

## Inside Form 990

*By Peter Swords*

*The annual IRS return for nonprofits reveals a lot about your organization. You can discover the same information about other groups by examining their returns.*

As most nonprofit managers probably know, the Form 990, "Return of Organization Exempt From Income Tax," is a report that nonprofits file annually with the Internal Revenue Service (IRS). An organization must file the form if it "normally" receives more than \$25,000 a year—that is, if its gross receipts for the immediately preceding three tax years average \$25,000 per year or more. Organizations with gross receipts of less than \$100,000 and total assets less than \$25,000 at the end of the year may file a short-form Form 990 called Form 990-EZ. Organizations that are classified as private foundations are required to file a Form 990-PF. Generally churches are not required to file a Form 990 (although some churches file voluntarily).

In addition to being the main IRS reporting form for nonprofits, Form 990 is also the basic component of the annual report that must be filed with a large number of state offices that regulate charitable solicitation. Many states require supplemental reports as well as the Form 990.

The Form 990 serves two essential purposes. First, it provides information that helps government agencies enforce the laws that govern nonprofits. For example, it helps regulators learn whether groups have been spending their funds in a way that might cause them to lose their charitable and tax-exempt status. Second, the Form 990 provides a great deal of financial information about the filing organization's financial condition, about its financial strength or weakness and about such things as the sources of its income.

The Form 990 is a very public document—and it is becoming more public. Today an organization's Forms 990 for the past three years must be shown to anyone who wants to see them. In addition, copies of these forms must be given to anyone who requests them (either in person or in writing) and who pays a reasonable fee—\$1 for the first page and 15 cents for every page thereafter plus postage, if applicable. Most Forms 990 beginning with the year 1997 are being posted on the World Wide Web by the National Center for Charitable Statistics (<http://nccs.urban.org>) and by Guidestar ([www.guidestar.org](http://www.guidestar.org)).

This means that your organization's Form 990 is already available to anyone who wants to examine it. It also means that you are able to inspect the 990 returns of nonprofit organizations similar to yours. That can help you understand how like-minded or competing groups operate. You may use the information in 990s to gather your own salary comparability studies for top management, or to learn about other groups' funding sources and board membership.

While much can be found out by examining an organization's Form 990 for one year, a great deal more can be learned by looking at its Forms 990 for three years. For example, if an organization reports the receipt of a considerable amount of income for three years from a particular source, such as program service revenue, it may be considered likely that the organization will continue to receive funds from this source in the future.

Here's some of what your own Form 990 tells a reader about your organization—and what you can glean about other organizations by examining their 990 returns:

### **How Much Income Did the Filer Receive, and From What Sources?**

A principal value of studying the financial information found in the Form 990 is to help you arrive at informed conclusions about the filer's ability to garner financial support in the future and thus to be able to continue its operations. Part I (Revenue, Expenses and Changes in Net Assets) contains much financial information that can help you in this regard.

Line 12 can give you an overall idea of the level of the filer's income-generating potential for the year being reported on. If you have access to the filer's Forms 990 for the past three years and you observe that for each year its Line 12 remains at the same level, you might conclude that it will be able to generate a similar amount in the immediately ensuing period. If the filer reports increasing amounts of revenue for the three years, you might conclude that its ability to generate income is growing stronger. A contrary conclusion may be reached if its total revenue decreases over the period. But you would need to know a great deal more about the filer's circumstances to be able to draw firm conclusions.

The Revenue section of Part 1 is broken down among 11 different sources of income (e.g., contributions, fees for services, dividends, etc.) You may be able to reach some interesting conclusions about the nature of a filer by examining

the sources of its income and their relative amounts. For example, some nonprofits may receive most of their funds from gifts. This income would be reported on Line 1 (Contributions, gifts, grants and similar amounts received). In contrast, some nonprofits receive most of their funds from charging fees for services. This income would be reported on Line 2 (Program service revenue). If the distinction between what may be called donative nonprofits (those that rely primarily on contributions) and what might be called entrepreneurial nonprofits (those that rely primarily on charging for their services) is relevant to you, learning about the relative amounts of the income that the filer receives from these different sources will be significant.

Program service revenue (Line 2) may include income from an unrelated business activity—that is, an activity that is not related to the filer's exempt purposes (other than in providing income to support such purposes). A reader of the filer's Form 990 can find out about unrelated business income that the filer may have generated by examining Part VII (Analysis of Income-Producing Activities) on page 6 of the Form 990.

Line 2 income also includes income from government contracts. A fair number of nonprofits get nearly all their support from government contracts. If this fact is important to you, you can learn this from reviewing Part I (and Part VII) of the Form 990.

Finally, it may be significant that a filer gets most of its income from membership dues reported at Line 3 (Membership dues and assessments). Income reported on Line 3 is for dues that members pay in return for benefits they receive from the filer. If the filer gets most of its income from Line 3 membership dues, that too may shed some light on the nature of the filer.

### **How Did the Filer's Total Expenses Break Down Among Program, Management, and Fundraising Expenses?**

The total expenses reported at Line 17 is one way to get a quick idea of how extensive a filer's activities are. In addition, the Expenses section of Part I permits the reader of a Form 990 to quickly find out what proportions of total expenses are made up by the three functional categories of expenses that are elicited by the form, namely, program (Line 13), management (Line 14) and fundraising (Line 15). Readers of the Form 990 may want to assure themselves that the filer is spending most of its resources on program matters and not on management or fundraising. By simply dividing a particular functional expense total (say, program services) by total expenses,

one can learn what percentage of total expenses has been spent on that function.

Program services expenses are those incurred in carrying out the organization's mission. Thus, expenses incurred by a social services organization in paying its social workers for delivering services to its clients would be program services expenses. Similarly, payments made by a performing arts organization to produce a play would be program services expenses. For a 501(c)(3) group, the activities that these expenses support are usually the basis of the organization's tax exemption.

Management and general expenses are those incurred in connection with providing overall administration to an organization. The IRS's "Instructions For Form 990" indicate that management and general activities include such things as preparing for and holding board meetings, working on office management and personnel problems, and accounting and investment activities. The Instructions also make clear that the expenses incurred in carrying out activities such as the supervision of program services or fundraising are included under those categories and are *not* included under "management and general." Thus, expenses incurred in preparing for and attending a staff meeting called to plan for a future program initiative or to assess present program activities would be part of the program services category (Line 13) and not the management and general category (Line 14). For many small organizations with small staffs, it is likely that management and general expenses will be low, since, in these groups, most of management's time is spent on supervising programs and fundraising, and relatively little time is spent on overall management activities.

### **Who is on the Group's Board and How Much Does Top Staff Get Paid?**

Part V (List of Officers, Directors, Trustees, and Key Employees) on page 4 of the Form 990 contains information of considerable interest. The name of each board member is listed. (The address of each board member is also given, but in many cases the address will be the same as the address of the filer.) Of course, most board members do not receive compensation for their work as board members, but if they do receive compensation for their duties, the amounts are reported here.

If the reader of a Form 990 knows something about some or all of a filer's board members, their identity can be significant information since the quality

of an organization's board members may reflect on the organization itself. Even if the reader knows little about the board members, if it appears from their last names for instance that several or many board members are from the same family, this may be significant to a reader, since an organization that is essentially directed by a single family may be of a different nature than one that has broad public representation.

Part V also reveals names, addresses and compensation information of key employees. Key employees are defined by the Instructions as including a filer's "chief management and administration officials" including the filer's "chief financial officer and the officer in charge of administration or program operations ... if they have authority to control the organization's activities, its finances or both." While the term "key employees" is somewhat imprecise, it clearly includes an organization's executive director and its chief financial officer, if that person has control over the organization's finances independent of the executive director.

Part I of Schedule A elicits compensation of the five highest paid employees who are paid more than \$50,000 that are not listed in Part V. (Schedule A is a six-page supplementary information return that is filed along with the Form 990 by most organizations exempt under section 501(c)(3).) Thus, the Form 990 and Schedule A will report on the salaries of at least the top six managers of the filer, assuming that there are five employees after the key employees listed at Part V who make more than \$50,000. In some cases, a higher number will be reported—for example, when more than one key employee is listed on Part V.

Part V of the Form 990 and Part I of Schedule A require that the full compensation be given for each individual listed. For both Part V and Part I of Schedule A, column (C) calls for an individual's basic compensation; column (D) calls for deferred compensation and employee benefits; and column (E) calls for expense account and other allowances. A compensation package often includes many elements (base salary, bonuses, deferred compensation, benefits, etc.). These parts of the Form 990 have been drawn so as to pick up a person's entire compensation package. If the Form 990 has been filled out correctly, it will all be there.

Together, these two parts tell a lot about the salaries of many of the filer's highest paid staff members. This information may be of considerable interest. A reader may, for example, want to learn what persons in top management positions are being paid in organizations similar to one she is interested in (e.g., one she works for or serves on the board of). Or a reader may draw some

very preliminary conclusions about the quality of a filer's management from the level of salaries that are being paid. Or a reader may have ideas about how much it is appropriate for a nonprofit group to pay top management officials and want to compare a filer's compensation arrangements with what she believes are appropriate levels of compensation. She may conclude that such payments by the filer are too high or too low by her standards. Finally, a reader may discover that the compensation reported as being paid to a particular employee is not what she believes the filer in fact paid the employee, or that the compensation of the employee about whom the reader is concerned is omitted from the Form 990. This omission may raise questions in the reader's mind.

In cases where a filer may have paid certain employees compensation at unreasonably high levels, the payments might be found to be "excess benefit transactions" under section 4958 of the Internal Revenue Code. This would result in a tax being imposed on the employees who received the unreasonably high compensation (and in some cases upon the board members who approved the payments). Line 89b in Part VI on page 5 asks whether the filer engaged in any section 4958 excess benefit transactions during the year. If the filer answers "Yes," a statement must be attached explaining each transaction. If a filer has answered "Yes," here, a reader of its Form 990 may wish to find out as much as she can about the transaction.

Sometimes a top management official will receive some of her salary from an organization other than the filer, and that other organization is related to the filer. Knowing about such arrangements may be important for someone focusing on compensation. Line 75 at the bottom of Part V provides such information. It asks whether any officer, director, trustee or key employee received aggregate compensation of more than \$100,000 from the filer and any organization related to the filer of which more than \$10,000 was provided by a related organization. If the filer checks the "Yes" box, it must attach a schedule explaining the payment arrangements.

Some people may be interested in finding out more about the comparative compensation levels paid to various staff members (e.g., top management salaries as compared to those employees working at the lowest salaries). The Form 990 does not provide any direct information on this subject, but some very rough sense of such differences may be gathered by comparing the average salary of the filer's total staff to the salary levels reported at Part V and Part I of Schedule A. A roughly approximate idea of the average compensation of the whole staff can be derived by dividing the sum of Lines 25(A), 26(A), 27(A) and 28(A), which report total compensation paid to staff,

by the total number of employees reported on Line 90b. Some insight may also be drawn from the bottom of Part I of Schedule A which asks for the total number of employees paid over \$50,000.

Finally, a reader of the Form 990 may be interested in knowing about any relatively large payments made to those who serve as independent contractors to the filer, such as professional fundraisers or lawyers. Part II of Schedule A (Compensation of the Five Highest Paid Independent Contractors for Professional Services) on page 1 of Schedule A requires the filer to list the five highest paid independent contractors (whether individuals or firms) who received over \$50,000 for the year. The Instructions state: "Examples of such contractors include attorneys, accountants, doctors and professional fundraisers."

### **Did the Filer Engage in any Self-Dealing Transactions During the Year?**

The IRS and state charity regulators want to ensure that the assets of nonprofit organizations won't be improperly used. They want to prevent the improper transfer of those assets to private interests in circumstances in which these assets should have been used to further the exempt purposes of the organizations. An example of such an improper transaction might be the sale by a board member of property he owns to the nonprofit organization on whose board he sits at a price in excess of its fair market value. Another example might be the furnishing of services to a board member without charge or at a price below market value.

These transactions may be generally described as "self-dealing." (Thus, a board member in effect deals with himself when his board buys from him.) Line 2 of Part III (Statement About Activities) on page 2 of Schedule A elicits information about these transactions. Such transgressions should be of interest not only to government regulators but also to anyone who is concerned about the organization's well-being.

In cases where the transaction involves the improper transfer of a filer's assets to individuals for no apparent reason, it is also picked up by the Line 2 series of questions about transactions between the filer and directors, key employees and others who might control the filer. For example, Line 2a asks in effect whether any sale, exchange or leasing of property occurred between the filer and a board member, key employee, etc. There are five such

questions (Lines 2a-e). They are to be answered "Yes" or "No." If the answer to any question is "Yes," the filer is required to attach a detailed statement explaining the transactions.

Of course, in some instances, a self-dealing transaction can be for the benefit of the organization. For example, a board member of the filer may sell property to the filer at a price below its fair market value. Thus, just because a Line 2 question is answered "Yes," it does not mean that the filer engaged in an improper act. Before reaching any conclusions in this regard, a careful reader will review the filer's explanation in the attachment that relates to the question.

If no explanation is provided or if the explanation appears evasive, a red flag may be raised in the reader's mind. If the filer engaged in a self-dealing transaction knowing it was improper, it is unlikely that it would answer the relevant Line 2 question "Yes." since doing so would be tantamount to admitting it had done something improper. In some cases, a reader of the filer's Form 990 may know of a self-dealing transaction from sources outside of the Form 990. If such a reader observes that the filer answered the relevant Line 2 question "No," she will be alerted to a problem and may decide to explore the matter further with the filer, or the IRS or the relevant state charity regulator.

### **Does the Filer Lobby?**

A number of nonprofit groups advocate for changes in public policy and, as part of their advocacy efforts, engage in lobbying. The term "lobbying" refers to attempts to influence legislators (or those who work with them) to support or oppose the enactment of some legislation. It may be done by directly contacting legislators (direct lobbying) or by asking others to contact them (grass-roots lobbying). Organizations exempt under Section 501(c)(3) are permitted to engage in some lobbying, but if they do too much they may jeopardize their tax-exemption. Line 1 of Schedule A's Part III (Statement of Activities) asks whether the filer attempted to influence national, state or local legislation. If the filer answers "Yes," it must report the total of expenses incurred in connection with its lobbying activities and complete the relevant section of Part VI of Schedule A.

There are several reasons why a reader may be interested in learning whether a filer has engaged in lobbying. The reader may believe that groups

like the filer should in fact advocate for changes that will address the problems that caused its clients to need help. Or a reader might have quite different ideas, and believe that groups like the filer ought to steer clear of the political process and thus refrain from lobbying. In some cases, a filer may be a group that advocates for a position or positions with which the reader disagrees.

As suggested, Line 1 of Schedule A's Part III will indicate whether the filer engaged in any lobbying and, if so, how much it spent on such activities. More can be learned by examining Part VI on page 5 of Schedule A. Organizations complete Part VI-A (Lobbying Expenditures by Electing Public Charities) if they have chosen under section 501(h) to have the question of whether they have engaged in a permissible amount of lobbying decided by how much they spend on lobbying. Groups that have not so chosen will complete Part VI-B (Lobbying Expenditures by Nonelecting Public Charities). If a filer has completed Part VI-A, a reader, by examining this part, can learn the total amount the filer spent on lobbying (Line 38) and of this total amount, how much was spent on grass-roots lobbying (Line 36) and how much was spent on direct lobbying (Line 37).

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