January/February 2008

New Form 990

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Appeared in *Trusteeship*
January/February 2008

Accountability. Transparency. Compliance. These three principles form the bedrock of best practices in nonprofit governance and are at the heart of a lively debate that has unfolded over the past five years. But as the saying goes, the devil is in the details.

I would wager that most governing board members do not associate the realization of these principles with the task of completing Form 990, the Internal Revenue Service information return filed by most tax-exempt organizations. To most trustees, tax forms are best left to accountants, the chief financial officer, and the audit committee.

But with the introduction this year of an all-new IRS Form 990, the time has come to discard this detachment. This means that board members will need to accept and embrace their role in enabling their organization to prepare the form in a manner that demonstrates that the institution is well governed.

As many have feared, the revised form imposes demands for painstaking documentation and asset valuation that may prove burdensome for some small colleges. Regardless, the unfortunate institution whose officials cut corners in completing this form risk an IRS audit, penalties, and public embarrassment. For this we can primarily thank a tightened federal policy prompted by the trend toward commercialization by many nonprofit organizations.

As is often the case, the journey to a healthy result is of greatest importance here. My advice is that a board should embrace the exercise of completing the new Form 990 as an opportunity to more fully understand and give needed direction to the institution it serves.

Make no mistake about it, this redesign is revolutionary. According to the IRS, it is intended to provide greater transparency, promote compliance, and lessen the burden on the filing organization. (Two out of three ain't bad...)

Though Form 990's genesis dates to the 1940s, the current form has not been seriously altered since 1979. In the climate of heightened concern about nonprofits that stray from their tax-exempt mission, many in Congress, the executive branch, and at the nonprofits themselves thought the existing ten-page form did not adequately illuminate the inner workings of modern tax-exempt organizations and allow for peer comparisons. Accordingly, the IRS launched an effort to redesign Form 990 to capture more relevant information. Following a public-comment period last summer, a final version was published in December. It will take effect in 2008 for returns that must be filed starting in spring 2009.

Here are eight things board members should know about the new Form 990.

1. ***This is much more than a tax form.*** If you ever were of the mind that the Form 990 was a tax document that didn't require board involvement, it is time to change your view. The new Form 990 is so much more than a financial reporting document. It contains questions designed to delve deeply into the governance processes of the organization, its compensation mechanisms, and its operating policies.

   Certainly, the financial disclosures remain a key portion of the form, including new disclosures about endowments. However, it is essential that the board focus directly on answers to the governance-related questions and make informed choices about the practices and policies that will ensure effective governance.

2. ***This is not your grandfather's Form 990.*** The original Form 990 was two pages long. The new Form 990 has a core form that is 11 pages and has 16 schedules. Most colleges and universities will have to fill out at least 14 of these schedules.

   In its public comments to the IRS on the redesigned Form 990, the National Association of College and University Business Officers predicted that many large and mid-sized institutions will need to add one full-time administrative position to collect and report data required to complete the new form. Notwithstanding the IRS's goal to the contrary, the burden on nonprofit organizations surely will increase, and that burden will not be the administration's alone. Boards have meaningful governance work to conduct to prepare the responses the expanded form requires.

3. ***Yesterday's tomorrow is today.*** The IRS did a commendable job of factoring in the more than 600 public comments it received before releasing the final version of the Form 990 on December 20, 2007. But

this is it. There will be no more comment periods, though the IRS has indicated it will continue to tweak the instructions throughout 2008 to ensure clarity and consistency in reporting.

IRS officials have granted some transitional relief with respect to the filing of the new Schedule K, Supplemental Information on Tax-Exempt Bonds, that will apply to many colleges and universities. It had been widely criticized for the additional reporting burden this schedule will place on affected organizations. The IRS will now delay full implementation of the schedule until 2009.

A similar delayed effective date will be available for the new Schedule H that will be required of academic medical centers and other hospitals. As for the core form and the other schedules, however, the IRS will stick to its timetable.

4. ***The IRS listened.*** The IRS received many substantive suggestions during the public-comment period (one-third of the comments were directed toward the new Schedule H) and, on balance, has markedly improved the utility of the form by incorporating important changes.

   For example, the discussion-draft Form 990 mandates the reporting of certain performance ratios apparently designed to establish benchmarks for comparing the efficiency of operations between exempt organizations. This would include the disclosure of the ratio of fund-raising expenses to total contributions; the ratio of total officer, director, trustee, and key employee compensation to total program service expense; and the disclosure of total expenses as a percentage of net assets. Given the diversity of higher education institutions and related foundations, these ratios would vary widely, and most commenters criticized these ratios as conveying no meaningful information in the abstract without further explanation.

   As a result, the IRS elected to remove these disclosures from the final version of the form and to substitute in their place the disclosure of certain financial information measured over a two-year period. (In the IRS's view, these ratios are relevant but are not important enough to appear on the first-page summary sheet that many will use to compare organizations.) The board nonetheless should discuss with administration how the organization measures up under these performance ratios and study the significance of the results. In addition, higher education institutions may need to work together to develop relevant performance benchmarks that would be useful to the public and to regulators in evaluating how well an organization is operated and governed.

5. ***Trustees will be more involved in reviewing the form.*** Typically, the Form 990 is prepared by the organization's finance staff or its external accountants. While these professionals will continue to do the heavy lifting, board involvement in the process with respect to the governance and operational questions is essential.

   Perhaps the most important governance questions on the new Form 990 are these: Was the Form 990 provided to the governing board before it was filed?

   What is the process the institution uses to review the Form 990? The IRS had never asked these questions of nonprofit organizations, and their inclusion in the new Form 990 clearly results from widespread sentiment to bolster hands-on board governance in nonprofits. Answering these questions does not require the board to *approve* how the form was completed, and there is no legal penalty for the failure of a board to do so. However, the questions do point out the need for board members to be conversant in the information presented in the Form 990.

   Critics of these questions argue that it poses significant logistical burdens; forms often are finalized only days before their due date, and some boards may oversee multiple organizations that must file a Form 990. Nonetheless, this is vital and a fiduciary duty of the board. Many commenters suggested to the IRS that review by a board committee, such as the audit committee, could fulfill this duty. And indeed, careful review of the form's financial data should be part of the responsibility of the budget and finance committee or the audit committee. But to consign review of the governance-related responses to a board committee is to miss an important opportunity for the organization to receive essential, hands-on leadership from its directors.

   Moreover, the Form 990 is a public document, easily accessed by the world through the Guidestar Web site. Shouldn't trustees be as conversant with the disclosures in the Form 990 as reporters who might use the information in a story?

6. ***The new Form 990 may elevate many governance best practices to de-facto requirements.*** Throughout the form, questions are asked with respect to whether the organization has various governance policies in place or whether it follows particular “good governance” practices. For example, Part VI of die Form 990 core form is dedicated entirely to statements

regarding governance, management, and disclosure. It asks the following questions:

- How many voting members are on the governing body? How many of them are independent?
- Does the institution have a written conflict-of-interest policy?
- Does the institution have a written whistle-blower policy?
- Does the institution have a written document retention and destruction policy?
- Does the institution contemporaneously document the meetings of the governing body and its committees?
- If the institution has branches or affiliates, does it have written policies and procedures governing their activities to ensure that their operations are consistent with the institution's?
- Did the institution's governing body receive the Form 990 before it was filed? Does the institution make the following available to the public: governing documents, conflict-of-interest policy, Form 990, Form 990-T, financial statements? If so, how?

These questions are consistent wit11 the IRS's “Good Governance Principles” released in draft form in 2007. Moreover, the IRS has indicated that it intends not only to continue but to increase the form's focus on governance.

Although most of the best practices suggested by the new Form 990 now are widely accepted in the nonprofit world, there is not universal agreement on the applicability of these practices to all colleges and universities. However, the form effectively may cause these practices to be viewed as a requirement, notwithstanding an IRS disclaimer to the contrary. Trustees should carefully explain the governance choices they have made on the form's new Schedule D, which permits a thorough discussion.

7. ***Be ready to discuss your endowment funds.*** A new Schedule D, Supplemental Financial Statements, has been included in the Form 990. The schedule calls for disclosure of certain financial information regarding the institution's endowment fluids, including contribution amounts, earnings and losses, expenditures for facilities and programs, and administrative expenses for the current year and previous four-year period.

8. The value of requiring such disclosures in the absence of a meaningful basis for comparing the amounts institutions may report is questionable. That's because the size of college and university endowments varies greatly, as does the rate of spending of investment earnings. What's more, because more than 90 percent of endowment funds are donor-restricted, each institution has unique spending constraints. As a result, valid comparisons of institutions based on a general expenditures disclosure are elusive.

   Nevertheless, college and university endowments are under increasing scrutiny, and Congress is weighing new restrictions, taxes, and mandatory payouts. Accordingly, board members should be prepared to answer public questions that will arise from these disclosures. Discussions with administrators regarding the significance of the variance in results among higher education institutions will be helpful.

9. ***Be ready to discuss executive compensation.*** It is now clear to most board members that the compensation of the president and senior executives is being scrutinized by regulators, the Congress, and charity watchdog groups. With the advent of the new Form 990, this surely will continue. Part VII of the core form requires disclosure of compensation to officers, directors, trustees, and key employees from the organization and its related organizations.

New Schedule J, Supplemental Compensation Information, will require detailed disclosure of compensation for these individuals-not only of base compensation but also of bonuses and incentives, severance and change-in-control payments, first-class travel, spousal travel, club fees, housing allowances, supplemental nonqualified retirement plans, and equity-based compensation.

With this level of disclosure, all directors, not just those who serve on the compensation committee, will need to more fully understand the institution's compensation processes and be prepared to respond to questions that result from these disclosures.

College and university boards and administrations should embrace the new Form 990 as an opportunity to improve transparency and achieve greater accountability. Those that do so will strengthen their ability to achieve their missions and sustain the public's support. Look at it this way: The Form 990 is not only a tax form but a report card. Trustees should ensure that they are proud to show it off.

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