



Form 990: Tips for Telling the Truth

The IRS Form 990 has been derided as a burdensome necessary evil. But it can also be your ally. For the large majority of organizations who are required to file the Form 990 each year to maintain tax-exempt status, completing the Form 990 is as integral to nonprofit life as answering the telephone. And, as when answering the telephone, how you complete the task conveys an image of your organization. If your organization depends on contributions to stay afloat, the Form 990 must also be filed with the Attorney General to maintain your state registration to solicit contributions.

WHY it matters: the Form 990 is no longer a document that languishes in government file cabinets. Instead, it has become a widely available commodity that is, in fact, reviewed by donors, reporters, competitors and curious members of the public. Not only must each organization make the Form 990 available to the public upon request, it has become widely available via the Internet at www.guidestar.org. Guidestar posts the IRS master file of tax-exempt charitable organizations in an easy-to-use database. If you are a charitable organization, an image of your Form 990 is likely on Guidestar.

HOW it matters: the Form 990 provides savvy organizations an opportunity to demonstrate responsible stewardship of charitable donations and a description of accomplishments. Organizations that persist in viewing the Form 990 as merely a tax return do so at their own peril. A lack of attention to the public nature of the Form 990 may inadvertently convey a negative impression of your organization. In short, your Form 990 serves as a barometer for your credibility.

The goal of the Minnesota Nonprofit Accountability Collaborative is to help preparers and nonprofit managers improve their Form 990 reporting. In turn, we believe that accurate reporting will allow organizations to present their activities and results in the strongest way to the public *and* to regulators.

Four of the most commonly misreported sections of the Form 990 are:

1. Program Service Accomplishments.
2. Statement of Functional Expenses.
3. Fundraising Expenses.
4. Insider Transactions.

This document provides a brief discussion of what you should know about each of these sections.

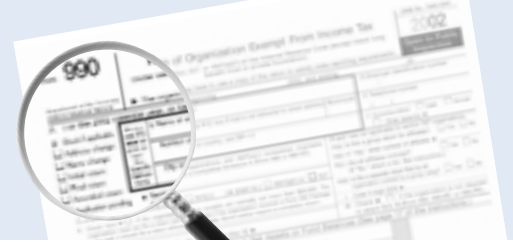
Program Service Accomplishments

Part III on page 2 of the Form 990 presents an organization with the opportunity to describe in detail its program service accomplishments. Too few organizations take this section seriously, yet this is the one part of the Form 990 that gives the reader a chance to understand what your organization is all about. Don't miss the chance to proudly describe your success and results of your programs for the reporting year.

Many organizations only report a cursory description of their programs and the dollar amount spent. For instance, "Job training—\$387,542," rather than "Trained, coached and successfully placed 182 underemployed, low-income individuals in new jobs at higher wages." Many organizations duplicate the same language in this section from year to year. This practice fails to comply with IRS instructions and amounts to false reporting if changes in programs are not reflected.

Reality checks

- Both the instructions to the Form 990 and the header at Part III ask the reporting organization to state accomplishments in numerical quantities, for instance, the number of clients served, number of classes taught, or number of meals served. Organizations with program achievements that are not measurable must provide an explanation.



- Organizations are required to describe both specific programs and the results of those programs. The instructions say to use the following format—
 - ✓ Describe/discuss the four largest programs for the year in order—starting with the largest and moving down in size. Organizations with more than four programs should summarize additional programs in line (e).
 - ✓ Charitable organizations exempt under IRC § 501(c)(3) and social welfare organizations exempt under IRC § 501(c)(4) must also report the amount of money expended as program expense for each of the reported program accomplishments.
- Small organizations may find reporting in this detail daunting at first, but it will get easier to rise to the challenge as they develop appropriate record keeping systems.
- Use quantitative measures of results to describe program outcomes.
- If you find the space provided in Part III of the Form 990 inadequate, attach additional information. But keep it concise. Do not attach newsletters and descriptive information that is not specifically responsive.
- Be consistent. Take care that program names and accomplishments reported on the Form 990 in Part III are the same as that reported in the audited financial statements and any other annual reports. The Charities Review Council of Minnesota standards require this consistency.

Tips

1. Avoid merely listing project names followed by dollar amounts.
2. Never copy last year's descriptions.

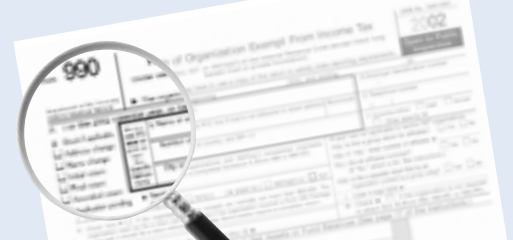
Statement of Functional Expenses

Part II, the Statement of Functional Expenses, is the four column section in which you are asked to report in Column A types of expenses such as salaries, rent, printing, postage, grants made, and telephone expenses and then divide and assign those costs to the functions of Program, Management and General and Fundraising in a matrix format. The opportunity presented here is to show donors and the public that your organization is devoted to furthering the mission of the organization and has properly spent available funds in a manner that best advances the organization's purposes.

Program expenses are those costs directly related to the charitable purposes and programs conducted by the organization. For instance, program expenses might include such items as the salary of the program director, the cost of the dedicated "1-800 helpline," and printing costs for public educational material. You are also permitted to allocate to the program function indirect costs such as the appropriate share of the rent, utilities, photocopier, computer costs, postage, telephones and other expenses needed to run the program.

Management and general expenses include those incurred in the oversight and business management of the organization, general recordkeeping, budgeting, insurance, accounting/auditing, personnel administration, financing and related administrative activities.

Fundraising expenses are those incurred in publicizing and conducting fund-raising campaigns, maintaining donor mailing lists, conducting special fund-raising events, preparing and distributing fund-raising manuals and materials, and soliciting contributions from individuals, foundations, and corporations.



Common problems to avoid

- Many organizations fail to enter expenses on the lines provided on the Form 990. Some ignore the instructions and lump a large portion of costs on Line 43 “Other” expenses with a schedule attached. This forces the reader to search for the information and may give the impression that the organization is trying to hide expenses or that it does not care enough to complete the Form 990 properly.
- Assigning expenses to the functions of program, management and general and fundraising can be difficult for many organizations. Many groups do not have a good understanding of how to allocate expenses and don’t keep the records necessary to perform accurate allocations.

Reality checks

- This section of the Form 990 is primarily for state charity regulators, but negative publicity and public pressure have made compliance with this requirement more of a priority for the IRS as well. State laws commonly require a charitable organization to provide a functional expense statement showing how much money was spent on the charitable purpose and on the administrative and fundraising expenses. Thus, all charities must learn how to properly allocate expenses across the three functional expense categories. This information is traditionally viewed as especially helpful to donors and the public at large.
- How does an organization ensure that the Statement of Functional Expenses is accurate? The only way to ensure accurate reporting is to create an internal ledger that includes a chart of accounts to record expenses in each of their natural classes (for instance, insurance or salaries) as well as to allocate each expense to the appropriate functional expense

category on an ongoing basis. Employees and others who report their time and expenses must be appropriately trained so that they can properly allocate their time and purchases to the appropriate class and category. For more help, please review the Minnesota Nonprofit Accountability Collaborative’s “Form 990: Tips for Recordkeeping.”

Fundraising Expenses

Raising money to conduct your programs is necessary and vital to the success and long term viability of the organization. Money does not fall down from the heavens and we all know that it costs money to raise money. You can’t send a grant proposal or an appeal letter without spending time to write it, buying paper on which to print it and postage with which to mail it. Benefactors from last year may have moved on to supporting a different cause or simply moved. It’s important to keep looking for new sources of financial support. And you must document your expenses accurately for these activities.

Organizations fear they will be judged harshly for spending money on fundraising. The key is to have an effective fundraising strategy and to spend what you must on those activities that work best for your organization. But don’t disguise an ineffective fundraising effort by failing to disclose the costs. The opportunity presented is to demonstrate that the fundraising expenses are reasonable in light of various factors, including the organization’s size, youth or maturity, types of programs, diversity (or lack thereof) of funding sources, and the “popularity” of its cause. What constitutes reasonable fundraising expenses is somewhat in the eye of the beholder. But it’s wise to be aware of donor and public expectations and do your best to meet them.



Common problems to avoid

Perhaps the number one complaint of the IRS, state regulators, and newspaper reporters looking at Forms 990 is that organizations understate or falsely report fundraising costs. It is often the case that organizations report \$-0- in fundraising expenses while raising hundreds of thousands of dollars from grant writing done by paid staff, or sponsoring sales events specifically to raise money for the organization but failing to reflect the expenses incurred as fundraising.

Reality checks

- Truthful recording of fundraising expense(s) requires adequate and fair documentation. Reporting disproportionately high fundraising expense may alienate potential or current donors, but reporting unrealistically low fundraising expense is a red flag for regulators and watchdog groups and can lead to accusations of misrepresentation or even fraud. As with all your reporting, let truthfulness be your guide in reporting fundraising expense.
- Special event reporting on the Form 990 can be confusing. Direct event expenses (for instance, the hall rental and catering costs for the annual banquet) are reported on Line 9b and deducted from the gross revenue on Line 9a. However, event marketing costs may not be deducted and must appear on the functional expense statement as fundraising expenses. Refer to the instructions.
- The expense of soliciting donations from supporters is a fundraising expense and must be reported in column D. This includes the costs of soliciting volunteers. Also, costs incurred in writing grants or asking for membership dues (to the extent that such fees from members do not “buy” tangible benefits or perks available from the organization) are a fundraising expense.

Tips for identifying fundraising costs

1. Allocating expenses for personnel starts with a good job description. If the executive director spends 25% of his or her time raising funds, it should be so reflected in the job description and then checked periodically against time and activity reports to see if the number remains valid. Track all labor including associated overhead costs. Document and record both direct fundraising expense (for instance, printing and postage) and indirect expenses, such as the time spent supervising the development director. Document how and on what basis fundraising expenses are assigned.
2. Identify and allocate printing, postage, telephone, computer and other materials costs for fundraising activities. Make sure your chart of accounts or bookkeeping system captures, codes or flags these costs as fundraising expenses.
3. Fees charged by outside professionals hired to consult on fundraising or to design marketing materials for a solicitation campaign must be reported as fundraising expenses on Line 30. Amounts greater than \$50,000 must also be reported on Schedule A.
4. The gross amount of contributions raised by an outside professional fundraiser must be reported on Line 1 and the fee retained by or paid to the fundraiser must be reported on the Form 990. Some organizations have reported only the net amount received by the charitable organization, hiding the true cost to raise those funds and presenting a distorted financial picture to donors, regulators and the public. In addition to the IRS reporting requirement, the information must be accurately reported on the Attorney General’s annual report.



5. Costs connected to collecting pledges and all advertising expenses associated with solicitations for support, whether in dollars or time, are fundraising expenses.
6. When a charity simultaneously communicates an educational and program message with an appeal for financial support, the organization may be permitted to allocate a portion of the costs to the program function and a portion to fundraising expenses. Under the accounting rules, the program message must include a request (or call to action) that the recipient of the message do something besides giving a donation to support the organization's mission.

Insider Transactions

Financial transactions that take place between the organization and its directors, officers, trustees, key employees and members of their families present a serious risk to the organization if done improperly. The most important recent change in federal tax-exempt law occurred when the 1996 Taxpayer Bill of Rights 2 added section 4958 to the Internal Revenue Code. This provision adds intermediate sanctions, or penalties, as an alternative to revoking the tax-exempt status of an organization when private persons improperly benefit from transactions with a nonprofit organization. Prior to the adoption of intermediate sanctions regulations, the only remedy available to the IRS was to revoke the organization's exemption when a transaction resulted in private inurement or private benefit. Intermediate sanctions penalize the person(s) rather than the organization.

Section 4958 applies to all organizations exempt under section 501(c)(3) other than private foundations, and to those exempt under section 501(c)(4). The Form 990 includes questions that enable the IRS to identify transactions between the organization and insiders.

Schedule A, Part III, Statements About Activities, question 2, asks whether the organization directly or indirectly engaged in any of the following acts with trustees, directors, officers, creators, key employees, substantial contributors, or members of their families, or with any taxable organization with which any such person is affiliated with as an officer, director, trustee, majority owner or principal beneficiary:

- Sale, exchange or leasing of property.
- Lending of money or extension of credit.
- Furnishing of goods, services, or facilities.
- Payment of compensation (or payment or reimbursement of expenses if more than \$1,000).
- Transfer of any part of its income or assets.

If the answer to any of the above questions is “yes,” the organization must attach a schedule explaining the transaction or exchange.

Part VI of the Form 990, line 89b, asks if the organization “engaged in any section 4958 excess benefit transaction during the year or did it become aware of an excess benefit transaction from a prior year?” If the answer is “yes,” an explanatory statement must be attached.

Tips

1. While a full discussion of intermediate sanctions is beyond the scope of this presentation and brochure, you are encouraged to include training on the subject for all new board members and to consult with an attorney when needed. There are many sources of information and advice on the topic. For instance, the chief regulator of tax-exempt organizations at the Internal Revenue Service, Steven T. Miller, has written a plain-language explanation of some of the federal rules for charities that are trying to make sure that they are not paying excess compensation to their top officials. It is available online at: <http://philanthropy.com/free/update/2001/05/2001051401.htm>



2. In addition to the federal intermediate sanctions regulations, under Minnesota law directors of your charitable organization owe a duty of loyalty to the corporation. This means that directors should avoid using their position in a manner that results in personal benefit or monetary gain for themselves or members of their family. One way to manage potential conflicts of interest is to have a written conflict of interest policy that promotes full disclosure of any financial transaction between an insider and the nonprofit organization. Under certain circumstances, a transaction or contract between a nonprofit organization and its director or an organization in which the director has a material financial interest may be legal. The key is that it must be in the best interests of the organization after full disclosure to the board.

3. Feel free to obtain and distribute the Attorney General's booklet on fiduciary duties to the board of directors of your organization. The booklet is on the Attorney General's website at www.ag.state.mn.us and paper copies are free.

Compensation

If someone chooses to look at your organization's Form 990, there is one section that will not likely be overlooked. The compensation section of the Form 990 is often of great interest, if only for the sheer openness of what we typically consider private or confidential information.

In Part V of the Form 990 exempt organizations must identify directors, trustees, officers, and key employees and report amounts paid to each or for their benefit during the reporting year. A key employee is someone who holds the authority to control the organization's activities or finances, such as the executive director, chief executive officer or chief financial offi-

cer. Each person in this capacity must be listed whether paid or not and the number of hours per week devoted to the position. The required break-outs include reporting all remuneration paid or incurred, using the following categories:

- Compensation, including amounts reported on the W-2.
- Expense account and other allowances.
- Contributions to employee benefit plans and deferred compensation.

Line 75 of the Form 990 also asks if any officer, director, trustee, or key employee received aggregate compensation of more than \$100,000 from your organization and all related organizations, of which more than \$10,000 was provided by the related organizations.

Conclusion

This summary only touches on some of the most visible areas of the Form 990. There are many other sections and questions that are difficult to complete and require more discussion and explanation. If you are preparing the Form 990 yourself, you are encouraged to read the Form 990 instructions, use Form 990 tax preparation software, consult as needed with a tax professional with Form 990 experience, and consider using reference material specifically for preparing the Form 990.

Disclaimer

This brochure is intended to give you general information about how to complete the IRS Form 990. The information is not intended as legal or accounting advice but as a guide to addressing some frequently misunderstood issues. Referring to the IRS Instructions or consulting a private accountant or attorney can best answer questions related to your specific situation.