

# Federal Form 990 Revisions

## A Move Toward Greater Accountability & Transparency of Nonprofits

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FULL REPORT

## Abstract

On December 19, 2007, the IRS released its draft of the revised Form 990, Return of Organization Exempt from Income Tax. This is the first major revision of that form since 1979. This paper highlights the changes to that form. Included in the highlights are reasons for the change which include enhancing transparency by providing the IRS and the public with a realistic picture of the organization, minimizing the organization's burden for filing, and promoting compliance.

### The Revision of the Federal Form 990 A Move Towards Greater Accountability and Transparency of Nonprofit Organizations

On December 19, 2007, the IRS issued a draft of its newly revised Form 990, the first major revision since 1979. In explaining its reasons for the revision, Acting IRS Commissioner Kevin Brown stated, “The tax-exempt sector has changed markedly since the Form 990 was last overhauled more than a quarter of a century ago . . . . We need a Form 990 that reflects the way this growing sector operates in the 21<sup>st</sup> century. The new 990 aims to give both the IRS and the public an improved window in the way tax-exempt organizations go about their vital mission.”(IRS, IR-2007117, 2007) In its Background Paper for the Form 990 redesign, the IRS stated more specifically that “the current form fails to meet the Service’s tax compliance interests or the transparency and accountability needs of the states, the public, and local communities served by the organization.”(pp.1-2)

The redesign was also prompted by the existing form’s “haphazard” and “illogical” design. This was a result of all of the “jury-rigging” the IRS did over the years to add the lines necessitated by changing laws and various compliance issues. Because reprogramming the IRS’s computer systems year after year was too cost-prohibitive, the additional lines were often added to the end of the form or squeezed into an existing—and often unrelated—question. (IRS, Phone Forum, 2007)

With these concerns in mind, the IRS cited “three guiding principles” in the redesign of the form: 1) enhancing transparency to provide the IRS and the public with a realistic picture of the organization filing the return; 2) accurately reflecting the organization’s operations so as to allow the IRS to efficiently assess the risk of noncompliance—thereby promoting compliance; and 3) minimizing the organization’s burden of filing. (IR-2007-117, 2007) The major overhaul has resulted in a ten-page core form complemented by up to 15 different schedules, each of which is to be completed by the filing organization on an as-needed basis.<sup>1</sup> The burden of filing is thus reduced for less complex organizations because many of the schedules will not be relevant.

The IRS cautions, however, that those not-for-profit organizations “with complicated compensation arrangements, related entity structures and activities that raise compliance concerns may have to spend more time providing meaningful information to the public.”(IRS, IR-2007-117, 2007) Notably, Hospitals, universities, and other larger, more complex organizations may have to complete more than ten of the schedules. (IRS, Phone Forum, 2007) In addition, a greater number of smaller organizations previously exempt from reporting will now have to file--depending on the amount of their annual gross receipts—either Form 990, Form 990 EZ, *Short Form Return of Organization Exempt from Income Tax*, or Form 990-N, *Electronic Notice for Tax-Exempt Organizations not Required to Form 990 or 990-EZ* (the “e-postcard”). Under the Pension Protection Act

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<sup>1</sup> The IRS opted for a single “core” form and a “menu” of schedules as opposed to developing a separate Form 990 for different types of hospitals, primarily because the IRS does not have the resources to develop the computer systems necessary to process multiple forms. Phone Forum—Draft Redesign Form 990, July 18-19, 2007.

of 2006, the IRS is required to revoke the tax-exempt status of any organization that fails to meet the filing requirement for three consecutive years. (IRS, Pension Protection Act)

In order to give organizations some time to familiarize themselves with the new Form 990, the IRS is instituting a phase-in process requiring only those organizations with gross receipts or total assets exceeding certain threshold amounts to begin filing the new form in each of the next three tax years. All of these changes will surely have an impact on practitioners who complete the forms for their clients and on the organizations required to file. Even now, while preparing the “old” 990 for the 2007 tax year, organizations must consider immediate measures for collecting the information required on the newly revised form.

### **WHY DO WE CARE ABOUT THIS?**

Even more interesting than the sweeping changes associated with the revision, is the intended use of the form by stakeholders in analyzing a nonprofit organization.

Individuals are often encouraged to review the 990 of an organization prior to making a contribution. Unlike a public company for which audited financial statements are open and available to the public, a nonprofit organization is only required to make its 990 available to interested individuals – i.e. those individuals who specifically make a request for the form. An interested individual may contact the organization to obtain a copy of the Form 990. Alternatively, there are websites, such as Guidestar ([www.guidestar.org](http://www.guidestar.org)), where individuals can access these forms. The newly revised form will give these

interested individuals – as well as the IRS – greater insight into the governance, administration, and effectiveness of the organization in meeting their mission.

#### **CHANGES TO THE CORE FORM:**

This section contains a broad overview of the changes and our interpretation of specific line items. At this time, the Internal Revenue Service has only issued draft instructions which will be open for public comment until June 1, 2008.

The first page of the form has been revised to expand the organization's identification information and include an overall summary of selected items from other areas on the form. The expanded identification information now includes the name and address of the principle officer, year of formation and state of legal domicile. The inclusion of the year of formation allows the users to view the financial information from the perspective of whether the organization is new, growing or stable.

The year of formation is also beneficial when comparing the independent number of voting members to the total number of voting members on the governance committee (lines three and four). It is not uncommon for newly formed organizations to have the founding members serve as the governing board. There is no magic number of years, or size of budget, that would require a board to start recruiting independent members. However, individual State Corporation/Charity laws or funding sources may have requirements for the number of members or the composition of the governing board. For

example, New York State Nonprofit Corporation law requires a minimum of three individuals on a board of directors (NPC Article 7 Sec 702) and the 1992 amendments to the federal Rehabilitation Act requires that the governing body of Independent Living Centers be comprised of a majority of individuals with significant disabilities. (Title VII, Part C, Sec 725 (c)(2)) Funding sources may also require that the board be comprised of a minimum number of members from the population that is being served. In any case, the governing body is the group of individuals who are responsible to set policy and direction for the organization and to hire and evaluate the chief executive. From a stakeholder perspective, the more independent the member, the more objective that member may be.

In addition to providing information on governance, the summary section requires the total number of volunteers as well as employees. This information is beneficial on a global basis in order to monitor the growth of the nonprofit sector as a whole. Previous versions of the 990 indicated only the number of employees on the organization's payroll on a certain date and did not ask for the number of volunteers. The inclusion of totals will be beneficial when comparing similar organizations. Specifically, it helps identify those organizations that rely heavily on a volunteer base to provide direct services, for example; an organization that provides meals for shut-ins

New to this form, and beneficial for users of the statements, is that it requires information to be provided from the prior year as well as the current year. This information may reveal a decline, for example, in program service revenues, in which case the user can

look at Part III, line 3 to see if the organization indicated it ended a program or otherwise made significant changes.

Program revenue continues to be detailed in Part VIII, Statement of Revenue, and the summary page includes only the amounts received from contributions and grants, program service revenue, investment income, and selected other revenues. Lines 7 (a) and (b) indicate the gross and net unrelated business income of the organization. Only recently has the 990-T been open for public inspection. Form 990-T, Exempt Organization Business Income Tax Return, is the form on which the organization reports its taxable income derived from a business activity unrelated to its mission. This information is invaluable to stakeholders. Based on the dollar amount of unrelated income, users may determine whether the exempt mission continues to be the organization's primary focus or, alternatively, if taxable endeavors are now overshadowing that mission. Of course, as with any analysis, this information must be viewed in light of all of the facts and circumstances. For example, an organization may have very high unrelated business income, but that income may support the majority of the program services provided by the organization in carrying out its exempt mission.

Selected expense information is also included in the summary and the breakdown of expenses by program, management, and fundraising is detailed in Part IX, Statement of Functional Expenses. In addition to listing the amounts paid out by the organization as a grant and amounts paid to or for members, the summary itemizes salaries and benefits, professional fundraising expenses, and other expenses. The organization's surplus or

deficit has been moved from the previous form's net asset section and is completed as the last entry in the expense section. Perhaps it may have been even more beneficial to stakeholders had this information been delineated into a stand alone section so as to be more readily apparent when viewing the overall summary of the organization.

The Part I summary continues with a section with the total of assets, liabilities, and net assets or fund balance. Immediately following this information is Part II with the signatures of the organization's officer and paid preparer's information. One item of concern, is the fact that these forms are published on websites, either the organization's own or a national one such as Guidestar, and now display the actual signature of the individuals executing the form – leaving the door wide open for unauthorized use of their signatures.

Part III remains as the Statement of Program Service Accomplishments and starts with the mission statement followed by questions indicating whether there are new programs or changes to existing programs. One welcome addition to Part III is its inclusion of revenue and expenses for its three major programs. Although this is beneficial to the user who will potentially contribute to the organization, this information must be viewed with caution. A major program may continually run a deficit due to the very nature of the program, but, if it significantly contributes to the organization's primary mission, then the organization may elect not to end that program. Organizations who do not receive adequate funding to fully support an individual program will need to be more cognizant

of how they allocate expenses across programs in order to provide users with an accurate picture of each program's sustainability.

In order to cure the haphazard and illogical design of the old form, Part IV Checklist of Required Schedules asks a series of questions which help determine which of the 16 schedules needs to be completed and submitted along with the core form. The majority of the information on the new schedules was included in previous versions of the 990 but much of it was lost by being embedded in the core form. The new schedules break the information out in a more organized fashion and enhance transparency by allowing for greater detail.

Part V, Statements Regarding Other IRS Filings and Tax Compliance asks a series of questions related to normal operating procedures for an organization. In particular, new to the core 990 form, are questions relating to filings for employee tax payments, W2-G for gaming, and Form 1098-C for contributions of vehicles. This section also includes a number of questions related to donor advised funds.<sup>2</sup>

Also new to the 990 is Part VI, Government, Management, and Disclosure, which requires reporting regarding governing body composition and governance and disclosure policies and practices. There is a statement next to the title indicating that “[s]ections A, B and C request information about policies not required by the Internal Revenue Code.”

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<sup>2</sup> A donor advised fund is a separate fund or account held by a controlling organization in the name of a donor who has or expects to have an advisory role in how his or her contribution will be distributed.

This statement may be misleading inasmuch as an organization might believe that it does not have to provide the information requested when in fact it is required to do so.

Section 6033(a)(1) of the Internal Revenue Code requires exempt organizations to file an annual return and to state “specifically the items of gross income, receipts, and disbursements, *and such other information* for the purpose of carrying out the internal revenue laws *as the Secretary by forms or regulations prescribe.*” (emphasis added).

Therefore, the taxpayer is required to answer the questions on the Form 990—even if the Internal Revenue Code does not require the specific information that is requested—by virtue of the fact that the information is requested on the form. “Congress has given discretion to the Commissioner to prescribe by regulation forms of returns and has made it to the duty of the taxpayer to comply.” (Comm’r v. Lane Wells Co., 1944)

In general, the questions in Part VI examine the relationships between directors and officers and ask for information relating to changes in the organization since the last 990 was filed. One item of particular interest is a question asking whether the 990 form was reviewed by the governing body prior to filing, in which case the organization must describe that review process in Schedule O, Supplemental Information to Form 990. This question is interesting from a stakeholder perspective since the 990 is not an audited form and can be, and has been, prepared by an employee of the organization, or even the treasurer of the board of directors. Not all nonprofit organizations are required to have a financial statement audit. Outside of receiving financial statements throughout the year, how extensive should this review process be? The question asked on the 990 delves into

whether there was a review but it fails to address whether the governing body has the knowledge or experience to conduct an adequate review.

Part VII consolidates a number of sections from the prior form and lists compensation of officers, directors, trustees, key employees, highest paid employees, and independent contractors. Organizations are now able to report compensation that was issued to these individuals by the organization itself or a related organization and has been reported on either a form W-2 or 1099. Compensation to former officers, key employees, or highly compensated persons does not need to be reported unless these individuals received \$100,000 or more. Compensation to former directors or trustees needs to be listed if they received \$10,000 or more. In general, directors or trustees serve on a voluntary basis and there should only be minimal compensation as reimbursement for expenses paid on behalf of their work for the organization. On occasion, it is not unusual for a director or trustee to act as the chief executive officer on an interim basis while the organization experiences a vacancy. In that case, a more significant reimbursement may be warranted.

Part VIII is the revised Statement of Revenue and is now broken down into three distinct sources of funding: contributions, gifts, and grants and other similar amounts. This section of the 990 is a combination of what appeared previously in Part I and Part VII of the old form. While program service revenue continues to be itemized, the new form does not require a break down of the amounts received from Medicare/Medicaid, fees and contracts from government agencies, and membership dues and assessments.

Part IX is the Statement of Functional Expenses and includes a revision of the specific line items to be reported. New to this section is a line for grants and assistance to governments, organizations, and individuals outside of the US. The line item for compensation for former officers, directors or key employees has been eliminated. If expenses do not fall into a specific line item, there still is a place to list them separately, however any expense that is grouped and labeled as “miscellaneous” may not exceed five percent of total expenses. The intent of these changes is to allow for greater transparency of the organization. However, even though there has been discussion regarding nonprofit organizations using their exempt status to fund questionable activities outside of the United States, this line item would also allow the stakeholder to determine the extent to which international organizations are spending their contribution locally and globally.

Part X, Balance Sheet, remains relatively the same as the prior form. Disappointingly, this form combines Pledge and Grants Receivable. Since an organization may have considerable amounts due from either source, users will no longer be able to determine whether the amount shown is to be received from contributors in the form of a pledge or a governmental agency as a contracted grant. This is also surprising in light of an apparent emphasis on reporting amounts spent on professional fundraisers. Also disappointing is that the receivables are all reported on a net basis. Although this is similar to corporate returns, the amount outstanding for the receivable versus the corresponding uncollectible amount would provide a better understanding of how effective the organization is in collecting its receivables.

The core form ends with Part XI, Financial Statements and Reporting. This section starts with the accounting method used that previously was indicated in the identifying information section of the previous version of the 990. It also asks whether the organization's financial statements were compiled, reviewed or audited by an independent accountant. If they have been, the form then asks if there is a committee that assumes responsibility for oversight of the audit, compilation, or review and also selects the independent auditor.

### **HIGHLIGHTS OF SELECTED SCHEDULES:**

Of the 16 possible schedules that an organization may be required to complete, the four that were of particular interest are Schedules G, H, J, and O. All of these include new or expanded information compared to the information reported on the previous version of the 990.

Schedule G, Supplemental Information Regarding Fundraising or Gaming Activities, is to be completed by organizations that receive more than \$15,000 from fundraising events or gaming activities or have paid more than \$15,000 to professional fundraisers. Part I of the form starts by asking for the types of activities used to raise funds, such as mail or phone solicitations. This is followed by the amounts paid to professional fundraisers and includes the related information related on the gross receipts and amount retained by the fundraiser. There is no rule of thumb as to the ideal percentage of funds raised that should be turned over to the hiring organization. Of course, the higher the better -- but, some

very small organizations view any dollar amount they receive net of fundraising expenses as a benefit, especially if these organization have no ability to fundraise on their own.

Schedule H, Hospitals, along with an accompanying worksheet, is a brand new schedule that is required of certain healthcare organizations, including hospitals. The schedule requires reporting on charity care, community benefit, billing and collection practices, and information on joint ventures. It allows the organization to describe its exempt mission and requires it to explain its community benefit activities, such as community health improvement services as well as cash or in-kind contributions to community groups.

Schedule J, Compensation Information, is an expansion of Part VII of the core form. Organizations are required to complete this schedule if they reported information on any former officer or key or highly compensated employee who received compensation of \$100,000 or more and former directors or trustees who received \$10,000 or more in compensation. There are questions related to providing for first-class or charter travel, travel for companions, or personal service requiring the organization only to provide relevant information but does not require the dollar amount spent to be disclosed.

As expected, Schedule J asks for information related to the determination of the CEO/Executive Director's salary. In addition to asking whether the organization used independent compensation consultants or compensation surveys, there is a question as to whether the Form 990 of other organizations was used. This question is relevant in light

of the IRS concern over excessive compensation. In a June 2004 hearing before the Senate Committee on Finance on charitable giving problems and best practices, Mark W. Everson, Commissioner of Internal Revenue stated:

Neither a public charity nor a private foundation can provide more than reasonable compensation. Reasonable compensation is determined with respect to the market value of the services performed and depends upon the circumstances of the case. *In general, reasonable compensation is measured with reference to the amount that would ordinarily be paid for comparable services by comparable enterprises under comparable circumstances.*

Section 501(c)(3) provides that the assets of an organization cannot inure to the benefit of private shareholders or individuals. If an organization pays or distributes assets to insiders in excess of the fair market value of the services rendered, the organization can lose its tax exempt status. Moreover, insiders of public charities and of private foundations are subject to excise taxes on any overpayments they receive. Although an overpayment to an insider of a public charity could result in a revocation of tax-exempt status, section 4958 of the Internal Revenue Code (Code) provides an intermediate sanction that ameliorates that result in many cases. Under section 4958, an excise tax can be imposed on the insider who received the overpayment and on certain managers who knowingly approved the overpayment.” (Emphasis added) (IRS, IR-2004-81, 2004)

Also relevant are the questions requesting information on compensation for any officer or director that was contingent on either revenues or net earnings for the organization filing the 990 or any related organization. Important to the stakeholder is whether the CEO/Executive Director’s entire compensation was based on either revenue or net earnings. In this case there may be the temptation to misrepresent the financial position of the organization by overstating the earnings or understating the expenses. Stakeholders also need to view the information when partial compensation is based on revenue or net earnings. It is not unusual for a CEO/Executive Director to receive an increase only if there is an increase in the organization’s performance or if the organization has a surplus. Hopefully there is enough information provided by the organization in its description to

allow the stakeholder to compare the relationship between the compensation and revenue or earnings.

Part II of Schedule J provides for further break down of an individuals salary and nontaxable benefits along with the compensation reported in the 990 of the prior year.

There is also the ability for organizations to complete Schedule O, Supplemental Information to Form 990, which is to be utilized by organizations who want to provide additional information as support to the form that is not covered under another schedule. It is expected that this form will be completed by organizations instead of the individual statements that were attached to the forms.

### **THE REVISED 990 – IS IT AN ATTEMPT AT A SARBANES-OXLEY ACT FOR NONPROFIT ORGANIZATIONS?**

Although nonprofit organizations are exempt from regulation through the Sarbanes Oxley Act, health care facilities have been practicing Corporate Compliance<sup>3</sup> since the late 1990's. Since Sarbanes-Oxley, many nonprofit organizations have voluntarily elected to implement parts of the Act that are able to be applied to exempt organizations. As mentioned at the beginning of this article, the 990 revision was developed in response to the IRS's concerns about transparency and accountability. The IRS observes that “a well-governed organization is more likely to be tax compliant. As a result, the questions . . . included have a two-fold purpose—to provide some insight into an organization's practices as well as to educate organizations about such practices . . .”(IRS, Form 990

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<sup>3</sup> Corporate Compliance guidance is issued through the Department of Health and Human Service Office of Inspector General and contains information regarding the prevention and detection of financial fraud and abuse.

Redesign, 2007, p. 3) The form 990 may not only be helpful, then, in revealing potential compliance issues for organizations that are not well-governed, but it may encourage an organization that does not currently “comply” with the policy questions being asked to consider taking measures for doing so.

Throughout the document and schedules the IRS asks for information that appears to be taken directly from the Sarbanes Oxley Act. For example, in Section 302 of Sarbanes Oxley the signing officers have to certify they have reviewed the financial reports. As mentioned earlier, with the new revision of the Form 990 the governing body of the nonprofit now has to indicate whether it has reviewed the 990 prior to filing. The Sarbanes Oxley Act also requires “whistleblower protection”. Similarly the 990 asks whether the organization has a written whistleblower policy, and in fact nonprofit organizations are subject to these requirements based on federal whistleblower protection laws found in See 18 U.S.C. sections 1513(e) and 1519. The same corporate influence is also found in the 990 through questions related to conflict of interest, document retention and destruction policies, and executive compensation.

While all of this is very good and should provide confidence that public money and private contributions are well spent, the majority of questions related to governance and policies do not appear on either the 990 E-Z or 990 Postcard, meaning only organizations with larger dollars in revenue and assets will be required to respond to them. This is troubling because many of the larger organizations already have these policies in effect or can readily implement them. It is the smaller organization that is more vulnerable to noncompliance simply because it does not have the resources or specialized knowledge to

recognize that these policies should be in place. Hopefully, after the IRS has experience with the revision for larger organizations, it will implement a checklist of good practice for small organizations as well.

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