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VIA E-MAIL TRANSMISSION

June 17, 2007

Lois G. Lerner
Director of the Exempt Organizations Division of the IRS

Ronald J. Schultz
Senior Technical Advisory to the Commissioner of TE/GE

Catherine E. Livingston
Deputy Associate Chief Counsel (Exempt Organizations)

Internal Revenue Service
Form 990 Redesign, SE:T:EO
1111 Constitution Avenue, NW
Washington, DC 20224

Dear Ms. Lerner, Mr. Schultz, and Ms. Livingston:

I am providing my comments regarding the Form 990 revisions proposed on June 14, 2007. This is an important project. Anyone who reviews the proposal will notice the significant thought and care that went into this phase of the project. I have my concerns and disagreements, but my comments are offered as constructive suggestions and observations.

A. **OVERARCHING PHILOSOPHICAL CONSIDERATIONS.** I have already seen comments from tax practitioners advising the Service to shy away from disclosure and focus on the Form 990 as a tax return. I do not find these comments surprising, but I do find them to be shortsighted, particularly to the extent that such comments are rooted in the belief that opaqueness and secrecy somehow serve the interests of tax-exempt organizations.

The Form 990 is best characterized as a tax return, but it is unique. Unlike other tax returns, it is subject to public disclosure pursuant to Section 6104 of the Code. When Congress enacted Section 6104, it clearly viewed the Form 990 as serving both the administrative needs of the Service and the public's interest in organizations that receive significant government subsidy in the form of tax-exemption, favorable bond financing, funding through tax-subsidized

contributions, favorable postal rates, exemptions from security law registration requirements, access to federal grant money, and many of the other benefits that come with charitable status.

The Omnibus Budget Reconciliation Act of 1987 ("OBRA 1987") greatly expanded public access to the Form 990 by requiring charities to make their Form 990s available to the public on request rather than requiring the public to obtain the forms from the Service. The legislative history to OBRA 1987 is clear in expressing congressional intent that the Form 990 be used by both the Service in administering the tax laws and the public in assuring accountability. Specifically, House Report 100-391 (1987) provides:

For example, the present-law disclosure procedure does not result in full and timely public disclosure of the activities of charitable organizations, as needed to facilitate accountability of such organizations to the public from whom they solicit tax-deductible funds. . . . In the case of charitable organizations, the committee believes that increased availability of information will help assure that the double tax benefits of deductibility of contributions and exemption from income tax are limited to organizations whose assets are devoted exclusively to charitable purposes, as required by the tax law. Also, because most such charities regularly solicit contributions or receive other support from the public, the public should have ready access to current information about the activities of these organizations...

Given this clear congressional intent, I hope that the Service will reject practitioner assertions that the Form 990 is merely a tax return and therefore its scope should be limited to numbers and answers to questions asking whether the organization has complied with specific Code sections. In rejecting this erroneous view, I hope the Service will remind these practitioners that both the public and the media have ready access to Forms 990 through GuideStar and the National Center for Charitable Statistics at the Urban Institute. In my experience, the first place virtually every reporter begins when investigating a charitable organization is GuideStar. Given that reality, charities and their advisors should welcome an expanded Form 990 which offers them the opportunity to better explain what otherwise might be raw and therefore potentially misconstrued information. In short, full disclosure is in everybody's best interests.

B. TOO MUCH RELIANCE ON INSTRUCTIONS. I had hoped that the revised Form 990 would be a self-contained form, with reduced reliance on lengthy instructions. Unfortunately that did not happen, and as the Service moves toward finalizing the Form 990, I hope the Service will reconsider the decision to place so much reliance on the instructions. Admittedly, completing Form 990 requires knowledge of both technical and complex concepts. Yet, the evidence will bear out my observation that people don't read instructions. This is true for preparing a tax return, setting up a new computer, or using a cell phone. The consumer electronics manufacturers and designers realized long ago that requiring people to read instruction manuals as a substitute for embedded and intuitive design only leads to technical support phone calls from unhappy and confused consumers.

The IRS has every right to expect that professionals will take the time to familiarize themselves with the instructions, but even a professional should be able to fill a tax return out without constantly referring to lengthy instructions. In the Background Paper to the Redesigned Draft Form 990, the Service indicates that it believes it has achieved greater transparency without adding to the compliance burden borne by nonprofits and their advisors. I view that as more aspirational than reality, but by developing a more self-contained form, I think the Service might move in a direction that everyone will benefit from.

My concern goes beyond minimizing the compliance burden. People are routinely using the data from the Forms 990 for financial analysis and comparisons. It is imperative that there be consistency between how organizations report information and respond to questions. Return preparers, be they volunteers or professionals, will inevitably guess wrong at what terms mean in questions, making their responses meaningless and even counterproductive. This makes a more self-contained form an imperative. Like everyone else who deals with the public, the IRS must be prepared to take the public as it is rather than as the Service would like the public to be.

If the Service is unable to significantly reduce the size of the instructions packet when it is finalized, then upon completion of the Form 990 revision process, the Service should immediately begin a project to place a Form 990 online that builds the instructions into a system of context-sensitive help. Congress should be encouraged to enact any necessary enabling legislation.

C. MOVEMENT AWAY FROM ATTACHMENTS IS A MISTAKE. On page 12 of the Core Form Instructions, the Service states:

Completing all lines. Do not leave any applicable lines blank or attach any other forms or schedules instead of entering the required information on the appropriate line on Form 990.

The Background Paper to the Redesigned Draft Form 990 indicates that this instruction in the Core Form Instructions is just part of a fundamental movement away from attachments. Specifically, the Background Paper states:

In addition, the revision continues the move away from allowing unstructured material (e.g., PDF files) to be filed with the form. In the context of electronic filing, such material presents technological and cost difficulties and in any event results in non-searchable data.

The laudable goals of full disclosure and transparency are best served by permitting organizations to freely attach documents containing supplemental information and disclosures. For example, some organizations have included a full set of financial statements, including the statement of cash flows and footnotes as PDF attachments. To eliminate ready access to this important information would be a mistake.

There are also questions of fundamental fairness. The Summary Page to the Core Form asks for several key metrics that are often misused by members of the public and watchdog

groups. Specifically, Lines 8b asks for a ratio of highly compensated employees to total program expenditures, and Line 19b asks for what is often characterized as a fundraising efficiency ratio. Organizations should be given the opportunity to explain these numbers through the inclusion of attachments. Otherwise, an organization that is just beginning a major capital campaign may have its fundraising efficiency metric unfairly compared to an organization that is not engaged in such a campaign.

The Background Paper refers to cost difficulties as one reason for moving away from attachments. I can understand how multiple PDF files could pose administrative issues. However, Adobe Acrobat Professional permits an organization to easily combine what could be multiple PDF files into one easily indexed (and bookmarked) PDF document. Admittedly handling even one PDF document might impose extra cost on the IRS. However, expending the funds to facilitate such an attachment is warranted given the revision's goals. Moreover, permitting attachments is consistent with fundamental fairness. In short, full disclosure and transparency are incompatible with reducing all information to numeric data or "yes/no" responses. The Service must be more flexible.

D. SUMMARY OF SPECIFIC SUGGESTED CHANGES AND ADDITIONS TO FORM 990. I set forth detailed suggestions regarding changes and additions to the proposed Form 990. To summarize the most important ones, I would like to see the Service: (i) add cash flow information to the information it collects; (ii) require a restricted, temporarily restricted, or permanently restricted designation for each asset category when the organization prepares its statements in accordance with SFAS 117; (iii) request more detailed information regarding compensation; and (iv) require disclosure of information regarding management letters received from auditors (the organization's use and response, rather than specific recommendations regarding changes to the system of internal controls). I would also like to see specific questions pertaining to financial fraud, and the presence of elected officials on boards. The Summary Page to the Core Form must either eliminate the financial efficiency metrics asked for on Lines 8b, 19b, 25, and 26, or provide adequate space for detailed explanations in immediate proximity to the questions. Finally, the IRS should reduce the scope of the relationships captured and reported in Part II of the Core Form.

E. SPECIFIC COMMENTS ON CORE FORM 990. Here are my line-by-line comments to the Core Form 990:

1. **Heading Block—Absence of Organizational Form.** On the Form 1023, the organization must indicate its organizational form. Unfortunately, the Form 1023 is not as readily available to the public as the Form 990. Consequently, the Service should add a question immediately before Line L which asks the organization to specify whether it is organized as a (i) corporation; (ii) charitable trust; (iii) limited liability company; or (iv) unincorporated nonprofit association. There are important governance implications from organizational form. If there are space limitations, this question could be added to Part III of the Core Form, Governance, which currently takes up only half a page.
2. **Heading Block—Status as a Membership Organization.** Three questions should be added asking whether the organization is a membership organization, and if so,

whether the members have voting rights and whether the members are corporate entities. These questions should immediately follow my new proposed question regarding organizational form. Once again, if there are space limitations, these questions could be added to Part III of the Core Form, Governance.

3. **Part I, Summary, Line 2—The Three Most Significant Activities.** Each of the three most significant activities should be listed on a separate line. This is very useful information and deserves to be listed so that it can be viewed at a glance. Placing the three activities on the same line makes it more likely that the information either will be abbreviated or disclosed in an attached exhibit, defeating ready access to the information.
4. **Part I, Summary, Line 2—Most Significant.** The instructions are inadequate. What is meant by “most significant?” Is this a judgment call, or is significance based on the number of employees or the value of the assets supporting the activity, or the number of people benefiting from it?
5. **Part 1, Summary, Line 8b—Compensation Metric.** This number compares the total compensation paid to those who are assumed to be highly compensated individuals to total program expenses. This focus suggests that a high percentage is bad or inappropriate despite the fact that a detailed analysis is necessary to determine the significance of a high percentage. Thoughtful people are trying to move the public and media away from reliance on simplistic and often misleading metrics like this one. The Service should eliminate this question unless the Service provides the organization with adequate space next to the number to explain why the number is low or high.
6. **Part 1, Summary, Line 19b—Fundraising Metric.** This number compares the total fundraising expenses to total contributions. The underlying assumption is that a lower percentage is better than a higher one. Once again, thoughtful people are trying to move the media and the public away from reliance on simplistic and potentially misleading metrics. Specifically, the Maryland Association of Nonprofits has promulgated a Standards of Excellence Code. Paragraph A of its Fundraising Standard provides as follows:

A nonprofit's fundraising costs should be reasonable over time. On average, over a five year period, a nonprofit should realize revenue from fundraising and other development activities that are at least three times the amount spent on conducting them.

This standard recognizes the artificial nature of a one-year measuring period. An organization might have begun a 3-year capital campaign, incurring significant upfront costs. Existing accounting principles do not permit those costs to be amortized over the three-year period. As a consequence, the number entered on Line 19b can be distorted and misleading. There are other legitimate reasons why there

might be one-year spikes in fundraising expenses which, when analyzed with a simplistic metric like 19b, do not reflect fundraising efficiency.

The BBB Wise Giving Alliance has also developed a set of standards for charity accountability. As a general rule, a charity will be deemed to have satisfied the BBB Wise Giving Alliance financial efficiency if the charity spends no more than 35% of related contributions on fund raising (Standard 9) and at least 65% of its total expenses on program activities (Standard 8). However, the Alliance realizes the problems with numerical metrics, resulting in the creation of an exception to the 35% and 65% standards. Under this exception, the charity is deemed to have met the standard if the charity,

[P]rovide[s] evidence to demonstrate that its use of funds is reasonable. The higher fund raising and administrative costs of a newly created organization, donor restrictions on the use of funds, exceptional bequests, a stigma associated with a cause and environmental or political events beyond an organization's control are among factors which may result in expenditures that are reasonable although they do not meet the financial measures cited in these standards.

Given these industry standards, the Service should either eliminate the question in Line 19b, permit organizations to calculate it over a three- or five-year period, and/or provide adequate space next to the number to permit the organization to explain it.

7. **Part I, Summary, Lines 25 and 26—Gaming and Fundraising.** These two questions should be eliminated. Once again, the Service is placing too much emphasis on common metrics that are often misleading and misused. At a minimum, space should be provided to permit organizations to explain the calculations and their implications. The Service has historically been mesmerized by high fundraising expenses paid to professional fundraisers. As Judge Posner pointed out in *United Cancer Council v. Commissioner*, 165 F.3rd 1173 (7th Cir. 1999), there might be legitimate reasons why fundraising fees based on a percentage of gross amounts raised are high. Questions 25 and 26 do not permit an organization to highlight those reasons. Schedule G should be sufficient.
8. **Part II, Compensation, Line 1a—Ordering the List of Individuals Whose Compensation is Disclosed.** Column B is helpful because it permits all relevant individuals to be included in one comprehensive schedule. It would be helpful if organizations were instructed to list the individuals in descending order (individual trustees or directors first, institutional trustees second, CEO or Executive Director third, and so forth rather than alphabetically). That would result in all the individuals within one classification being grouped together.
9. **Part II, Compensation, Line 3—Use of the Glossary.** The instructions do not define the term “independent.” That is left to a glossary. While I understand how a

glossary reduces the size of the instructions, I believe it is asking too much for people to read instructions and know that there is a supplemental glossary. If the Service is going to rely on a glossary, then when it uses a term in the instructions that is defined by the glossary, the Service should use bold, italics, capital letters, or some otherwise identifying font characteristic to provide a signal to the reader.

Also, when the instructions make a reference to a Code section or a Treasury Regulation, they should be clear that the referenced legal authority is controlling.

10. Part II, Compensation, Line 5b—Covered Relationships are Too Broad.

Investigative reporters will like this question, but compliance is impractical. Specifically, the question asks whether any person who is an officer, director, or trustee has a relationship with anyone listed in Section A, which would include volunteer directors. I certainly can envision a cultural institution with 70 volunteer board members and a partner in a major law firm who serves as its volunteer secretary. In many communities, this lawyer and his law firm will have professional relationships with many of the other board members that are unrelated to the cultural institution. This question would force the organization to divulge all of those relationships. The organization is unlikely to have access to that information and disclosure of client relationships might raise attorney-client privilege issues. The problem is compounded once affiliated entities are added to the requirements. This rule would be far more workable if disclosure were required only when the person on Schedule A or the officer is compensated. The fundamental problem is the failure to distinguish between paid staff and volunteer officers.

I suspect the Service will receive many comments containing other examples of when these disclosure requirements are unworkable or too broad.

11. Part III, Statement Regarding Governance, Question 1a—Definition of the Governing Body. This question provides a perfect example of the problems that come with separating the form from the instructions. Only after reviewing the glossary does it become evident that the “governing body” includes both voting and nonvoting directors and trustees. At a minimum, the question should be revised to read as follows:

Enter the number of governing body members, including both voting and nonvoting members.

If the Service does not do this, some organizations will include just voting members while others will include both voting and nonvoting members. As a consequence, statistical and comparative analysis of this question will be meaningless.

From a substantive standpoint, this question should be split into two questions, one asking for the number of voting members and the other asking for nonvoting members. There should also be questions asking for the number of ex-officio board members (with separate numbers reported for voting and non-voting members),

emeritus members, and other nonvoting board members. A valuable revision to Form 990 was made in 2005 with Question 75a to Part V-A, which reads:

Enter the total number of officers, directors, and trustees permitted to vote on organization business at board meetings.

This question should be retained.

12. **Part III, Statements Regarding Governance, Question 3b—Review of Conflicts of Interest.** At a minimum, this question needs to be refined. First, the Service should substitute “board or committee of the board” for “organization.” Second, and related, the Service should set a dollar threshold (e.g., the value of the transaction exceeds \$5,000, or 2% of the organization’s gross revenue, whichever is greater), rather than relying on what will be differing views of what constitutes a material conflict.

More to the point, this question either should be eliminated or significantly revised. It carries the implication that something is wrong if a lot of conflicts are reviewed. As a general matter, I am disturbed when organizations are engaged in many and a wide variety of conflicts-of-interest transactions. I am not the least bit disturbed when a conflicts-of-interest policy results in potential conflicts being surfaced for review by the board, followed by the board refusing to approve the transactions. This is a case where a more opened-ended question would be appropriate.

13. **Part III, Statement Regarding Governance, Question 4—Responses to Whistleblowers.** In Question 3b, the form asks about the number of conflicts reviewed pursuant to the conflicts-of-interest policy. Why doesn’t the form ask about the number of incidents that are brought to the board’s (or a committee’s) attention as a result of a report by a whistleblower? I have similar reservations about this question that I expressed question 3b, but whatever the decision, I believe consistency is warranted.
14. **Part III, Statement Regarding Governance, Question 5—Document Retention Policies.** The definition of *document retention and destruction policy* is in the glossary. Once again, separating the instructions/glossary from the form will result in inconsistent and incorrect responses to this question. Based on my experience in talking about record retention and destruction policies to nonprofit groups, most nonprofits mistakenly believe a record retention schedule is a retention and destruction policy. The retention schedule is part of a policy, but it is not the policy.
15. **Part III, Statement Regarding Governance, Question 6—Approval of Minutes.** This question should be prefaced with the phrase “As a general practice.” I can envision scenarios where an organization regularly prepares and approves minutes, but because of scheduling issues or a requested rewrite of a portion of proposed minutes before they are approved, minutes for one or two meetings are not *contemporaneous*, as that term is defined. By prefacing the question as I have

suggested, the organization would still be able to answer “yes” if the board had been attentive and diligent in reviewing meeting minutes before they are approved.

16. **Part III, Statement Regarding Governance, Question 8—Preparation of Financial Statements.** This is not a meaningful question. It seems to assume that having someone other than the outside auditors prepare the financial statements would be unusual, which is a faulty assumption. The better question would be to ask whether the financial statements are prepared by a paid employee of the organization, on the one hand, or a volunteer, on the other. In both cases, asking whether these individuals have financial training or are CPAs would provide both the public and the IRS with some sense of the amount of reliance that should be placed on the statements.
17. **Part III, Statement Regarding Governance, Question 9—Committees.** Why is this question limited to audit committees? Committees are important to a well-functioning board. The Service should ask whether one or more committees address the following functions: (i) executive; (ii) compensation; (iii) audit; (iv) finance; (v) investment/endowment; and (vi) gift-acceptance.
18. **Part III, Statement Regarding Governance, Question 10—Board Review of Form 990.** This excellent question needs to be rephrased if it is to be meaningful. The question should ask whether there was a presentation to the governing body about the Form 990 at a meeting of that body, or alternatively, whether a copy of the Form 990 was given to each member of the governing body. As phrased, an organization cannot answer “Yes” if its practice is to distribute the Form 990 to members of the governing body, because it does not know whether the members reviewed the Form 990.
19. **Part III, Statement Regarding Governance, Question 11—Public Disclosure of Documents.** The n/a designation needs clarification. “Not applicable” could mean that the organization doesn’t have an audit report or that it does not make it available to the public. Moreover, the listed documents should also include the Form 1023/1024 exemption application.
20. **Part III, Statement Regarding Governance—Financial Issues.** I would suggest adding a separate component to the governance questions for financial issues. The following are among the issues that I believe should be addressed:
 - a. If the organization’s financial statements are audited, did the independent auditor provide the organization with a management letter?
 - b. If the organization received a management letter,
 - i. Was it reviewed by the board or the audit committee?

- ii. Did the board or the audit committee instruct the organization's management to address the suggestions set out by the independent auditors in the management letter?
- iii. Does the board or audit committee regularly follow up with management regarding management's progress in implementing suggested responses to the management letter?
- c. During the last five years, has the organization received a qualified audit opinion from its independent auditors? If so, a copy of each qualified opinion should be attached.
- d. If applicable, does the organization undergo an audit required by the Single Audit Act and OMB Circular A-133?
- e. Does the organization regularly adopt an annual operating budget for the organization?

The Service should be particularly interested in the answers to questions a through c, because it must use the financial information that the organization's accounting system is generating as part of the audit process. The Service should be more concerned about organizations that are ignoring the advice of outside professionals or are having disputes with them.

- 21. **Part IV, Statement of Revenue, Line 1b—Contributions from Outside Fundraiser Efforts.** The instructions should specify whether this number is based on gross revenue raised by the fundraiser, or is net of fundraiser fees. The more informative approach would be to have two separate sub-line items—*Gross Funds Raised* and *Amount Retained by Fundraiser for Fees and Expenses*—with the net number then placed on Line 1b.
- 22. **Part IV, Statement of Revenue, Lines 1c and 11—Fundraising Event Contributions vs. Revenue.** Separating these two lines has proven to be a problem, with some organizations failing to report the contributions as a separate item on the current Form 990. Moreover, even when organizations follow the instructions, members of the media may fail to read the two lines together. From a usability standpoint, the two lines should be in the same location. I acknowledge that this will distort the contributions number. As a compromise, the revision should change Line 1c to read as follows:

Contributions from Fundraising Events (See Line 11 for
the Corresponding Event Revenue)
- 23. **Part IV, Statement of Revenue, Line 3—Membership Dues.** If an organization reads the instructions, the treatment of membership dues is *relatively* clear. It would be helpful if those instructions were better reflected in the form. Specifically, rather than placing non-benefit related membership dues in the catchall Line 1f, why not

have a separate category for those benefits immediately before Line 1f, and then change Line 1f to Line 1g? This is where dues paid to advocacy organizations would go. To the extent an organization bifurcates its membership dues between Line 1f and Line 3, there should be a required disclosure that explains the basis for the bifurcation.

24. **Part IV, Statement of Revenue, Lines 4 and 5—Dividends and Interest.** Rather than mix dividends and interest on Line 5, Line 4 should be divided into part a (short-term debt) and part b (long-term debt). Short-term debt would be debt with a maturity of one year or less. Line 5 would then be limited to dividend income.
25. **Part VI, Balance Sheet, Line 3—Pledges.** Significantly more information is required with respect to pledges. The numerical disclosures should follow FASB 116, Paragraph 24, requiring an aging schedule (due within a year, due between one and five years, and due more than five years). The amount of pledges from disqualified persons should also be disclosed. Failure to pay those pledges timely could raise issues under the intermediate sanctions, making this a relevant question. Finally, and this might be more appropriately reported in Part III to the Core Form, the organization should describe its write-off policy. Does it generally enforce an unpaid pledge, or does it routinely write off unpaid pledges? This is relevant to those who might be considering a contribution in reliance on the promises of others to make contributions.
26. **Part VI, Balance Sheet, Assets.** Some charities may be the beneficiaries of split-interest arrangements. Others may have turned management of assets over to community foundations through fiscal agency arrangements (see SFAS 136 for details on accounting for fiscal agency arrangements). The Core Form's balance sheet should do a better job of segregating assets subject to these arrangements from other assets.
27. **Part VI, Balance Sheet, Lines 28, 29, 30—Unrestricted, Temporarily Restricted, and Permanently Restricted Assets.** The proposed revisions make no changes to these three lines. As is, this disclosure is not particularly useful because it aggregates amounts. The Core Form's balance sheet should be revised to provide for disclosure of restrictions for each asset category comparable to that presented in GAAP-compliant financial statements if the organization has financial statements prepared in accordance with SFAS 117. Elsewhere, the Service indicates that it is requiring disclosure because certain information is not readily available to the public. This is important information and unless the organization publicly releases its financial statements—which many organizations do not—this information is not available to the public.
28. **Part VI, The Missing Statement of Cash Flows.** The Form 990 requires the organization to disclose its balance sheet and income statement. It does not require the organization to disclose its statement of cash flow (statement of sources and uses of funds). Generally Accepted Accounting Principles define these three statements as core financial statements. See SFAS 117, Paragraph 6. To receive an unqualified

audit opinion, an organization's financial statements must include all three statements. I have tried, but it is difficult to recreate a statement of cash flows from the balance sheet and income statement information reported elsewhere in Part VI. It is time that the Form 990 requires this third statement.

29. **PART VII, GENERAL ACTIVITIES—REORDERING QUESTIONS.** The questions in Part VII cover a wide variety of disparate issues. As presented, there is no logic to the ordering of these questions. For ease of use purposes, the Service should consider re-ordering the questions so that the order of the questions tracks the sequential flow of Schedules A through R.
30. **Part VII, General Activities, Lines 6a, 6b, 6c, and 6d—Tax Exempt Bonds.** Question 6a is appropriate. Questions 6b, 6c, and 6d should be moved to Schedule K. These questions are inconsistent with the overall laudable approach of separating detail that is applicable to select organizations through the use of discrete schedules.
31. **Part VII, General Activities, Lines 11 and 12—Questions Regarding Investment Review and Protecting Exempt Status.** These questions should be eliminated. While good governance is the goal, not everything needs to be reduced to a written policy. I would much prefer to have a knowledgeable tax professional, and the board when appropriate, reviewing these issues on an ongoing basis rather than having every organization adopt a boilerplate form that is stashed in a file cabinet. In the case of Line 11, why is it more important to review investments in disregarded entities as opposed to reviewing all investments?
32. **Part VII, Other IRS Filings, Lines 4a and 4b—Personal Benefit Contracts.** As noted, the design of the Form 990 should facilitate completion without the need to constantly refer to instructions. By using the term *personal benefit contract*, the form obscures the focus of these two questions. These questions should refer to “life insurance or annuity contracts.”
33. **Part VII, Other IRS Filings.** There should be a question asking whether an employee, contractor, or agent stole, embezzled, or otherwise engaged in financial fraud that resulted in a loss to the organization in excess of \$5,000 or 2% of gross revenue, whichever is less. There is much debate over the extent of fraud and financial mismanagement in the nonprofit sector. As far as I know, there is no comprehensive assessment. The IRS is in the unique position to gather meaningful statistics on this issue. To the extent the Form 990 is used by prospective donors to assess whether to make a charitable contribution to an organization, what could be more relevant than knowing whether a contribution is likely to be used to further mission, or stolen by an insider for personal gain?

There is a clear tax administration reason for the IRS to ask this question. Treasury Regulation Section 53.4958-4(c)(1) provides as follows:

In no event shall an economic benefit that a disqualified person obtains by theft or fraud be treated as consideration for the performance services.

Presumably this language was added to the regulations so that the intermediate sanctions could be invoked to force a disqualified person to return what would seem to be an automatic excess benefit. Many organizations are aware that they must report the payment of excess benefits when responding to Question 5a of Part VIII of the Core Form, but I would venture that most don't view a theft or embezzlement as an event that could trigger the intermediate sanctions. By asking the suggested question, the Service would be obtaining information to permit it to better enforce the tax laws.

34. **PART IX, STATEMENT OF PROGRAM SERVICE ACCOMPLISHMENTS, LINE 1—CHANGE IN ACTIVITIES.** The *organizational test* set out in Treasury Regulation Section 1.501(c)(3)-1(b)(1) focuses on exempt purposes, while the *operational test* in Treasury Regulation Section 1.501(c)(3)-1(c)(1) focuses on the organization's primary activities. Although Question 3 of Part III to the Core Form does ask about changes to the organization's governing documents, neither that question nor Line 1 of Part IX ask specifically about changes in purposes as distinct from changes in activities. Either Question 3 should be modified, or an additional question should be asked following Line 1 to elicit a response that focuses specifically on change in purposes.

F. **SCHEDULE, SUPPLEMENTARY INFORMATION.** I will leave it to others with more practical experience with the technical distinctions between public charities and private foundations to comment on the specifics of this schedule. The Service is to be commended for isolating this issue. The form makes clear once again why a major legislative overhaul is necessary to simplify an unnecessarily complex determination.

G. **SCHEDULE B, CONTRIBUTORS.** No change, no comment.

H. **SCHEDULE C, POLITICAL CAMPAIGN AND LOBBYING ACTIVITIES.**

1. **Two Additional Questions.** The Core Form should include two additional questions:
 - a. Does the organization's governing body include or does the organization employ any key employees who held elected office or who served as paid staff members or campaign aides to someone who held elected office?
 - b. Does the organization have a written policy regarding political activity by officers, directors, or employees?

Politicians do have a right to form and to serve on the boards of charities, but the tax law prohibits charities from intervening in political campaigns. Just as the Form 990 asks for special disclosures related to highly-compensation and disqualified person to

permit the Service to enforce tax law provisions aimed at those persons, the Form 990 should ask for necessary information related to politicians involved with charities to permit the Service to better hone its focus on charities that may be more susceptible to prohibited interventions and abuse. For a comprehensive discussion of recent and potential abuses of charities by politicians, see my article, *THE WILD, THE INNOCENT, AND THE K STREET SHUFFLE; THE TAX SYSTEM'S ROLE IN POLICING INTERACTIONS BETWEEN CHARITIES AND POLITICIANS*, 54 *Exempt Organization Tax Review* 117 (November 2006).

2. **Schedule C, Part 1-A, Political Campaign and Lobbying Activities—Enhanced Political Activity Questions.** Question 1 of Part VIII of the Core Form asks about political activity. It directs organizations that answer “yes” to proceed to Schedule C. I assume the enhanced political activity questions are those found in Part 1-A. First, and most importantly, the internal referencing structure does not make much sense. The introductory notes/commentary suggests that the Service expects all organizations to complete this portion of Schedule C. The apparent goal is to elicit facts that might suggest that the organization has engaged in political activity despite its belief that it has not. Yet, by answering “no” to Question 1 of Part VIII, the very organizations that the Service wants more information from don't provide it.

Given the 2004 and 2006 PACI reports, the paucity of questions designed to uncover political interventions is surprising.

I. **SCHEDULE D, SUPPLEMENTAL FINANCIAL STATEMENTS.**

1. **Schedule D, Part VIII, Supplemental Financial Information—Fin 48.** Thank you for proving correct one of my predictions about likely responses to Fin 48. See my article, *APPLYING FIN 48 TO TAX-EXEMPT ORGANIZATIONS: TOO MUCH OF NOTHING OR IT'S ALL TOO MUCH?*, 56 *Exempt Organization Tax Review* 157 (May 2007). Now, if the Service is going to require this information, it should include the statement that is included in the Overview to Schedule D on Schedule D itself so that taxpayers fully understand their rights. Specifically, the following statement should be included:

Disclosure of this footnote on the Form 990 has no impact on the Service's position relating to requests for tax accrual workpapers. Such workpapers will continue to be governed by existing Internal Revenue Manual. Organizations should call 202-XXX-XXXX to report alleged violations by Service personnel of those restrictions on the use of tax accrual workpapers.

2. **Schedule D, Part X, Organizations Maintaining Collections of Art—Receipt of Partial Interests.** Given the recent controversial legislation regarding gifts of partial interests of art works, the Service should ask whether the organization has received such gifts, together with a request for other relevant information. I do note that this is covered to some extent in Schedule M, Non-Cash Contributions.

3. **Schedule D, Part X, Organizations Maintaining Collections of Art—Footnote Disclosure.** I have no problem with the request for relevant footnotes from the organization's financial statements. However, why not just ask for all the footnotes from the financial statements? For example, in this same section the Service effectively asks for liabilities attributable to pension plans (to the extent they are not otherwise reported on Line 23 of Part VI). The footnotes to financial statements generally include detailed discussions of these liabilities. When I am reviewing an organization's finances, I am just as interested in those liabilities as I am in the treatment of collections. Selective disclosures are not helpful.
 4. **Schedule D, Part XI, Trust/Escrow Accounts—Definition.** It is not clear what an escrow account is for purposes of this question. Is this a reference to split-interest trusts, fiscal agencies, or something else? The Service will receive useless responses unless it better defines what arrangements this question is directed at.
 5. **Schedule D, Endowment Funds—General Observations.** This will prove to be useful information, but more information is warranted. Specifically, the data should be broken down into the unrestricted, temporarily restricted, and permanently restricted categories. Moreover, board designated endowment should be separately presented. At a minimum, there should be an additional question asking what rate, if any, that the board has adopted as a spending rate. Equally important, but likely to be more controversial, there should be a series of questions asking about investment objectives, portfolio mix, identification of investment managers, and investment management fees.
 6. **Schedule D, Reconciliation of Revenue Per Audited Financial Statements—General Observations.** Unfortunately, this schedule is largely unchanged. In my experience, it is often impossible to use this schedule to work from the tax statements to the financial statements. This appears to be due to the heavy reliance on "Other," with organizations rarely providing much detail. The Service should either rework this schedule, or require organizations with audited financial statements to submit them with the Form 990.
 7. **Schedule D, Reconciliation of Expenses Per Audited Financial Statements—General Observations.** See comment 6 immediately above.
- J. **SCHEDULE E, PRIVATE SCHOOLS.** No comments at this time.
- K. **SCHEDULE F, STATEMENT OF ACTIVITIES OUTSIDE THE UNITED STATES.** No comments at this time.
- L. **SCHEDULE G, SUPPLEMENTAL INFORMATION REGARDING FUNDRAISING ACTIVITIES.**
1. **Schedule G, Supplemental Information Regarding Fundraising Activities.** Within the last month, the AICPA promulgated Technical Practice Aid Section 6140, which addresses some technical issues regarding accounting for fundraising expenses. This aid mentions the AICPA's Audit and Accounting Guide for Not-for-Profit

- Organizations, which also addressed fundraising expenses. I have not yet had a chance to fully review Section 6140 or compare the AICPA Audit Guide to the proposed Form 990 and the relevant instructions. If the Service has not, I would strongly urge it to consider the merits of conforming tax reporting of fundraising expenses with the financial accounting treatment of those expenses.
2. **Schedule G, Supplemental Information Regarding Fundraising Activities.** With this information, there is no need for Questions 25 and 26 to Part 1 of the Core Form. Both interested members of the public and the media will quickly come to know and love Schedule G. Therefore, forcing organizations to further summarize this information serves no purpose and opens the summaries up to misuse and misinterpretation.
 3. **Schedule G, Part II, Line 2, Supplemental Information Regarding Fundraising Activities—Charitable Contributions.** There has been ongoing controversy over whether fundraising events that lose money are important loss leaders for charities. Some are offended when a large annual ball loses money as top donors dine on caviar and sip champagne. Others contend that these events cement long lasting relationships with major donors, more than paying for themselves in future contributions. I don't take sides in that debate, but I am concerned that it may influence what charitable contributions are included on Line 2. The Service should adopt a convention that Line 2 only includes charitable contributions that are either collected as part of the admission fee or that are made at the event.
 4. **Schedule G, Part II, Supplemental Information Regarding Fundraising Activities—Advertising and Sponsorship.** There should be separate revenue lines for advertising fees (in program books) and event sponsorship payments (excluding purchases of tickets or tables).
 5. **Schedule G, Part II, Column C—Other Events.** Even though a specific event-by-event breakdown of dollar amounts is required, I think organizations should list each event (date and type) to the extent gross revenue from an event exceeded \$10,000.
 6. **Schedule G, Additional Information—Politicians.** There should be a question asking whether elected officials attended the event on a complementary basis, and another question asking whether elected officials or candidates spoke at the event.
 7. **Schedule G, Part III, Gaming—Publications.** As an aside, the Service's publications on charity gaming do not provide adequate information regarding withholding and backup withholding obligations. If organizations are going to be asked to provide this level of detail, more detailed publications should be available.
- M. **SCHEDULE H, HOSPITALS.** No comments at this time, except to note that given the controversy over these issues in recent years, I suspect most hospitals will have this information readily available. The critical issue will be whether the hospitals believe the requested information permits them to tell their side of the story.

- N. **SCHEDULE I, SUPPLEMENTAL INFORMATION ON GRANTS.** No comment at this time.
- O. **SCHEDULE J, SUPPLEMENTAL COMPENSATION INFORMATION.**
1. **Schedule J, Supplemental Compensation—Compensation Committee.** There should be a question asking whether the board utilizes a compensation committee (see Item 17 to Section D of this letter).
 2. **Schedule J, Supplemental Compensation—Compensation Consultants.** There should be a question asking whether the board retains an outside compensation consultant to assist it with setting senior executive compensation. If so, there should be follow-up questions asking whether the board retains the consultant directly and whether the consultant is retained by the organization for other work.
 3. **Schedule J, Supplemental Compensation—Monitoring of Reimbursements.** There should be a question asking whether the board (or a committee) monitors expense account reimbursements to the executive director/CEO and the CFO.
 4. **Schedule J, Supplemental Compensation Information, Line 1—Tally Sheet.** The requested information is broken down in terms of tax terminology. I would like to see the Service move away from that approach, and instead rely on the format of tally sheets that are typically presented at board meetings.
 5. **Schedule J, Supplemental Compensation Information, Line 2—Accountable Plan.** The more relevant question (or an additional question) would seem to be whether the organization adheres to an accountable plan, as defined in Code Section 62(c) and Treasury Regulation Section 1.62-2.
 6. **Schedule J, Supplemental Compensation Information, Line 3—First Class Travel, Club Dues, and Personal Residence.** There should be a separate line for each of these items. There should be a fourth line for other supplemental compensation such as personal chefs, gift allowances, personal secretaries for spouses, and use of automobiles and private jets.
- P. **SCHEDULE K, SUPPLEMENTAL INFORMATION ON TAX-EXEMPT BONDS.** No comment at this time.
- Q. **SCHEDULE L, SUPPLEMENTAL INFORMATION ON LOANS.**
1. **Schedule L, Parts 1 and 2, Supplemental Information on Loans—Legality.** In view of an investigative report, Parts 1 and 2 should contain a question asking whether the loan is legal under state law. See Harvy Lipman and Grant Williams, *Assets on Loan: Nonprofit Groups Lend Millions to Officials, Chronicle Study Finds*, *Chronicle of Philanthropy* (Feb. 5, 2004). I suspect state charity regulators would appreciate this question because it would provide them with information, as well as cause some charities to review state law.

2. **Schedule L, Parts 1 and 2, Supplemental Information on Loans—Past Due.** Parts 1 and 2 should contain a question asking whether the loan is past due.

R. **SCHEDULE M, NON-CASH CONTRIBUTIONS.**

1. **Schedule M, Non-Cash Contributions.** There should be a question asking whether the organization has a gift-acceptance policy. If so, there should be a follow-up question asking whether each gift was accepted in accordance with the policy.
2. **Schedule M, Non-Cash Contributions.** There should be a statement that the charity is not responsible for the valuation, but is relying on the valuation set out in the qualified appraisal.

S. **SCHEDULE N, LIQUIDATION, TERMINATION.** No comment at this time.

T. **SCHEDULE R, RELATED ENTITIES.** No comment at this time.

U. **CONCLUSIONS.** I think all interested parties will agree that the team assigned to the Form 990 project has produced an excellent proposal. I have no doubt that the Service will receive many comment letters and that the final version will reflect many of the comments.

I would hope that the Service will consider providing periodic progress reports summarizing how it is responding to comments, even going so far as to occasionally put out a notice indicating that the Service is considering incorporating certain suggestions. This would permit all interested parties to react timely to possible changes to the proposal and expedite finalization.

My focus in this letter has been on the forms. In the coming weeks, I plan to take a closer look at the instructions. I will provide the Service with any additional comments should I have them. In the meantime, thank you for permitting me to have input into this important process.

Sincerely yours,

Jack B. Siegel
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