the composition of boards may change and this information should be disclosed annually on Form 990.

Recommendation:

Add a question to Part V of the Form 990 asking whether officers, directors or trustees are related to each other, through either family or business relationships, and add definitions of "family relationship" and "business relationship."

Issue #27 — Make Annual Reports and Audited Financials Available to the Public.

Review of Issue: The public and other users of Form 990 data currently have not way of knowing if there are additional sources of information available that will be helpful in evaluating the organization.

Recommendation:

Add check boxes to the introductory section of the Form 990, asking "Does the organization publish an annual report? Is it made available to the general public?" and "Does the organization produce audited financials? Are these made available to the general public?"

Issue #28 — Allow Filing of Consolidated Returns for Affiliated Organizations.

Review of Issue: Presently, where an organization has a group exemption ruling, the parent must file at least two returns – one for itself and one for the organizations covered by the group exemption. These separate Forms 990 include material inter-company income, expenses, assets and liabilities that distort the overall operations and financial position of the organization and make it difficult for donors and others to use the information return data. The distortion of organizational data is exacerbated when oversight organizations evaluate charities based solely on statistical analysis of Form 990's. Using raw unconsolidated data in cases where the related entities perform separate but complementary functions can lead to highly erroneous conclusions

about organizational performance. Allowing a parent and its closely controlled affiliate charities to file a combined Form 990 would provide much better information to those using the Form 990 information and be less burdensome for the reporting charities.

Recommendation:

Provide option of filing a combined Form 990 for parent organization and all affiliates that are subject to its supervision and control, and that meet the current criteria for filing a group return.

Comments, questions, and additions are welcome.
Please email to qrlevis@aol.com and llampkin@ui.urban.org.