

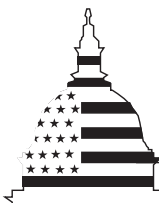
GAO

Report to the Chairman and Ranking
Minority Member, Committee on
Finance, U.S. Senate

April 2002

TAX-EXEMPT ORGANIZATIONS

Improvements Possible in Public, IRS, and State Oversight of Charities



G A O

Accountability * Integrity * Reliability

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Abstract Millions of donors annually give hundreds of billions of dollars to charities. ¹ While this giving helps meet charitable purposes, congressional and media concerns have arisen about whether some charities spend too much on fundraising and general management and not enough on program services to meet the charitable purposes related to the tax-exempt status. ² Such concerns have heightened since the outflow of charitable giving after the tragedies of September 11, 2001.		
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Abbreviations

AICPA	American Institute of Certified Public Accountants
GPRA	Government Performance and Results Act
IRC	Internal Revenue Code
IRS	Internal Revenue Service
NASCO	National Association of State Charity Officials
SOI	Statistics of Income



United States General Accounting Office
Washington, DC 20548

April 30, 2002

The Honorable Max Baucus
Chairman
The Honorable Charles E. Grassley
Ranking Minority Member
Committee on Finance
United States Senate

Millions of donors annually give hundreds of billions of dollars to charities.¹ While this giving helps meet charitable purposes, congressional and media concerns have arisen about whether some charities spend too much on fundraising and general management and not enough on program services to meet the charitable purposes related to the tax-exempt status.² Such concerns have heightened since the outflow of charitable giving after the tragedies of September 11, 2001.

Given these concerns, you asked us to review the oversight of charities. Oversight relies on the public (including donors, organizations that oversee charities—referred to as “watchdogs”—and the media), the Internal Revenue Service (IRS), and states. This combined oversight not only checks compliance with relevant laws, but also guides the public’s decisions about donations and stems abuses by charities. Although the common belief is that the vast majority of charities strive to meet their charitable purpose, if a few charities abuse the public trust, the support given to the charitable community can be undercut.

This report focuses on the adequacy of (1) publicly reported Form 990 (see app. I) data on charity spending in facilitating public oversight of

¹ Charities, recognized by Internal Revenue Code (IRC) Section 501(c)(3), are exempt from paying income taxes on the funds collected for charitable purposes. Charitable purposes include serving the poor and distressed; advancing religious, educational, and scientific endeavors; protecting various human and civil rights; and addressing various societal problems.

² Also known as “management and general,” the term “general management” refers to expenses for salaries, rent, professional fees, and other management functions that are not directly allocated to program services or fundraising.

charities,³ (2) IRS's oversight of charities, and (3) IRS's data sharing with state agencies that oversee charities. In researching these issues, we met with IRS and Department of the Treasury officials and reviewed IRS documents. We did the same at state and watchdog groups that oversee charities. We reviewed studies on charities and analyzed IRS's data on its oversight of charities and its Forms 990 on charity operations from filing years 1994 through 1999. Data for more recent years were not available when we did our work.

Results in Brief

Publicly available data on spending by charities can facilitate public oversight of charities, but the Form 990 data alone are not adequate for such oversight, and caution is warranted in using the data. Although one principal use of Form 990 data on charities' spending is to show the portion of funds that a charity spends on its charitable purpose, the accuracy of such data has not been measured. Various groups such as public watchdog groups have expressed concerns about expense reporting, and IRS has found and acted on instances of inaccurate reporting. However, IRS has not assessed, and is just beginning to develop plans to assess, the extent to which charities are properly reporting expenses.

Moreover, caution is warranted in using the Form 990 expense data, especially to compare charities, because charities have considerable discretion in recording their expenses in the program services, general management, and fundraising categories. Different approaches for charging expenses as well as different allocation methods can result in charities with similar types of expenses allocating them differently among the three categories. IRS has added a checkbox to the Form 990 to collect information about whether a charity is using the guidance issued in 1998 by the American Institute of Certified Public Accountants (AICPA) for allocating certain types of fundraising expenses. IRS also is asking for comments on whether adherence to this guidance should be required for certain charities.

IRS has neither data on the type and extent of possible compliance issues in the charity community nor results-oriented goals and strategies for its oversight of charities. As a result, it is difficult to make judgments about

³ IRS Form 990 is the return charities report their financial data annually and other activities. Our analysis did not include 990-EZ or 990-PF filers.

the adequacy of its oversight of charities. At the same time, concerns arise about the adequacy of oversight because IRS's resources have not kept pace with the growth in the charitable sector, and some measures indicate that available resources may not be used as effectively as in the past. From 1996 through 2001, IRS staffing for overseeing exempt organizations fell by about 15 percent while the number of applicants to become tax-exempt charities increased 9 percent, and the number of Forms 990 filed by charities increased 25 percent. The rate at which IRS examined these returns rose from 0.64 percent in 1996 to 0.73 percent in 1998 and 1999, before falling to 0.43 percent in 2001. Although IRS has plans to improve its oversight of tax-exempt organizations, including some in the charity community, it does not plan to measure the overall compliance of charities with federal tax laws and Form 990 reporting requirements, and it has not developed long-term, results-oriented goals, and a strategy for achieving them across charities.

State officials believe that inadequate data are shared by IRS to assist them in overseeing charities. IRS does not proactively share certain data that states are permitted to receive, such as denials and revocations of charities' tax-exempt status. Furthermore, federal tax law prohibits sharing certain data that state officials believe would be valuable, such as the status and results of examinations of charities' returns. IRS has agreed to develop plans to improve its sharing of data currently available to states and to work with Treasury and state officials to explore possible changes to federal law to expand data sharing with the states, coupled with protections of the confidentiality of the data.

We are recommending that IRS ensure that it obtains reliable data on charities' compliance with applicable laws and regulations—including for Form 990 reporting—and develop longer-range, results-oriented goals and strategic plans to help identify the level of oversight and resources that IRS should devote to charities. In addition, we are recommending that IRS develop in consultation with states better ways to share data as allowed by law and, identify whether and how additional IRS data that are unavailable to the states could be shared to enhance their charitable oversight while protecting the confidential nature of the data in concert with the Department of the Treasury and state officials.

We obtained comments on a draft of this report from IRS. (See app. VI.) IRS agreed with the findings in the report and said that the agency would assist in tax administration related to charities and identified the actions underway or planned to address our recommendations. IRS also said that the report did not sufficiently recognize certain ongoing agency efforts

related to the issues covered in the report. While the IRS's letter provided additional context on those issues, we believe the issues did not need additional elaboration in the report. We did change our draft to more explicitly recognize that IRS is beginning to develop plans to assess the accuracy of charities' expense reporting. The Agency Comments and Our Evaluation section discusses the IRS's comments.

The Department of the Treasury's Office of Tax Policy also provided comments on this report. (See app. VII.) Treasury officials said they would continue pursuing legislation to expand state access to selected IRS oversight data.

Background

Internal Revenue Code (IRC) Section 501(c) establishes 27 categories of tax-exempt organizations. The largest number of such organizations falls under Section 501(c)(3), which recognizes charitable organizations. Generally, charities pay no income taxes on contributions received, but they can be taxed on income generated from unrelated business activities. These charities and related parties may be subject to several additional IRS excise taxes and penalties for certain actions, such as not filing a required tax return. Generally, taxpayers may deduct the amount of any contributions to charities from their taxable income.

By 2000, IRS had recognized 1.35 million tax-exempt organizations under Section 501(c), of which 820,000 (60 percent) were charities.⁴ Social welfare, labor, and business leagues accounted for 280,000 (21 percent) of the tax-exempt organizations. The remaining organizations (about 19 percent) were exempt under other Section 501(c) categories. At the end of 1999, the assets of Section 501(c)(3) organizations approached \$1.2 trillion and their annual revenues approached \$720 billion.

The term charitable, as defined in the regulations that underlie IRC Section 501(c)(3), includes assisting the poor, the distressed, or the underprivileged; advancing religion; advancing education or science; erecting or maintaining public buildings, monuments, or works; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights; and combating community deterioration

⁴ Because IRS has not identified how many of these organizations have ceased to be active, these numbers are likely to be overstated. The Treasury Inspector General for Tax Administration has recommended that IRS take steps to improve such data.

and juvenile delinquency. An organization must apply for IRS recognition as a tax-exempt charity that strives to meet one or more of these purposes. In general, a charity is to serve broad public interests, rather than specific private interests.

Generally, public charities are required to file annual information returns with IRS that are also available to the public. The larger charities file Form 990, *Return of Organization Exempt from Income Tax*. Smaller charities—with gross receipts of less than \$100,000 and total assets of less than \$250,000—are allowed to file an abbreviated Form 990-EZ. The smallest charities, with less than \$25,000 in gross receipts, and certain other types of organizations, such as churches and certain other religious organizations, are not required to file. The Form 990 is to be filed within about 5 months of the end of the charity’s accounting year, with extensions available.

Form 990 has 105 line items on 6 pages, as well as 45 pages of instructions. The data on various finances and activities provide a basis for reviewing whether the organization continues to meet the requirements for tax exemption. The form also has two schedules: Schedule A and Schedule B. Schedule A covers several areas, including compensation of employees and independent contractors earning over \$50,000 annually; lobbying activities; sources of revenue; and relationships with noncharitable exempt organizations, such as social welfare organizations. Schedule B is to be filed by certain charities that receive contributions of \$5,000 or more from one or more donors. Charities may be required to file other forms in specific situations.⁵ Appendix I describes the Form 990.

IRS and various stakeholders—such as the states and “charity watchdogs”—oversee charitable operations to protect the public interest in part by reviewing the Forms 990. Certain charities, including those receiving federal and private grants, obtain independent financial audits. To the extent that such audit information is available in conjunction with Forms 990, those doing the oversight have more information on the financial status of the charities, and individuals can make more informed

⁵ Forms include Form 990-T, Exempt Organizations Business Income Tax Return, which reports taxable business income unrelated to a charitable purpose; Form 1120-POL, U.S. Income Tax Return for Certain Political Organizations, which reports net investment income of more than \$100 and spending to influence an election; and Form 4720, Return of Certain Excise Taxes on Charities and Other Persons, which reports excess lobbying expenses.

choices about donations to specific charities. Recognizing the importance of public oversight and a “free market”, where charities compete for donations, Congress expanded public disclosure of and access to the Form 990. Such oversight is important to help support charities, inform donors about how their money is spent on a charitable purpose, and stem potential abuses.

Objectives, Scope, and Methodology

Our objectives in this review were to analyze the adequacy of (1) publicly reported Form 990 data on charity spending in facilitating public oversight of charities, (2) IRS’s oversight activities for charities, and (3) IRS’s data sharing with state agencies that oversee charities.

For the spending data reported by charities, we interviewed IRS officials and experts (e.g., AICPA, the Urban Institute) to learn about charities’ reporting of expense data on the Form 990 and about independent financial audits. We reviewed studies such as those done by the Urban Institute, academicians, and the Chronicle on Philanthropy to better understand the expense data. We analyzed expense data reported by charities on the Form 990. IRS’s Statistics of Income (SOI) Division had available data on charity expenses, but those data only covered up to 1998 and did not include data on “joint-cost allocations” (e.g., allocating selected expenses between education and fundraising).⁶ To obtain at least 2 years of joint-cost data, we purchased filing years 1998 and 1999 data from the Urban Institute which contracts with IRS to digitize Form 990 data for the full population of charities that filed Form 990. For some large charities, primarily hospitals, expense data such as by line items of the Form 990 were not available to the Urban Institute. Thus, only joint-cost data and aggregate data for expenses, assets, and revenues for 1999 are presented throughout our report. Because several sources of data were used, data are presented by filing, tax, and fiscal years in this report.

For IRS oversight of charities, we talked with responsible IRS officials to identify oversight processes when charities apply for recognition of their tax-exempt status and when IRS examines Forms 990 filed by charities. For these types of oversight, we reviewed documentation on IRS’s processes and criteria used to review applications and examined Forms

⁶ SOI collects its data through stratified random samples of all Forms 990 filed for a year. As a result, the weighted data estimates developed from the samples are subject to sampling errors that affect their precision. Appendix II discusses these data estimates and the sampling issues.

990. We also analyzed related data for fiscal years 1996 through 2001. For applications, such IRS data included the number and types of applications received and their dispositions. For examinations, such data focused on the number and types of examinations and their results. In addition, we contacted other federal agencies, such as the Federal Trade Commission, to understand the types of oversight of charities that they conducted and the extent to which they coordinated that oversight with IRS. Appendix V discusses our selection of the agencies and our work.

For IRS data sharing with states, we interviewed IRS officials and reviewed IRS documents. We did the same at the National Association of State Charity Officials (NASCO), which represents 38 states that oversee charities to protect public interests. We participated in an October 9, 2001, annual NASCO conference. At the conference, we asked state officials about their oversight and coordination with IRS or others. We talked with Treasury, IRS, and state officials about the tradeoffs of changing the law to allow IRS to share oversight data (e.g., examination results) with state charity officials. We also reviewed related studies and articles.

For all three objectives, we collected documents from and talked with officials at various organizations. We talked with officials at the Joint Committee on Taxation about its reports in 2000 on disclosure of tax data on charities and on public, IRS, and state oversight. On the basis of referrals from IRS and NASCO, we talked with and collected documents from officials at the Council on Foundations, the Independent Sector, the GuideStar project at Philanthropic Research Inc., the Direct Marketing Association, and others that were knowledgeable about charity data, oversight, or fundraising. We reviewed documents from and talked with officials at three watchdog groups—Better Business Bureau Wise-Giving Alliance, Charity Navigator, and American Institute of Philanthropy—that oversee charities.

We also asked for comments on short sections or summaries of the draft report from the organizations that provided data or perspectives on those sections. We made technical changes to the report where appropriate after receiving their comments. For example, we did not use the 1999 detailed expense data from the Urban Institute after receiving its comments. The Urban Institute did not have the necessary data to resolve certain discrepancies with the detailed data (e.g., reported line item amounts not equaling reported aggregate amount for expenses) before we issued the report. As a result, we deleted analyses of the detailed expense data for 1999 that had been in the draft report.

We conducted our work in Washington, D.C., from June 2001 through March 2002, in accordance with generally accepted government auditing standards. We provided a draft of this report to IRS for review and comment. IRS's and Treasury's comments are in appendices VI and VII, respectively.

Little is Known About Form 990 Data Accuracy Despite Concerns of IRS and Others

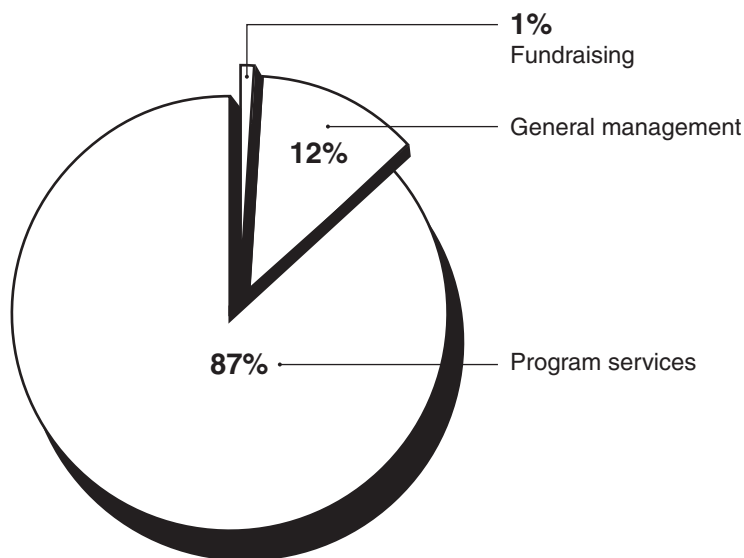
Although disclosure of charity spending data can facilitate public oversight, caution in interpreting the data, is warranted. No measures are available on the accuracy of the expense data and substantial discretion in allocating the expenses makes use of the data problematic in comparing charities. Given such data limitations, public oversight of charities cannot rely solely on the expense data reported on the Form 990.

A key potential use of data on charities' spending is to show what portion is spent on charitable purposes through program services (i.e., efficiency). In aggregate, the data show that from 1994 through 1998, charities allocated, on average, 87 percent of their spending to charitable program services and the remainder to fundraising and general management,⁷ suggesting a high-level of spending efficiency, as shown in figure 1. These percentages did not vary much by size of the charity.⁸

⁷ Program services means activities that provide goods and services to beneficiaries or members to fulfill the charitable purposes. Fundraising means activities associated with soliciting funds. General management includes salaries, travel, professional fees, and other expenses.

⁸ These percentages vary somewhat when analyzing only part of the charity universe. For example, when analyzing only charities that reported fundraising expenses, the percentages change to 85 percent for program service, 13 percent for general management, and 3 percent for fundraising. Note that, due to rounding, the total does not add to 100 percent.

Figure 1: Charity Expenses for Program Services, General Management, and Fundraising as a Percentage of Total Expenses, 1994-1998.



Source: SOI 1994-1998.

Accuracy of Form 990 Data Has Not Been Measured

Although Form 990 expense data are a principal source to support donors' informed judgments about whether to support a charity, the accuracy of the expense data has not been measured. At the same time, however, IRS officials and watchdog groups have expressed concerns about potential or actual inaccuracy in Form 990 expense data.

Because efficiency is a criterion that donors may use in selecting among charities, charities have an incentive to report their expenses in a manner that makes them appear to be efficient. IRS has discovered instances in which charity fundraising expenses have been underreported because charities have "netted" such expenses against the funds raised. According to IRS, fundraising expenses include fees paid to professional fundraisers as well as in-house expenses (e.g., salaries) for fundraising.

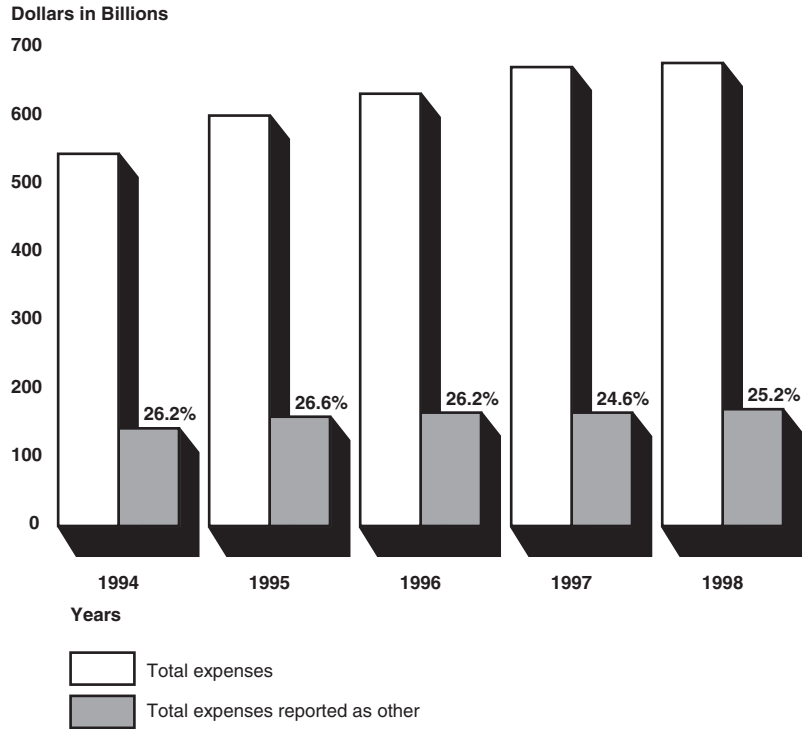
For example, a charity might contract with a professional fundraiser to raise donations. The fundraiser might raise \$250,000, charge the charity a fee of \$150,000, and give the charity the remaining \$100,000. When reporting to IRS, the charity "nets fundraising expenses" by reporting the \$100,000 as a direct public contribution and does not report the \$150,000

retained by the professional fundraiser as a fee. Such reporting does not comply with IRS instructions, under which the charity should report the full amount raised (\$250,000) as the direct public contribution and the fee retained by the fundraiser (\$150,000) on line item 30 of the Form 990.

As with netting of fundraising expenses, IRS has found that some charities have misreported professional fundraising fees as “other” expenses, but has not measured the extent to which charities do this. In these cases, a charity would report professional fundraising fees on line item 43 of the Form 990, along with other expenses, rather than on line item 30 for such fees.⁹ IRS requires charities to itemize expenses on 22 different line items on Form 990 and expressly prohibits reporting professional fundraising or other fees on line item 43 with “other” expenses that are not appropriate for the accompanying 21 line items. Available data do not show the extent to which charities may fail to properly itemize their expenses such as for professional fundraising, but “other” expenses represent a significant portion of all reported expenses. Our analysis showed that for 1994 through 1998, on average, 26 percent of all expenses were reported as “other” expenses, as shown in figure 2.

⁹ The Urban Institute and GuideStar also have reported on problems they have found with some charities misreporting fundraising expenses on Forms 990. GuideStar maintains, for public use, a database of nonprofit organizations and charities, their financial details, and their purposes and programs.

Figure 2: Total Expenses Compared to Percent of Total Expenses Reported as “Other,” 1994-1998

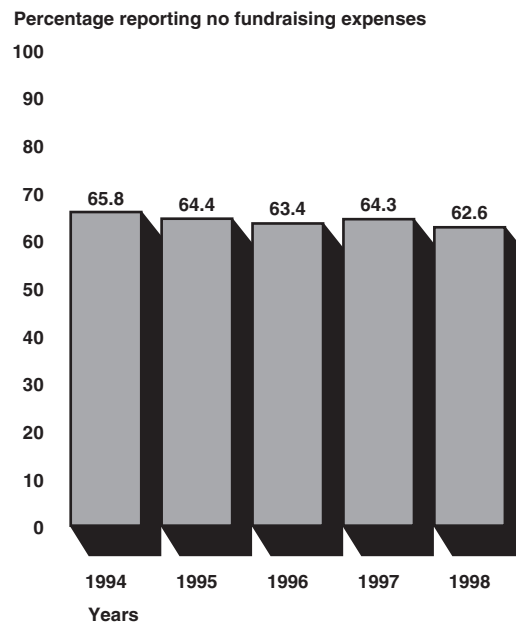


Source: Form 990; SOI, 1994-1998.

Despite not knowing the extent of misreporting, IRS has been sufficiently concerned that it has taken steps to better ensure charities properly report their expenses, especially for fundraising. Regarding netting of fundraising fees, IRS clarified its reporting instructions in 2001 and publicized the changes. Regarding reporting fundraising (and “other” fees) on the designated Form 990 line item rather than on the “other” expense line item, IRS believed its instructions were clear, but has reiterated them in its Continuing Professional Educational text for fiscal year 2002 and in training for its examiners. IRS makes this text available to tax practitioners and the public to inform them about the proper application of tax laws and regulations. IRS is instructing its examiners during fiscal year 2002 to check whether fundraising is being properly reported and to impose penalties where appropriate. IRS plans to convene a taskforce to consider what projects should be undertaken involving fundraising and Form 990 reporting, but the details have not yet been determined.

Within the charitable community, various organizations have been concerned about the accuracy of charitable expense reporting, with concerns often focusing on fundraising expenses. A 1999 Urban Institute study of Form 990 expense data found that 59 percent of 58,127 charities that received public donations either reported zero fundraising expenses or left this line item blank on the Form 990. Using the same criteria as the Urban Institute, our analysis of the Form 990 data from 1994 through 1998 found the number, on average, to be 64 percent, as shown in figure 3.¹⁰

Figure 3: Percent of Charitable Organizations Receiving Public Contributions and Reporting No Fundraising Expenses, 1994-1998



Source: SOI 1994-1998.

Charity experts have noted that those receiving donations are likely to incur some fundraising expenses, depending on certain circumstances (e.g., size or area of operation). The Urban Institute found it perplexing

¹⁰ We did similar analyses for all charities, regardless of whether they received public donations. From 1994 to 1998, 69 percent of all charities reported either no fundraising expenses or left this line item blank (line item 15) on the Form 990. We further analyzed how many charities reported no fees paid to professional fundraisers on the Form 990 from 1994 through 1998. On average, over 93 percent of all charities reported either no fees paid to professional fundraisers or left this line item blank (line item 30) on the Form 990.

that so many charities would report no fundraising expenses, but acknowledged that several factors could account for low fundraising expenses.¹¹ For instance, it noted that the smaller the amount of funds raised, the less likely charities may be to incur fundraising expenses. However, the Urban Institute did not indicate the amount that could be raised without incurring fundraising expenses. Thus, it would not be surprising for some charities, such as small ones or newer ones, to have little or no fundraising expenses.

The Urban Institute also notes that charities that raise revenues through “special events and activities” (Form 990, line item 9c) may legitimately report little or no fundraising expenses. When we accounted for those reporting special event expenses among those represented in figure 3, we found that, on average for 1994-1998, 34.8 percent of all remaining charities that received contributions did not report fundraising expenses.

In addition, various articles have discussed problems in charities’ reporting of fundraising expenses. For example, a May 2000 article in the *Chronicle of Philanthropy* discussed how some charities leave the “public in the dark” by not reporting fundraising expenses.¹² The article discussed how some charities in three states reported no fundraising expenses on the Form 990, although state records indicated that they had such expenses.

Charities Have Discretion in Determining How to Charge or Allocate Expenses to Program Services

Charities have discretion in determining how to charge expenses to program services as well as allocating expenses among the Form 990 functional categories for charitable program services, general management, and fundraising. The differences in the methods used can result in two charities with similar activities allocating their expenses differently among the functional expense categories on the Form 990. Figure 4 shows the three functional expense categories and the related lines for specific expenses.

¹¹ The Urban Institute also has discussed how the amount of fundraising reported can be skewed when supporting charities raise funds for affiliates. In such cases, IRS instructions state that the supporting charity should report these expenses as fundraising.

¹² “Charities Zero Sum Game: By Claiming No Fundraising Costs, Groups Keeps the Public in the Dark”, *Chronicle of Philanthropy*, May 18, 2000.

Figure 4: Functional Expense Categories and Related Lines for Specific Expenses

990 Return of Organization Exempt From Income Tax

OMB No. 1545-0047

2001 Open to Public Inspection

Department of the Treasury Internal Revenue Service

Under section 501(c)(3) of the Internal Revenue Code (except black lung benefit trust or private foundation)

The organization may have to use a copy of this return to satisfy state reporting requirements.

For the 2001 calendar year, or tax year beginning 2001, and ending 2001

Employer identification number

Check if applicable: ☐ New organization, ☐ Name change, ☐ Initial return, ☐ Final return, ☐ Amended return, ☐ Application pending

Section 501(c)(3) organizations and 4947(a)(1) nonexempt trusts must attach a completed Schedule A (Form 990 or 990-E)

Organization type (check only one): ☐ 501(c)(3) () 501(c)(29) () 4947(a)(1)

Check here ☐ if the organization's gross receipts are normally not more than \$50,000, but if the organization received a federal contract, it should file a return without financial statements. Some states require a complete return.

Gross receipts: Add lines 8b, 9b, 10b, and 11b to line 12

Part I Revenue, Expenses, and Changes in Net Assets or Fund Balances

1 Contributions, gifts, grants, and similar amounts received:

a Direct public support 1b

b Indirect public support 1c

c Government contributions (grants) 1d

d Total (add lines 1a through 1d) (cash \$ noncash \$) 1e

2 Program service revenue including government fees and contracts (from Part VII, line 23)

3 Membership dues and assessments 3

4 Interest on savings and temporary cash investments 4

5 Dividends and interest from securities 5

6a Gross rents 6a

b Less: rental expenses 6b

c Net rental income or (loss) (subtract line 6b from line 6a) 6c

7 Other investment income (describe) 7

8a Gross amount from sales of assets other than inventory 8a

b Less: cost or other basis and sales expenses 8b

c Gain or (loss) (attach schedule) 8c

d Net gain or (loss) (combine line 8c, columns (A) and (B)) 8d

9 Special events and activities (attach schedule)

a Gross revenue (not including \$ of contributions reported on line 1a) 9a

b Less: direct expenses other than fundraising expenses 9b

c Net income or (loss) from special events (subtract line 9b from line 9a) 9c

10a Gross sales of inventory less returns and allowances 10a

b Less: cost of goods sold 10b

c Gross profit or (loss) from sales of inventory (attach schedule) (line 10a minus line 10b) 10c

11 Other revenue (from Part VII, line 10) 11

12 Total revenue (add lines 1d, 2, 3, 4, 5, 6c, 7, 8d, 9c, 10c, and 11) 12

13 Program services (from line 44, column (B)) 13

14 Management and general (from line 44, column (C)) 14

15 Fundraising (from line 44, column (D)) 15

16 Payments to affiliates (attach schedule) 16

17 Total expenses (add lines 13 and 14, column (A)) 17

18 Excess or (deficit) for the year (subtract line 17 from line 12) 18

19 Net assets or fund balances at beginning of year (from line 21, column (A)) 19

20 Other changes in net assets or fund balances (attach explanation) 20

21 Net assets or fund balances at end of year (combine lines 18, 19, and 20) 21

For Paperwork Reduction Act Notice, see the separate instructions. Form 990 (2001)

- Charitable organizations are required to report expense totals from the Statement of Functional Expenses on Part II of the Form 990

Expenses		
13 Program services (from line 44, column (B))	13	
14 Management and general (from line 44, column (C))	14	
15 Fundraising (from line 44, column (D))	15	
16 Payments to affiliates (attach schedule)	16	
17 Total expenses (add lines 13 and 14, column (A))	17	

- Charitable organizations allocate (assign) expenses in three account groups (i.e., program services, management and general, and fundraising) by object classification (e.g., salaries, legal fees, travel)

Expense object classes

Part II Statement of Functional Expenses

Do not include amounts reported on line 8b, 8c, 9b, 10b, or 16 of Part I.

	(A) Total	(B) Program services	(C) Management and general	(D) Fundraising
22 Grants and allocations (attach schedule) (cash \$ noncash \$)	22			
23 Specific assistance to individuals (attach schedule)	23			
24 Benefits paid to or for members (attach schedule)	24			
25 Compensation of officers, directors, etc.	25			
26 Other salaries and wages	26			
27 Pension plan contributions	27			
28 Other employee benefits	28			
29 Payroll taxes	29			
30 Professional fundraising fees	30			
31 Accounting fees	31			
32 Legal fees	32			
33 Supplies	33			
34 Telephone	34			
35 Postage and shipping	35			
36 Occupancy	36			
37 Equipment rental and maintenance	37			
38 Printing and publications	38			
39 Travel	39			
40 Conferences, conventions, and meetings	40			
41 Interest	41			
42 Depreciation, depletion, etc. (attach schedule)	42			
43 Other expenses not covered above (itemize): a	43a			
b	43b			
c	43c			
d	43d			
e	43e			
44 Total functional expenses (add lines 22 through 43, Organizations completing columns (B) through (D) carry these totals to lines 13-15)	44			

Joint Costs. Check ☐ if you are following SOP 98-2. Are any joint costs from a combined educational campaign and fundraising solicitation reported in (B) Program services? ☐ Yes ☐ No. If "Yes," enter (B) the aggregate amount of these joint costs \$. (C) the amount allocated to Program services \$. (D) the amount allocated to Management and general \$. (E) the amount allocated to Fundraising \$.

Part III Statement of Program Service Accomplishments. (See Specific Instructions on page 24.)

Many Types of Expenses
Comprise Program Service
Functional Expenses

Although the three expense categories differ, their boundaries overlap. Fundraising activities may be mixed with program services, especially when a charity provides education related to its charitable purpose in a fundraising solicitation. Similarly, general management expenses may be mixed with the delivery of program services and fundraising. Charity employees may, for instance, spend time managing the daily support of the charity, spend time participating in raising funds, and spend time providing program services.

We analyzed the portions of total program service expenses (line item 13 of Form 990) during 1994 through 1998 that came from (1) grants and specific assistance (line items 22 and 23) that can only be charged to program service expenses to meet the charitable purpose or (2) expenses such as salaries, travel, etc. (line items 24 through 43) that can be charged to the program service, fundraising, and general management categories. It is important to recognize that expenses such as salaries and travel can be charged to program services when they are incurred in connection with meeting the charitable purpose. Table 1 shows the analysis of the types of expenses comprising program service expenses.

Table 1: Line Items as a Percentage of Program Service Expense, Filing Years 1994-1998

Line item object classes	1994	1995	1996	1997	1998	5-year average
Grants and allocations	5.8	5.3	5.2	5.8	6.5	5.7
Specific assistance to individuals	1.6	0.7	7.1	8.8	1.2	3.9
Grants and specific assistance, subtotal	7.4	6.0	12.3	14.6	7.7	9.6
Benefits to/for members	2.7	6.9	0.6	0.7	0.8	2.3
Compensation to officers, directors	0.6	0.7	0.7	0.7	0.8	0.7
Other salary & wages	34.5	32.6	32.6	32.7	36.4	33.8
Pension contributions	1.1	1.1	1.1	1.0	1.1	1.1
Other employee benefits	4.2	3.9	3.7	3.6	3.9	3.9
Payroll taxes	2.3	2.2	2.2	2.1	2.3	2.2
Compensation related, subtotal	45.5	47.3	41.0	40.9	45.2	44.0
Professional fundraising fees	^a	^a	^a	0.01	0.02	0.01
Supplies	8.3	7.9	8.2	8.1	8.9	8.3
Occupancy	2.6	2.5	2.6	2.6	2.9	2.6
Depreciation, depletion, etc.	3.7	3.8	3.8	3.8	4.2	3.8
Travel	0.8	0.7	0.8	0.7	0.8	0.8
Miscellaneous other categories ^b	4.9	4.7	4.7	4.6	4.9	4.8
Other expenses (line 43)	26.8	27.2	26.7	24.8	25.5	26.2
All other expenses, subtotal	47.1	46.7	46.7	44.6	47.2	46.4
Total	100	100	100	100	100	100

Note: Totals may not add to 100 percent due to rounding.

^aProfessional fundraising fees were allocable only to the fundraising expense column.

^bIncludes accounting fees, legal fees, telephone, postage and shipping, equipment rental and maintenance, printing and publications, conferences, conventions and meetings, and interest.

Source: IRS SOI data.

Expense Allocation Methods Affect Comparisons Among Charities

Charities can use different methods (which are not reported on the Form 990) for charging and allocating expenses. Such differences can affect comparisons across charities. Thus, charity watchdog groups, organizational donors, or others may draw inappropriate conclusions when comparing the expenses charged to program services or allocated across the three functional categories. Neither IRS nor the professional accounting accrediting bodies require or prohibit particular allocation

methods. In general, any method for charging or allocating expenses should be reasonable, logical, and consistently applied given the circumstances and facts. Organizations that provide funds or grants to charities are likely to provide guidance or requirements for charging and allocating expenses and to require independent financial audits.

Among the methods for allocating joint fundraising costs, the three methods mentioned routinely by accounting professionals and in accounting texts are the: (1) physical units method, (2) relative direct cost method, and (3) stand-alone joint-cost allocation method. Each method can produce a different financial “portrait,” and no one method is appropriate for all circumstances.

The method used determines the allocation of expenses among fundraising, program services and general management. For example, suppose a charity contracts with an external fundraiser to conduct a mail solicitation in which the letter combines program service (education) and fundraising text over 100 lines. The fundraiser’s \$1 million fee covers expenses for identifying potential donors and creating and mailing the letter. The charity must devise a way to equitably allocate the fundraiser’s expenses. One way is to use the physical units method of allocation. The physical units method uses identifiable, measurable, and calculable physical aspects of fundraising instruments to allocate expenses. In this example, the physical aspects are the number of text lines in the solicitation letter. If 10 lines of text covered fundraising and 90 lines covered program services, an allocation based on counting lines would allow the charity to allocate \$100,000 to fundraising and \$900,000 to program services.

However, this method of allocation may be inappropriate if most of the expenses incurred actually related to the use of the donor mailing list—the value of which relates more to fundraising than to program services. The stand-alone joint-cost-allocation method might provide a more reasonable allocation in this circumstance. If this method were used, and if \$750,000 of the fundraiser’s fee covered the value of its mailing list, at least \$750,000 of the \$1 million in total costs would be for fundraising and no more than \$250,000 would count for program services. Thus, the method used can materially influence the allocation of a charity’s expenses.

In March 1998, the AICPA published Statement of Position 98-2 (SOP 98-2) “Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fundraising” to

provide guidance on the allocation of joint activities, such as those when program services and fundraising are involved. SOP 98-2 was intended to provide consistent, clear, and detailed guidance for reporting joint activities. SOP 98-2 sets three criteria (purpose, audience, and content) that must be met to allocate such joint-cost expenses to the Form 990 program services or management and general categories, rather than to fundraising. The three SOP 98-2 criteria are:

- Purpose: should show that fundraising activities will help meet a program service or general management purpose.
- Audience: should show that donors are selected to meet a program service or a general management purpose rather than to contribute only funds.
- Content: should show that the content of the joint activity supports the charity's program service or general management purpose.

According to AICPA, if any of these criteria are not met, then all expenses should be allocated to fundraising. All three criteria require a call for action in order to allocate expenses to program services. A call for action makes general requests for involvement with an activity or cause, regardless of whether the individual contributes funding to those requesting the involvement. Absent a call to action, SOP 98-2 recognizes the activity as fundraising, and no expenses should be allocated to program services.

IRS added a checkbox to the 2001 Form 990 to indicate whether SOP 98-2 had been used to account for joint costs. IRS noted that the purpose was to facilitate the understanding of those reading the Form 990. IRS also is asking for comments on whether the use of SOP 98-2 should be required for certain filers (such as those above a specified amount of assets) to ensure greater uniformity in expense allocations and better comparison of fundraising expenses across charities. According to an AICPA official, charitable organizations may use this guidance, regardless of their accounting method.

Evaluating Charities Relies on More than Ratios on Spending Efficiency

Caution in relying on Form 990 expense data for public oversight of charities is also warranted because spending efficiency can vary for a number of reasons. Charity watchdog groups, GuideStar, the Urban Institute, and others have spoken against reliance on spending efficiency ratios as the sole measure of a charity's worthiness. The expense data and related efficiency ratios (such as program service expenses compared with all expenses) do not provide much perspective on other attributes of

charities, such as how well they accomplish their charitable purpose, regardless of the amounts spent.

Charity watchdogs have evolved to help monitor charities and enhance public oversight. In general, within the resources they have, these watchdog groups use the Form 990 data and other available data to analyze aspects of selected charities. These watchdog groups analyze spending efficiency ratios, but note limitations that could mislead the public on which charities are and are not doing well. Spending efficiency fluctuates with factors such as the popularity of the cause, age of the charity, and type of charitable activities. For example, an established, well-known charity may spend more money on fundraising than a newer charity. A charity also may have wide swings in its spending for charitable purposes if, for instance, those purposes are affected by sudden changes from events such as natural disasters. Also, a charity saving funds to build a facility to serve its charitable purpose may have no program service expenses until adequate funds are raised to begin the project.

When evaluating a charity, the public also considers how well a charity accomplishes its charitable purposes, which is not measured by spending data. However, measuring accomplishments and comparing charities on that basis is difficult to do according to the Independent Sector, the Urban Institute, and others (such as academicians). Given the wide diversity in the charity community, no standard rules have been devised to guide charities in reporting accomplishments. The Form 990 has a section that asks charities to report what was accomplished with the program service expenses; IRS's instructions allow discretion on reporting those accomplishments.

Other standards that the charity watchdog groups have suggested for evaluating charities include the manner in which the charity governs itself, raises funds, informs the public, accounts for its finances, prepares budgets and financial documents, and has independent audits or reviews. Each of these standards can be viewed as contributing information that can be useful for evaluating charities.

Imbalances Between IRS's Charity Oversight Workload and Resources Necessitate Better Planning to Improve Compliance and Resource Decisions

Determining the adequacy of IRS's oversight of charities is difficult, in part, because IRS has little data on the compliance of charities, and because IRS generally has not established results-oriented goals for its oversight of charities against which to measure progress. Concerns also arise with the adequacy of oversight because IRS has not kept up with growth in the charitable sector. IRS staffing for overseeing tax-exempt organizations fell between 1996 and 2001 while at the same time the number of new applications for tax exemption and the number of Forms 990 filed increased. By shifting staff, IRS has continued to process new applications and, as a consequence, has generally decreased its examinations of existing charities.

IRS has recognized that its oversight of charities and other tax-exempt organizations is limited and is formulating plans to measure tax-exempt organizations' compliance levels and improve its oversight activities. Because IRS does not have an accurate picture of charities' compliance and it is unclear how its plans would yield such data, IRS lacks key information for making decisions on how much charity oversight is needed, the amount of resources needed for the oversight, and how to improve its use of available resources. In addition, IRS's plans for improving its oversight activities generally do not define what results it intends to achieve in overseeing charities.

IRS Focuses on Reviewing Applications and Examining Annual Returns

IRS oversight of charities primarily consists of two activities. First, IRS reviews and approves applications filed by charities for the recognition of tax-exempt status. Second, IRS annually examines a small percentage of the annual returns filed by charities. Through these activities, IRS tries to ensure that charities merit the recognition of a tax-exempt status as well as the retention of it.

In carrying out these two functions, IRS generally is not responsible for taking adverse actions or even suggesting improvements in a charity's operations based on evidence about how well a charity spends its funds or meets its charitable purpose. Rather, IRS focuses on other issues related to the tax exemption for charities. For instance, in reviewing applications for recognition as tax-exempt charities, IRS focuses on whether applicants plan to undertake activities that meet the criteria for tax-exempt status and that adhere to standards such as restrictions on private benefits accruing to charity officials. Similarly, when examining charities' Forms 990, IRS checks for compliance with specific requirements applicable to charities, such as meeting a recognized charitable purpose. On the basis of discussions with IRS and state officials, oversight of charities' efficiency

and effectiveness is more likely to be accomplished through the public’s decisions about which charities to support and through states’ efforts to ensure that charities do not abuse their charitable status.

As for oversight of applications, IRS revenue agents review the applications of organizations seeking tax-exempt status as charities. If an application is approved, IRS provides a letter to the charity approving its tax-exempt status. Comparing fiscal years 1998 through 2001, the number of applications for charity status submitted to IRS has increased from about 54,000 to about 59,000, or about 9 percent, as shown in table 2. Over all 4 years, the number of applications denied stayed below 100. (See app. III for a description of the application process.)

Table 2: Number of Charity Applications Received and Disposed, by Fiscal Year						
Fiscal year	Applications received	Types of disposals of applications				
		Approved	Denied	Did not submit fee	Withdrawn by charity	Did not submit all documents
1998	54,119	36,743	73	1,473	883	11,056
1999	50,724	39,281	39	764	890	8,433
2000	58,029	45,233	59	390	899	8,853
2001	58,938	42,308	58	450	894	9,204

Note: IRS did not have the data for fiscal years 1996 and 1997.

Source: IRS data.

In examinations, IRS seeks to ensure that charities meet federal tax requirements. In examining a return, the revenue agent requests and reviews information from a charity to check the accuracy of items on the return and to verify that a charity is operating to meet a charitable purpose. As shown in table 3, comparing fiscal years 1996 through 2001, the number of annual returns (Forms 990) increased from about 228,000 to about 286,000 (25 percent) while the number examined dropped from 1,450 to 1,237 (15 percent). Thus, IRS examined a smaller percentage of returns and charities—dropping by 2001 to 0.43 percent and 0.29 percent, respectively. (See app. IV for a description of the examination process.)

Table 3: Number of Examinations and Examination Rates for Charity Returns, by Fiscal Year

Fiscal year	Number of annual returns filed	Number of annual returns examined	Examination rate (returns)	Number of charities examined	Examination rate (charities)
1996	228,013	1,450	0.64	896	0.39
1997	231,161	1,584	0.69	946	0.41
1998	260,885	1,912	0.73	1,238	0.48
1999	235,333	1,723	0.73	1,294	0.55
2000	273,649	1,294	0.47	875	0.32
2001	285,733	1,237	0.43	835	0.29

Note: Because some examinations of larger charities involve Forms 990 filed for more than 1 year, the number of returns examined exceeds the number of charities examined each year.

Source: IRS examination data.

In addition, examinations are taking longer. (See app. IV for the results.) For fiscal years 1996 through 2001, the time required to examine charity returns nearly tripled when a charity agreed to changes proposed by IRS and increased about seven times when a charity disagreed. IRS officials did not know the reasons for such increases in time and were concerned. Given the concern, IRS has started analyzing ways to better select the most noncompliant returns for examination. The date for completing the analysis was not set, as of March 2002.

Multiple Priorities and Limited Resources Contribute to Fewer Examinations

At least three related reasons help explain the decline in the number of charity examinations. First, IRS has had to adjust the level of charity oversight given many other priorities involving all other types of taxpayers. Second, the resources devoted to oversight dropped for fiscal years 1996 through 2001. Last, IRS moved revenue agents from doing examinations to processing the increased application workload.

IRS has many other priorities as the agency that collects the proper amount of revenue to fund the programs that Congress and the executive branch have approved. For example, to deal with millions of individual and business taxpayers, IRS has established four operating divisions organized around the type of taxpayer—Wage and Investment, Small Business/Self-Employed, Large and Mid-Size Business, and Tax-Exempt and Government Entities (TE/GE). TE/GE deals with charities, many other types of exempt organizations, pension plans, Indian tribal governments, and other types of government entities. Each of these activities competes

for staffing and funding. Furthermore, although TE/GE has the major charity oversight role among federal agencies,¹³ its oversight is limited.

The staffing devoted to IRS's exempt organization function and oversight has declined in recent years. IRS was unable to provide the staffing levels for reviewing charity applications and examining the Form 990. However, from fiscal years 1996 through 2001, total staffing for the exempt function has fallen from 958 to 811, or about 15 percent. For application and examination oversight of all exempt organizations, the staffing fell from 609 to 546, or about 10 percent. A 1997 IRS memorandum pointed out that the staffing level for the entire organization that is now TE/GE had been essentially flat since its creation in 1974 (2,075 in 1974 to 2,123 in 1997) while the workload in terms of the size of the sectors that it regulated had doubled.

IRS also shifted revenue agents from doing examinations to help process the increasing application workload. Because all applications must be processed and oversight staff had not increased, IRS moved agents from doing examinations. In fiscal year 2001, IRS took steps to hire about 40 additional staff to help process applications, which would allow revenue agents to return to doing examinations.

New IRS Approach to Improve Compliance and Oversight Will Not Cover All Charities and Does Not Define Desired Compliance Results

Given increased workload and declining resources, IRS officials are developing an approach to better gauge the extent and types of compliance issues for tax-exempt organizations and to improve their oversight strategies. However, the current approach would not provide information on compliance problems of the full charitable community. Nor does it define the overall results IRS hopes to achieve in a manner that would facilitate strategic investments of resources and that can be used to assess IRS's overall progress in improving its oversight strategies.

IRS's new approach is to study segments of the tax-exempt community, that is, market segments, to better understand existing compliance issues.¹⁴ Through these studies, IRS intends to develop indicators of

¹³ Appendix V discusses the limited oversight roles provided by other selected agencies such as the Federal Trade Commission and United States Postal Inspection Service.

¹⁴ Market segments involve homogeneous groups of tax-exempt organizations. IRS also plans to start 9 compliance projects in 2002 to address known areas of noncompliance such as unrelated business income.

compliance for 35 selected market segments and analyze ways to address compliance problems. According to IRS, the results of the market segment studies are intended to help refine the selection criteria for identifying noncompliant returns for examination as well as help identify other strategies to improve compliance such as additional guidance, clearer instructions, or correspondence on apparent noncompliance. Understanding compliance problems and measuring compliance among the various types of charities also is intended to help determine where to focus resources.

As of February 2002, about half of the selected segments dealt with a wide variety of tax-exempt organizations that were not charities and about half dealt with various types of charities such as those for hospitals, colleges, and churches.¹⁵ It was not clear how IRS would use the results to get a picture of compliance across all charities, even though charities account for most of the applications and Forms 990. Without an understanding of the extent and nature of compliance problems across all charities, IRS will have difficulty in making data-driven decisions about the strategies for improving oversight as well as the level of oversight and resources needed.

IRS plans to start work on these market segments as resources and data allow. Due to resource limitations, IRS believes that at the present rate the completion of all planned studies will take until fiscal year 2008. During fiscal year 2002, IRS plans to work on six segments.¹⁶ IRS officials said that they selected segments based on experience and judgment.

As part of IRS's overall performance management system, TE/GE has developed a plan to guide its operations. That plan covers TE/GE's responsibilities, including those for charities. The plan specifies, for instance, the number of employees to be assigned to each activity, the number of applications and examinations IRS expects to process, and how long such activities take, and the satisfaction of tax-exempt organizations with IRS's services and its employees.

¹⁵ The other charity segments include organizations involving amateur athletics, childcare, community trusts, economic development, education, grant making, health maintenance, low-income housing, nursing homes, private foundations, religious organizations, schools, science and research, social service, charitable support, charitable trusts, and veterans.

¹⁶ These include social clubs, labor organizations, business leagues, community trusts, social service organizations, and religious organizations that are not churches.

For fiscal years 2003 and 2004, TE/GE has proposed staffing increases in two initiatives for known concerns. Although the proposed increases do not focus on charities, their implementation might assist IRS's charitable oversight. One initiative calls for adding 20 staff to work on improving the quality and quantity of IRS data and studying uses of non-IRS databases. The second initiative requests 30 additional staff to enhance IRS's examination presence in the exempt organization community. IRS officials said both initiatives would require similar increases in staff during future years.

Although TE/GE's plan and initiatives provide an understanding of what IRS intends to do with its staff and other resources, IRS has not identified what longer-range results it intends to achieve for charities. The planning principles in the Government Performance and Results Act (GPRA) and incorporated into IRS's Strategic Planning, Budgeting, and Performance Management process call for agencies to define the measurable results they are attempting to achieve, generally over several years. This approach is intended to ensure that agencies have thought through how the activities and initiatives they are undertaking are likely to add up to a meaningful result that their programs are intended to accomplish. The TE/GE plan does not, for instance, provide goals for improving the compliance levels of tax-exempt organizations as a whole or for charities in particular. The plan also does not discuss the basis for IRS's judgment that the proposed initiatives are the best ways to improve compliance.

IRS officials said that longer-range planning could be useful. They noted, however, that their ability to undertake significant initiatives for charities must be considered in the context of IRS's overall responsibilities. Furthermore, they said that establishing a link between their activities and changes in charities' compliance is challenging and this makes planning to achieve certain types of results difficult. Many agencies face this challenge.¹⁷ However, GPRA's and IRS's planning requirements suggest that the process of focusing on intended results, while often challenging, promotes strategic and disciplined management decisions that will be more likely to be effective than planning that is not results-oriented.

¹⁷ See General Accounting Office, *Managing for Results: Using GPRA to Assist Oversight and Decisionmaking*, [GAO-01-872T](#), (Washington, D.C.: June 19, 2001) and *Managing for Results: Federal Managers' Views Show Need for Ensuring Top Leadership Skills*, [GAO-01-127](#), (Washington, D.C.: Oct. 20, 2000).

Although Federal and State Officials Generally Support More IRS Sharing of Data with States, Many Issues Must Be Considered

IRS data sharing with the states to facilitate state oversight of charities is limited in two ways. First, IRS does not have a process to proactively share data that it is allowed to provide to states, such as data on the denial or revocation of tax-exempt status. Second, federal law generally prohibits IRS from sharing data with states about its reviews of applications for recognition of charities and its examinations of existing charities. State officials believe that accessing IRS's oversight data would help them allocate resources in overseeing charities. Because federal taxpayer data are subject to statutory confidentiality protections, a number of issues, such as security procedures to protect federal tax data, would need to be considered if data sharing were expanded.

Many States Oversee Charities to Protect the Public

Many states oversee charities to protect the public. Although overlap exists, IRS and state oversight differs. IRS focuses on whether the charity meets tax-exempt requirements and complies with federal laws, such as those governing the use of funds for a charitable purpose rather than private gain. States have an interest in whether charitable fundraising is fraudulent and whether the charity is meeting the charitable purpose for which it was created.

The majority of states oversee charities through their attorneys general and charity offices. State attorneys general usually have broad power to regulate charities in their states. These states monitor charities for compliance with statutory and common-law standards and have the option of correcting noncompliance through the courts. Furthermore, these states usually regulate the solicitation of funds for charitable purposes. Some states require professional fundraisers to register and file information on specific fundraising contracts.

IRS Does Not or Cannot Share Much of Its Oversight Data on Charities with States

IRS does not have a process to proactively share oversight data with states as permitted by federal law and cannot share much of its data because of legal prohibitions. IRC Sections 6103 and 6104 govern the types of oversight data that IRS can share with states for purposes of overseeing charities.

In general, to protect taxpayer confidentiality, Section 6103 prevents IRS from publicly disclosing tax return data for all types of taxpayers, unless

explicitly allowed.¹⁸ For charities, this means IRS cannot share most data about examinations. The general restriction against disclosure stems primarily from a right to privacy. Congress only granted the explicit exceptions when it determined that the need for the disclosure of the data outweighed the right to privacy. Criminal and civil sanctions apply for the unauthorized disclosure or inspection of federal tax returns and return data.

Although tax-exempt organizations also may assert a right to privacy for interactions with IRS, Congress has developed different disclosure rules and has been expanding the levels of public disclosure. The rationale for disclosure has been that the public supports tax-exempt organizations through direct donations and the tax benefits accruing from their tax-exempt status and, thus, has a strong interest in information about the organizations. Section 6104 exists to provide more disclosure about tax-exempt organizations. For charities, it provides some exceptions to Section 6103 prohibitions so that states can request access to certain IRS data, such as details on revocations of tax-exempt status, to support state oversight of charities.

Table 4 shows the types of IRS oversight data that states can and cannot get. The second column indicates IRS data that are available to states, the third column indicates IRS data that state charity officials can request through Section 6104 under certain conditions, and the fourth column indicates IRS data that cannot be shared due to Section 6103 prohibitions.

¹⁸ For example, IRS can share such data with states for administering state tax programs, enforcing child support programs, verifying eligibility/benefits for public assistance, and investigating criminal activities.

Table 4: Availability of IRS Application and Examination Data on Charities to States

Types of IRS data states might want to access ^a	Available to states	Available to state charity officials if designated ^b	Not available to state charity officials
Approved application	X		
Denied application		X	
Withdrawn application			X
Pending/appealed application			X
Notice of revocation	X		
Notice of deficiency		X ^c	
Details on denials, revocations, or notices of deficiency		X ^c	
Receipt of state referrals	X		
Actions on state referrals			X
Ongoing examination data			X
Closed examination files			X ^d

^aIRS officials are researching whether states can gain access to data on intermediate sanctions against individuals at a charity due to excess benefits and IRS closing agreements with the charity.

^bFor Section 6104(c), an appropriate state officer can receive this information. For example, a state attorney general, state tax officer, or any state official charged with overseeing organizations of the type described in Section 501(c)(3), if so designated.

^cApplies to a mailing of a notice of deficiency under Section 507 and chapters 41 or 42. Section 507 applies to penalties on the termination of private foundations. Chapter 41 applies to charity lobbying expenditures and chapter 42 applies to charity-related excise taxes, such as for intermediate sanctions.

^dCan request access to closed files only for those resulting in a revocation or certain notices of deficiency and only if they can show they need the files and how they will use the files.

Source: IRC Sections 6103 and 6104 and IRS officials.

IRS Does Not Have a Process to Regularly Share Data That States Can Obtain

As table 4 shows, the appropriate state officials can obtain details about the final denials of applications, final revocations of tax-exempt status, and notices of a tax deficiency under Section 507, or Chapter 41 or 42. However, IRS does not have a process to regularly share such data.

Under Section 6104, IRS cannot share these details with the appropriate state officials unless they formally request these details and disclose their intent to use the data to fulfill their official functions under state charity law. IRS is to ensure that each request is reasonable, relevant, and necessary before releasing the data. Appropriate state officials may ask IRS for details such as examination results, work papers, reports, filed statements, application documents, and other information on determinations. State charity officials can have access to such data if they prove they are an appropriate state official as evidenced by a letter from the state attorney general on the functions and authority of appropriate

officials with enough facts for IRS to determine that they can access the data.

State charity officials would like regular access to such data. NASCO officials—state officials in 38 states who oversee charities—said that quicker access to information on denied applications and revocations helps stop charities from continuing suspicious activity. If such data are not provided quickly, the charity can dispose of assets or change its operations. Knowing the details about the revocation can also help states track individuals who try to re-establish similar suspicious operations in other states.

IRS and the state officials said that data on denials, revocations, and notices are worth sharing. However, from fiscal years 1996 through 2001, few charity applications were denied compared to the over 50,000 applications submitted annually (see table 2), and few examinations resulted in revocations or notices of deficiency compared to over 1,000 examinations closed annually (see table 3), as shown in table 5.

Table 5: Number of Denied Charity Applications, Revoked Charities, and Notices of Tax Deficiencies Sent to Charities, Fiscal Years 1996-2001

IRS actions on charities	Number of IRS actions per fiscal year					
	1996	1997	1998	1999	2000	2001
Denied applications	^a	^a	73	39	59	58
Revoked charities	16	12	24	8	27	9
Notices of tax deficiency	^b	^b	^b	^b	^b	^b

^aData not available.

^bIRS could not provide data on the number of notices of tax deficiency sent for taxes assessed under Section 507 as well as Chapters 41 and 42. However, the number of these notices would be less than the number of examinations that closed with a proposed assessment of any type of tax or a penalty. For fiscal years 1996 through 2001, about 140 examinations, on average, closed annually with some type of tax or penalty assessment against charities.

Source: IRS data.

However, IRS lacked a proactive process to regularly inform state officials of steps to be taken to request the data that are available under Section 6104. NASCO officials said many states are not clear about the rules for making these requests and about the types of details that are available. Such requests used to be sent to the district office director. IRS's reorganization has abolished this position, and IRS has not developed a new process due to its focus on other priorities related to its reorganization.

IRS plans to develop a new process. IRS officials said in February 2002 that they started compiling a list of state officials who can receive IRS data on charities. They said that a barrier has been having enough staff to develop the process and negotiate agreements with each state on requesting, transmitting, protecting, and overseeing use of the data. Afterwards, managing this data-sharing process could pose additional resource challenges, depending on how the process would work. Officials said that a proposed system could be ready to discuss with states during the spring of 2002.

States Want Access to Protected IRS Data on Charity Applications and Examinations

Although IRS and the states have a common interest in overseeing charities, Section 6103 generally prohibits IRS from sharing data with state agencies about actions, such as examinations of charities. These prohibitions apply even to IRS examinations that result when a state agency refers concerns about specific charities to IRS. Neither can IRS disclose actions on pending or withdrawn applications.

State officials who oversee charities believe that Section 6103 hampers their efforts to identify charities that defraud the public or otherwise operate improperly. They offered only anecdotal information on the extent to which such charities exist, but they believed that even a few abusive charities should be pursued because the betrayal of public trust could adversely affect the support given to all charities.

At the annual NASCO conference in October 2001, state charity officials offered favorable comments about IRS's outreach and education efforts, but pointed to problems created by IRS not being able to share data on pending and closed examinations and on pending and withdrawn applications. State officials were particularly concerned about not being able to get feedback on IRS actions on a state referral because of Section 6103 prohibitions. IRS officials said that state referrals are productive to examine, but IRS only can confirm receipt of the referral and whether the tax exemption was revoked. Other concerns expressed by state charity officials with IRS not being allowed to share its oversight data follow.

- States might waste resources investigating a charity that IRS is examining or has found to be compliant (at least in those areas that IRS examined).
- States might be unaware of questionable charities for a long time, which allows those charities to continue operating before the states know to pursue them.
- States might miss opportunities to build better cases against charities when they observe suspicious activities.

State officials say that often times they cannot fully use their powers to protect the public because of the lack of readily available data. State officials said that when they learn of a suspicious activity, they need information quickly. The officials said that they could head off a suspicious activity by asserting their state powers, noting that usually the threat of action is enough. However, questionable charities tend to move from state to state. State officials cited a need to compare IRS application data with state charity registration information to quickly deal with registrants that have a questionable past.

State charity officials saw an advantage in greater data sharing because IRS does not have the authority to correct the fraudulent or suspicious charitable activities that states can correct. IRS can deny or revoke the charity's tax-exempt status. As a tax administrative agency, IRS is interested in the tax-exempt status of a charity and whether it should continue. IRS generally does not pursue charity-related fraud. If others (such as states) have proved fraud, that proof can justify denial or revocation of a tax exemption.

State charity officials provided examples of how expanded sharing of examination and application data would help the states. Having examination results would allow the states to better monitor the operations of specific charities, determine their compliance with state laws, and correct any noncompliance earlier. Having data about pending and withdrawn applications could help states to be aware of potential problems and be more proactive in protecting the public. According to state officials, during the months that an application is pending, a so-called charity may not be operating to serve charitable purposes, and the public may incorrectly assume that it is tax-exempt and that donations are tax deductible.

Treasury officials noted, however, that sharing examination data could be misleading. For example, the examination may involve issues unrelated to the organization's tax-exempt status. In addition, sharing data about pending applications could result in disclosure of taxpayer information that is entitled to the confidentiality protections of Section 6103 if the taxpayer is not ultimately determined to be tax-exempt.

Sharing IRS Oversight Data on Charities Requires Consideration of Various Issues

IRS and Treasury officials said that while they see value in the principle of sharing data with states, certain issues need to be considered in determining the scope of data sharing and the protection that should govern such sharing. In addition, the officials noted that both the IRS and states would incur various costs and burdens that need to be balanced in judging which data should be shared, what benefits would be obtained, and which means of sharing data would be the most appropriate. The officials said that they were formulating a position on legislative proposals to expand access, with appropriate taxpayer protections. Treasury officials said they supported a provision included in draft legislation (H.R. 3991, Taxpayer Protection and IRS Accountability Act of 2002) that would permit IRS to share more data with state officials to assist them in administering state laws regulating charitable organizations. Issues raised by IRS regarding any legislative proposals included:

- Any disclosure of IRS data raises the issues of how the data are used and who uses the data. Understanding these issues is needed to make informed judgments about how best to share the data and to protect against improper disclosures.
- Granting access to pending applications and examination data raises more challenges compared to those for final application and examination data. These challenges relate in part to concerns about privacy and due process rights. To the extent IRS shares data on issues for which it has not completed its work, use of the data by states would need to recognize this significant limitation. Influencing this issue is the fact that the interests of IRS as a tax administrator do not fully converge with the interests of state charity officials who are not tax officials.
- The proper legal vehicle for expanding access to IRS's application and examination data would need to be considered. Two basic legal provisions are Section 6103 (which prevents disclosure) and Section 6104 (which enhances disclosure). Other legislative provisions might be worth considering, depending on the types of data that state charity officials want to access and their intended uses.
- The legal vehicle chosen would also affect the types and rigors of the controls created to protect the data from improper disclosure and misuse. For example, Section 6103 imposes rigorous requirements on the receipt, storage, and use of the data in all forms (e.g., paper versus electronic) to protect IRS data as well as imposes various training and oversight requirements to ensure conformance to the protections. The controls and protections under Section 6104 generally are considered to be less rigorous. The level of protection that should be provided for data shared with states is an important issue.

Considering the previously mentioned issues, IRS and states would need to be aware of the resources required to develop and implement agreements on how the data are to be used, who can use the data, and how the data are to be transmitted, maintained, and protected. In some cases, the resources in terms of staffing, training, space, and computer capabilities could be significant.

Conclusions

With assets approaching \$1.2 trillion and annual revenues approaching \$720 billion, charities represent a substantial presence in American society. The approximately 250,000 active charities range from very small, local efforts to very large, sophisticated hospitals and universities. The public—including the donors, media, and watchdog groups—IRS, and the states oversee charities. In this oversight framework, IRS has a limited role in considering how well charities are spending funds or accomplishing charitable purposes. Instead, the framework envisions a “free market” in which charities compete for donations, in part, based on such spending or accomplishments. Key to the proper functioning of this marketplace is the availability of reliable data, such as Form 990 data, that donors can use to make informed choices about which charities merit their contributions.

However, due to suspected but unmeasured inaccuracy in some charities’ reporting of their expenses and to the range of discretion that charities have in charging and allocating expenses, Form 990 expense data alone are not adequate for public oversight of charities and should be used with caution. Recently, IRS officials have taken steps to address incidents of inaccurate expense reporting and have sought comments on one set of guidance for allocating expenses.

IRS’s investment in reviewing charity applications and examining charity returns has not kept pace with the growth in the number of applications and returns. More informed decisions about the resources to devote to this investment could be made if IRS had a better understanding of the type and extent of compliance problems in the charitable community as well as a clear plan for how IRS would use its resources to achieve certain results, such as specific improvements in the compliance of charities. Neither of these is currently available, even though IRS has initiatives to increase its staffing for all exempt organizations. IRS’s plan for improving compliance will not provide data on the extent of the compliance problems and the level of oversight needed across the charitable community. Nor does the plan identify results-oriented goals and strategies, resources needed to accomplish such goals, and measures to gauge its progress toward goal accomplishment.

However, given the size of the charitable community, it is unrealistic to expect that IRS would ever review more than a minor portion of charities. Furthermore, certain issues related to charities, such as the extent to which their fundraising activities may be misleading, can be addressed by state officials. Thus, helping to make state oversight of charities as effective as possible would enhance oversight of the charity community. State officials who oversee charities believe data that IRS can provide, but that often does not flow to them, as well as certain data that IRS is prohibited from sharing due to federal protections for taxpayers' confidentiality, would make their oversight more effective. IRS and Treasury officials recently have started to discuss whether and how to share more data with the states. However, the timing and likely outcomes of these discussions is not yet clear. Also, the specific types of data that would be useful, the best means of sharing that data, the resources needed, and the taxpayer protections that would apply to the data, need to be worked out between federal and state officials. Furthermore, any proposal to change the law that restricts disclosure of certain IRS data to the states would require Congress and Treasury to make policy decisions about the balance between the privacy rights of charities and the public's interest in more disclosure.

Recommendations

To improve oversight by the public, IRS, and the states, we recommend that the commissioner of Internal Revenue

- ensures (either through the planned market segment studies or other means) that IRS obtains reliable data on compliance issues (including expense reporting) for the full charity community;
- develops results-oriented goals, strategies (including levels of staffing and other resources to accomplish the goals), and measures to gauge progress in accomplishing those goals when overseeing the charity community; and
- develops, in consultation with state charity officials, a procedure to regularly share IRS data with states as allowed by federal tax law.

In addition, we recommend that IRS, in concert with the Department of the Treasury and state charity officials, identify the specific types of IRS data that may be useful for enhancing state charity officials' oversight of charities, the appropriate mechanisms for sharing the data, the resources needed, and the types and levels of protections to be provided to prevent improper disclosure and misuse. IRS and Treasury should continue drafting specific legislation to expand state access to selected IRS oversight data and ensure adequate levels of protection for any data that would be shared.

Agency Comments and Our Evaluation

We obtained comments on a draft of this report from IRS. (See app. VI.) IRS agreed with the findings in the report and said that the agency would assist in tax administration related to charities and identified actions underway or planned to address our recommendations.

We support IRS's timely actions on our recommendations and believe IRS's actions are generally responsive to our recommendations. As IRS moves forward with its plans, however, we encourage the commissioner of Internal Revenue to ensure that the actions IRS takes will cover all aspects of our recommendations. For instance, although IRS's comments indicate that IRS will develop goals and measures for its oversight of charities, the comments do not mention identifying the levels of staffing and other resources needed to accomplish such goals.

Although generally agreeing with our findings and indicating that actions were planned or being taken in relation to our recommendations, IRS had certain reservations about the report. First, IRS said that our draft report implied that IRS was not looking at the extent to which charities are properly reporting expenses. Also, according to IRS, the agency has established a task force to develop examination projects for reporting accuracy and that examiners have been instructed to review this issue. Our draft report did recognize these actions. However, the task force had not yet begun to develop projects at the time we did our work, and examiners look at only a very small portion of charities annually. Thus, neither of these actions indicated that IRS would be obtaining reliable overall measures of how accurately charities report their expense data. We did modify our Results in Brief discussion to more explicitly recognize that IRS is beginning to consider how to assess charities' expense reporting.

IRS also said that the draft report did not sufficiently recognize the breadth of IRS's responsibilities related to tax-exempt organizations. In the draft, we recognized IRS's other responsibilities both in providing statistics on the portion that charities represent of all tax-exempt organizations and by explicitly noting the range of responsibilities that fall under TE/GE and that those responsibilities compete for staffing and funding with IRS's efforts to oversee charities. IRS's letter provided some additional data demonstrating the breadth of IRS's responsibilities.

Finally, IRS did not believe that our draft report provided sufficient recognition of the strategic planning process followed by TE/GE. IRS was, in part, concerned that the draft report indicated it was not clear that IRS's current plans would yield an accurate picture of charities' compliance. IRS said TE/GE's long-term plan to do market segment studies will provide

reliable information on the compliance level of various segments of the charitable community. Our draft report described IRS's strategic planning efforts related to its oversight of charities and thus did recognize that some planning has been done. However, as shown in the comments, those plans do not yet include such things as results-oriented goals or performance measures to assess IRS's progress. Furthermore, although we believe the market segment studies should provide useful information on charities' compliance, as discussed earlier, we did not see sufficient evidence to conclude that reliable data on charities' expense reporting would be generated. In addition, at the time of our report, IRS was requesting public comments on whether it should define additional market segments to study, thus raising uncertainty over whether the currently planned work would cover all charities to yield adequate data on their compliance issues.

The Department of the Treasury supports the overall goal of increasing the information IRS can share with state officials who oversee charities. (See app. VII.) Treasury also recognized that appropriate safeguards must be in place to protect the confidentiality of taxpayer information. Treasury officials said that they intend to pursue developing appropriate legislation to expand state access to IRS's oversight data. Treasury's plans are consistent with our recommendations.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this report. We will then send copies of this report to the secretary of the Treasury; the commissioner of Internal Revenue; the director, Office of Management and Budget; and other interested parties. We will also make copies available to others on request. The report is also available on GAO's home page at <http://www.gao.gov>.

This report was prepared under the direction of Tom Short. Other major contributors were Rodney Hobbs, Daniel Mesler, Demian Moore, and Oliver Walker. If you have any questions about this report, please contact Tom Short or me at (202) 512-9110.



Michael Brostek
Director, Tax Issues

Appendix I: Description of Form 990

Reporting Requirements

Tax-exempt organizations recognized by the Internal Revenue Service (IRS) are required to annually file Form 990 or Form 990-EZ (Return of Organization Exempt From Income Tax) if their annual gross receipts are normally more than \$25,000. Organizations that have less than \$100,000 in gross receipts and total end of year assets of less than \$250,000 may use Form 990-EZ. This appendix describes the Form 990 and the information requested and provides a copy of the Form 990.

What is the Form 990?

The Form 990 is used primarily as an IRS information return and a public information document. The Form 990 relies on self-reported information from filers. Most of the 27 types of exempt organizations that fall under Section 501(c)¹ use this form along with Section 527 political entities and Section 4947 (a)(1) nonexempt charitable trusts.

What Law Governs Use of the Form 990?

Section 6033(a)(1) of the Internal Revenue Code (IRC) grants the secretary of the Treasury the power to use any forms or regulations to obtain financial information from 501(c)(3) organizations, such as gross income, receipts, and disbursements. In addition, this section requires all 501(c) organizations to file an annual information return. Form 990 is due by the 15th day of the 5th month of the organization's accounting cycle, after the close of the taxable year.

How is the Form 990 Used?

The Form 990 and any additional schedules can facilitate the public's ability to scrutinize the activities of tax-exempt entities. For many years, Section 6104 (b) permitted an interested person to request a copy of Form 990 from IRS. However, Congress created Section 6104 (d)(1)(B) to allow interested persons to obtain the Form 990 from the tax-exempt organizations. Furthermore, IRS and state regulatory bodies use the financial information listed on the Form 990 to help monitor activities of charities, including their spending.² The states have had significant input in developing the Form 990 and are working with IRS to implement refinements.

¹ Except black lung benefit trusts or private foundations. Private foundations file the Form 990-PF.

² The Form 990 is also filed with some state tax/revenue agencies.

How Has the Form 990 Changed Over the Years?

The first Form 990 covered tax-year 1941. This 2-page form included only three yes/no questions, an income statement, and a balance sheet, although some line items required attached schedules. By 1947, the form (including instructions) had reached 4 pages, although some portions applied only to certain types of organizations. The required financial information was more extensive and incorporated a line item on the income statement for the total compensation of all officers and a \$3,000 reporting threshold for contributions made to the organization. IRS also included a checkbox for affiliated organizations that file group returns. By 2001, the Form 990 had 6 pages (10 parts with 105 line items), 2 schedules (A and B) covering 13 pages, and a 45-page instruction book. Figure 5 shows the 6 pages comprising the Form 990.

Appendix I: Description of Form 990
Reporting Requirements

Figure 5: Form 990

Form	990	Return of Organization Exempt From Income Tax Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except black lung benefit trust or private foundation)	OMB No. 1545-0047 2001 Open to Public Inspection
Department of the Treasury Internal Revenue Service		The organization may have to use a copy of this return to satisfy state reporting requirements.	
A For the 2001 calendar year, or tax year beginning _____, 2001, and ending _____, 20			
B Check if applicable: ☐ Address change ☐ Name change ☐ Initial return ☐ Final return ☐ Amended return ☐ Application pending		C Name of organization _____ Number and street (or P.O. box if mail is not delivered to street address) Room/suite _____ City or town, state or country, and ZIP + 4 _____	
D Employer identification number _____		E Telephone number () _____	
F Accounting method: ☐ Cash ☐ Accrual ☐ Other (specify) _____		H and I are not applicable to section 527 organizations. H(a) Is this a group return for affiliates? ☐ Yes ☐ No H(b) If "Yes," enter number of affiliates _____ H(c) Are all affiliates included? ☐ Yes ☐ No (If "No," attach a list. See instructions.) H(d) Is this a separate return filed by an organization covered by a group ruling? ☐ Yes ☐ No I Enter 4-digit GEN _____	
J Organization type (check only one) ☐ 501(c) () (insert no.) ☐ 4947(a)(1) or ☐ 527			
K Check here ☐ if the organization's gross receipts are normally not more than \$25,000. The organization need not file a return with the IRS; but if the organization received a Form 990 Package in the mail, it should file a return without financial data. Some states require a complete return.			
L Gross receipts: Add lines 6b, 8b, 9b, and 10b to line 12			
Part I Revenue, Expenses, and Changes in Net Assets or Fund Balances (See Specific Instructions on page 16.)			
Revenue	1 Contributions, gifts, grants, and similar amounts received:		
	a Direct public support	1a	
	b Indirect public support	1b	
	c Government contributions (grants)	1c	
	d Total (add lines 1a through 1c) (cash \$ _____ noncash \$ _____)	1d	
	2 Program service revenue including government fees and contracts (from Part VII, line 93)		2
	3 Membership dues and assessments		3
	4 Interest on savings and temporary cash investments		4
	5 Dividends and interest from securities		5
	6a Gross rents	6a	
	b Less: rental expenses	6b	
	c Net rental income or (loss) (subtract line 6b from line 6a)	6c	
Expenses	7 Other investment income (describe _____)		7
	8a Gross amount from sales of assets other than inventory (A) Securities (B) Other		
	b Less: cost or other basis and sales expenses	8b	
	c Gain or (loss) (attach schedule)	8c	
	d Net gain or (loss) (combine line 8c, columns (A) and (B))	8d	
	9 Special events and activities (attach schedule)		
	a Gross revenue (not including \$ _____ of contributions reported on line 1a)	9a	
	b Less: direct expenses other than fundraising expenses	9b	
	c Net income or (loss) from special events (subtract line 9b from line 9a)	9c	
	10a Gross sales of inventory, less returns and allowances	10a	
	b Less: cost of goods sold	10b	
	c Gross profit or (loss) from sales of inventory (attach schedule) (subtract line 10b from line 10a)	10c	
11 Other revenue (from Part VII, line 103)		11	
12 Total revenue (add lines 1d, 2, 3, 4, 5, 6c, 7, 8d, 9c, 10c, and 11)		12	
Net Assets	13 Program services (from line 44, column (B))		13
	14 Management and general (from line 44, column (C))		14
	15 Fundraising (from line 44, column (D))		15
	16 Payments to affiliates (attach schedule)		16
	17 Total expenses (add lines 16 and 44, column (A))		17
18 Excess or (deficit) for the year (subtract line 17 from line 12)		18	
19 Net assets or fund balances at beginning of year (from line 73, column (A))		19	
20 Other changes in net assets or fund balances (attach explanation)		20	
21 Net assets or fund balances at end of year (combine lines 18, 19, and 20)		21	

For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11282Y Form 990 (2001)

Appendix I: Description of Form 990
Reporting Requirements

Form 990 (2001)

Page 2

Part II Statement of Functional Expenses

All organizations must complete column (A). Columns (B), (C), and (D) are required for section 501(c)(3) and (4) organizations and section 4947(a)(1) nonexempt charitable trusts but optional for others. (See Specific Instructions on page 21.)

Do not include amounts reported on line 6b, 8b, 9b, 10b, or 16 of Part I.		(A) Total	(B) Program services	(C) Management and general	(D) Fundraising
22	Grants and allocations (attach schedule) . . . (cash \$ _____ noncash \$ _____)	22			
23	Specific assistance to individuals (attach schedule)	23			
24	Benefits paid to or for members (attach schedule)	24			
25	Compensation of officers, directors, etc. . . .	25			
26	Other salaries and wages	26			
27	Pension plan contributions	27			
28	Other employee benefits	28			
29	Payroll taxes	29			
30	Professional fundraising fees	30			
31	Accounting fees	31			
32	Legal fees	32			
33	Supplies	33			
34	Telephone	34			
35	Postage and shipping	35			
36	Occupancy	36			
37	Equipment rental and maintenance	37			
38	Printing and publications	38			
39	Travel	39			
40	Conferences, conventions, and meetings . .	40			
41	Interest	41			
42	Depreciation, depletion, etc. (attach schedule)	42			
43	Other expenses not covered above (itemize): a	43a			
	b	43b			
	c	43c			
	d	43d			
	e	43e			
44	Total functional expenses (add lines 22 through 43). Organizations completing columns (B)-(D), carry these totals to lines 13-15 .	44			

Joint Costs. Check ☐ if you are following SOP 98-2. Are any joint costs from a combined educational campaign and fundraising solicitation reported in (B) Program services? . ☐ Yes ☐ No If "Yes," enter (i) the aggregate amount of these joint costs \$ _____; (ii) the amount allocated to Program services \$ _____; (iii) the amount allocated to Management and general \$ _____; and (iv) the amount allocated to Fundraising \$ _____.

Part III Statement of Program Service Accomplishments (See Specific Instructions on page 24.)

What is the organization's primary exempt purpose? ▶ _____

All organizations must describe their exempt purpose achievements in a clear and concise manner. State the number of clients served, publications issued, etc. Discuss achievements that are not measurable. (Section 501(c)(3) and (4) organizations and 4947(a)(1) nonexempt charitable trusts must also enter the amount of grants and allocations to others.)

	Program Service Expenses (Required for 501(c)(3) and (4) orgs., and 4947(a)(1) trusts; but optional for others.)
a (Grants and allocations \$ _____)	
b (Grants and allocations \$ _____)	
c (Grants and allocations \$ _____)	
d (Grants and allocations \$ _____)	
e Other program services (attach schedule) (Grants and allocations \$ _____)	
f Total of Program Service Expenses (should equal line 44, column (B), Program services) ▶	

Form 990 (2001)

Appendix I: Description of Form 990 Reporting Requirements

Form 990 (2001)

Page 3

Part IV Balance Sheets (See Specific Instructions on page 24.)

Note: Where required, attached schedules and amounts within the description column should be for end-of-year amounts only.		(A) Beginning of year	(B) End of year
45	Cash—non-interest-bearing		45
46	Savings and temporary cash investments		46
47a	Accounts receivable	47a	
b	Less: allowance for doubtful accounts	47b	47c
48a	Pledges receivable	48a	
b	Less: allowance for doubtful accounts	48b	48c
49	Grants receivable		49
50	Receivables from officers, directors, trustees, and key employees (attach schedule)		50
51a	Other notes and loans receivable (attach schedule)	51a	
b	Less: allowance for doubtful accounts	51b	51c
52	Inventories for sale or use		52
53	Prepaid expenses and deferred charges		53
54	Investments—securities (attach schedule) ☐ Cost ☐ FMV		54
55a	Investments—land, buildings, and equipment: basis	55a	
b	Less: accumulated depreciation (attach schedule)	55b	55c
56	Investments—other (attach schedule)		56
57a	Land, buildings, and equipment: basis	57a	
b	Less: accumulated depreciation (attach schedule)	57b	57c
58	Other assets (describe ☐)		58
59	Total assets (add lines 45 through 58) (must equal line 74)		59
60	Accounts payable and accrued expenses		60
61	Grants payable		61
62	Deferred revenue		62
63	Loans from officers, directors, trustees, and key employees (attach schedule)		63
64a	Tax-exempt bond liabilities (attach schedule)		64a
b	Mortgages and other notes payable (attach schedule)		64b
65	Other liabilities (describe ☐)		65
66	Total liabilities (add lines 60 through 65)		66
Organizations that follow SFAS 117, check here ☐ and complete lines 67 through 69 and lines 73 and 74.			
67	Unrestricted		67
68	Temporarily restricted		68
69	Permanently restricted		69
Organizations that do not follow SFAS 117, check here ☐ and complete lines 70 through 74.			
70	Capital stock, trust principal, or current funds		70
71	Paid-in or capital surplus, or land, building, and equipment fund		71
72	Retained earnings, endowment, accumulated income, or other funds		72
73	Total net assets or fund balances (add lines 67 through 69 OR lines 70 through 72; column (A) must equal line 19; column (B) must equal line 21).		73
74	Total liabilities and net assets / fund balances (add lines 66 and 73)		74

Form 990 is available for public inspection and, for some people, serves as the primary or sole source of information about a particular organization. How the public perceives an organization in such cases may be determined by the information presented on its return. Therefore, please make sure the return is complete and accurate and fully describes, in Part III, the organization's programs and accomplishments.

Appendix I: Description of Form 990 Reporting Requirements

[illegible]

Appendix I: Description of Form 990
Reporting Requirements

Form 990 (2001)		Page 5	
Part VI Other Information (See Specific Instructions on page 27.)		Yes	No
76	Did the organization engage in any activity not previously reported to the IRS? If "Yes," attach a detailed description of each activity . . .	76	
77	Were any changes made in the organizing or governing documents but not reported to the IRS? . . . If "Yes," attach a conformed copy of the changes.	77	
78a	Did the organization have unrelated business gross income of \$1,000 or more during the year covered by this return? . . .	78a	
b	If "Yes," has it filed a tax return on Form 990-T for this year? . . .	78b	
79	Was there a liquidation, dissolution, termination, or substantial contraction during the year? If "Yes," attach a statement . . .	79	
80a	Is the organization related (other than by association with a statewide or nationwide organization) through common membership, governing bodies, trustees, officers, etc., to any other exempt or nonexempt organization? . . .	80a	
b	If "Yes," enter the name of the organization ▶ . . . and check whether it is ☐ exempt OR ☐ nonexempt.		
81a	Enter direct or indirect political expenditures. See line 81 instructions . . . 81a	81a	
b	Did the organization file Form 1120-POL for this year? . . .	81b	
82a	Did the organization receive donated services or the use of materials, equipment, or facilities at no charge or at substantially less than fair rental value? . . .	82a	
b	If "Yes," you may indicate the value of these items here. Do not include this amount as revenue in Part I or as an expense in Part II. (See instructions in Part III.) . . . 82b	82b	
83a	Did the organization comply with the public inspection requirements for returns and exemption applications? . . .	83a	
b	Did the organization comply with the disclosure requirements relating to quid pro quo contributions? . . .	83b	
84a	Did the organization solicit any contributions or gifts that were not tax deductible? . . .	84a	
b	If "Yes," did the organization include with every solicitation an express statement that such contributions or gifts were not tax deductible? . . .	84b	
85	501(c)(4), (5), or (6) organizations. a Were substantially all dues nondeductible by members? . . .	85a	
b	Did the organization make only in-house lobbying expenditures of \$2,000 or less? . . . If "Yes" was answered to either 85a or 85b, do not complete 85c through 85h below unless the organization received a waiver for proxy tax owed for the prior year.	85b	
c	Dues, assessments, and similar amounts from members . . . 85c		
d	Section 162(e) lobbying and political expenditures . . . 85d		
e	Aggregate nondeductible amount of section 6033(e)(1)(A) dues notices . . . 85e		
f	Taxable amount of lobbying and political expenditures (line 85d less 85e) . . . 85f		
g	Does the organization elect to pay the section 6033(e) tax on the amount on line 85f? . . .	85g	
h	If section 6033(e)(1)(A) dues notices were sent, does the organization agree to add the amount on line 85f to its reasonable estimate of dues allocable to nondeductible lobbying and political expenditures for the following tax year? . . .	85h	
86	501(c)(7) orgs. Enter: a Initiation fees and capital contributions included on line 12 . . . 86a		
b	Gross receipts, included on line 12, for public use of club facilities . . . 86b		
87	501(c)(12) orgs. Enter: a Gross income from members or shareholders . . . 87a		
b	Gross income from other sources. (Do not net amounts due or paid to other sources against amounts due or received from them.) . . . 87b		
88	At any time during the year, did the organization own a 50% or greater interest in a taxable corporation or partnership, or an entity disregarded as separate from the organization under Regulations sections 301.7701-2 and 301.7701-3? If "Yes," complete Part IX . . .	88	
89a	501(c)(3) organizations. Enter: Amount of tax imposed on the organization during the year under: section 4911 ▶ ; section 4912 ▶ ; section 4955 ▶ . . .		
b	501(c)(3) and 501(c)(4) orgs. Did the organization engage 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 "Yes," attach a statement explaining each transaction. . . .	89b	
c	Enter: Amount of tax imposed on the organization managers or disqualified persons during the year under sections 4912, 4955, and 4958. . . . ▶		
d	Enter: Amount of tax on line 89c, above, reimbursed by the organization. . . . ▶		
90a	List the states with which a copy of this return is filed ▶ . . .		
b	Number of employees employed in the pay period that includes March 12, 2001 (See instructions.) 90b		
91	The books are in care of ▶ . . . Telephone no. ▶ () . . . Located at ▶ . . . ZIP + 4 ▶ . . .		
92	Section 4947(a)(1) nonexempt charitable trusts filing Form 990 in lieu of Form 1041—Check here . . . ▶ ☐ and enter the amount of tax-exempt interest received or accrued during the tax year . . . ▶ 92		

Form 990 (2001)

Appendix I: Description of Form 990
Reporting Requirements

Form 990 (2001)

Page 6

Part VII Analysis of Income-Producing Activities (See Specific Instructions on page 32.)

Note: Enter gross amounts unless otherwise indicated.

	(A) Business code	(B) Amount	(C) Exclusion code	(D) Amount	(E) Related or exempt function income
93 Program service revenue:					
a _____					
b _____					
c _____					
d _____					
e _____					
f Medicare/Medicaid payments					
g Fees and contracts from government agencies					
94 Membership dues and assessments					
95 Interest on savings and temporary cash investments					
96 Dividends and interest from securities					
97 Net rental income or (loss) from real estate:					
a debt-financed property					
b not debt-financed property					
98 Net rental income or (loss) from personal property					
99 Other investment income					
100 Gain or (loss) from sales of assets other than inventory					
101 Net income or (loss) from special events					
102 Gross profit or (loss) from sales of inventory					
103 Other revenue: a _____					
b _____					
c _____					
d _____					
e _____					
104 Subtotal (add columns (B), (D), and (E))					
105 Total (add line 104, columns (B), (D), and (E)).					

Note: Line 105 plus line 1d, Part I, should equal the amount on line 12, Part I.

Part VIII Relationship of Activities to the Accomplishment of Exempt Purposes (See Specific Instructions on page 32.)

Line No.	Explain how each activity for which income is reported in column (E) of Part VII contributed importantly to the accomplishment of the organization's exempt purposes (other than by providing funds for such purposes).
▼	

Part IX Information Regarding Taxable Subsidiaries and Disregarded Entities (See Specific Instructions on page 33.)

(A) Name, address, and EIN of corporation, partnership, or disregarded entity	(B) Percentage of ownership interest	(C) Nature of activities	(D) Total income	(E) End-of-year assets
	%			
	%			
	%			
	%			

Part X Information Regarding Transfers Associated with Personal Benefit Contracts (See Specific Instructions on page 33.)

(a) Did the organization, during the year, receive any funds, directly or indirectly, to pay premiums on a personal benefit contract? . . . ☐ Yes ☐ No

(b) Did the organization, during the year, pay premiums, directly or indirectly, on a personal benefit contract? . . . ☐ Yes ☐ No

Note: If "Yes" to (b), file Form 8870 and Form 4720 (see instructions).

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than officer) is based on all information of which preparer has any knowledge.

Please Sign Here	Signature of officer _____	Date _____
	Type or print name and title. _____	
Paid Preparer's Use Only	Preparer's signature _____	Date _____
	Preparer's SSN or PTIN (See Gen. Inst. W) _____	Check if self-employed ☐
	Firm's name (or yours if self-employed), address, and ZIP + 4 _____	EIN _____
		Phone no. _____



Form 990 (2001)

Appendix II: Analysis of Form 990 Data on Expenses Reported by Charities

The tables in this appendix describe charities by expenses, revenues, assets, joint-cost reporting, and direct assistance payments. The data are from Parts I and II of the Form 990 (excluding Forms 990-EZ and 990-PF). Data for tables in this appendix represent all Form 990 filers for filing years 1994-1998. IRS's Statistics of Income (SOI) Division provided data for filing years 1994-1998. SOI data represent a weighted sample based on a stratified random sample of all returns filed by charities in a filing year. Filing year 1998 and 1999 data were purchased from the Urban Institute. Urban Institute data represent the actual population of charity filers. Except for the section on joint-cost reporting and for 1999 totals reported in table 7, for consistency, we used SOI data exclusively for analyzing filing years 1994-1998.

Methodology and Statistical Variations for SOI Data

SOI provides data on charities by selecting a sample of each year's Form 990 data and keypunching the sample data into a database. Filing year 1998 was the most recent year for which SOI data were available when we did our work. Data are classified into strata defined by amount of total assets. The sampling rate by stratum ranges from 100 percent for organizations with assets of \$10 million¹ or more to 0.45 percent for the smallest asset class in both 1994 and 1995. From these samples, SOI calculates a weighted total number of Form 990 filers for each filing year.

Because the SOI data are based on samples, coefficients of variation should be taken into account. Sampling sizes and the corresponding coefficients of variation for selected yearly aggregate categories are presented in table 6. Because coefficients of variation are associated only with aggregate data, and because weighting factors are associated with asset data only, we do not present data other than that which are available at the aggregate level and by asset category.

¹ In 1997, SOI increased the lower bound of the 100 percent sample rate to \$30 million.

Table 6: Sample Size and Coefficients of Variation, by Filing Year

Year	Sample size	Weighted charity population	Coefficient of variation (percent)			
			Total charities	Total revenues	Total expenses	Total assets
1994	10,788	136,627	1.61	0.73	0.78	1.20
1995	11,553	142,790	1.60	1.50	1.63	1.29
1996	12,474	149,902	1.57	1.43	1.57	1.46
1997	13,058	155,330	1.09	0.48	0.55	0.06
1998	13,954	162,559	1.05	0.42	0.47	0.07

Source: IRS SOI Division.

Total Charities,
Revenues, Expenses,
and Assets

Financial category totals for individual filers include revenues, expenses, and assets. The yearly aggregate totals for these categories are presented in table 7. Each financial category provides information about the resources or operations of charities. Revenue amounts help describe how successful a charity is in raising funds. Asset amounts describe the resources owned by charities that support its mission. Total expenses, in relation to total revenues, help show whether the charity is generating surpluses, deficits, or breaking even from its operations during the period.

Table 7: Number of Charities and Reported Amounts of Revenues, Assets, and Expenses, by Filing Year

Dollars in millions

Year	Total number of charities filing	Total revenues	Total assets	Total expenses
1994	136,627	\$ 587,428	\$ 991,605	\$ 546,649
1995	142,790	\$ 661,584	\$ 1,141,409	\$ 602,985
1996	149,902	\$ 702,291	\$ 1,291,492	\$ 636,065
1997	155,330	\$ 752,565	\$ 1,437,156	\$ 675,233
1998	162,559	\$ 749,890	\$ 1,349,649	\$ 682,558
1999	163,414	\$719,251	\$1,215,218	\$ 655,028

Source: Tabulation of data from Form 990: SOI, 1994-98 and Urban Institute, 1999.

Functional Expenses

Total expenses found on line item 17 of the Form 990 are comprised of three “functional” expense categories and “payments to affiliates.”² The

² For each of the 5 years analyzed, fewer than 5 percent of all charities reported any payments to affiliates. For 1994-1998, “payments to affiliates” does not exceed .70 percent of total expenses in any year.

three types of functional expenses are reported in separate columns of Form 990 Part II as Program Services, General Management and Fundraising. Twenty-two specific object class expenses (line items 22-43) further break down these categories. “Other expenses” (line item 43) is for reporting expenses not captured by line items 22-42. IRS instructions prohibit reporting professional fundraising fees, accounting fees, or legal fees on line item 43, and require other expenses to be itemized on line item 43. Tables 8 and 9 describe the three functional expense categories and the “other” expense category.

Table 8: Total Expenses, Total Functional Expense Amounts, and Total Expenses Reported as “Other,” by Filing Year

Dollars in millions					
Year	Total expenses	Program services	General management	Fundraising	“Other”
1994	\$546,649	\$471,332	\$68,715	\$5,283	\$142,746
1995	\$602,985	\$522,785	\$73,145	\$5,519	\$159,950
1996	\$636,065	\$549,857	\$77,299	\$6,037	\$165,920
1997	\$675,233	\$584,286	\$81,135	\$6,581	\$165,604
1998	\$682,558	\$583,030	\$87,248	\$7,499	\$171,026

Note: “Total expenses” are reported on line item 17 and on line item 44, column A of Form 990 and are the sum of the three functional expense category totals. Functional expense category totals are reported on Form 990 line item 44, Columns B-D, and are the sum of line items 22-43. “Other” expenses are reported on line 43 of Part II.

Source: Tabulation of data from Form 990: SOI, 1994-98.

Table 9: Total Functional and Total “Other” Expenses as a Percentage of Total Expenses, by Filing Year

Year	Program services	General management	Fundraising	“Other”
1994	86.4	12.6	1.0	26.2
1995	86.9	12.2	0.9	26.6
1996	86.8	12.2	1.0	26.2
1997	87.0	12.1	1.0	24.6
1998	86.0	12.9	1.1	25.2
Average	86.6	12.4	1.0	25.8

Source: Tabulation of data from Form 990: SOI, 1994-98.

**Object Class
Expenses**

Functional expenses in Part II are further broken down by 22 specific object classes, including one class for “other” expenses. Each object class, except for—grants and allocations, specific assistance to individuals, and benefits paid to or for members—may be allocated across the three functional expense categories. Table 10 shows these expenses.

**Appendix II: Analysis of Form 990 Data on
Expenses Reported by Charities**

Table 10: Representation of Line Item as a Percentage of Functional Category Total

5-Year Average, Filing Years 1994-98				
Line item	Object class	Program service	General management	Fundraising
22	Grants and Allocations	5.7	^a	^a
23	Specific Assistance to Individuals	3.9	^a	^a
	Direct Assistance, subtotal	9.6	^a	^a
24	Benefits to/for members	2.3	^a	^a
25	Compensation to officers, directors	0.7	4.4	3.9
26	Other salary & wages	33.8	35.1	32.9
27	Pension contributions	1.1	1.6	1.3
28	Other employee benefits	3.9	5.1	3.6
29	Payroll taxes	2.2	2.9	2.4
	Compensation Related, subtotal	44.0	48.9	44.2
30	Professional Fundraising fees	^b	^b	6.1
33	Supplies	8.3	5.3	3.4
36	Occupancy	2.6	4.2	2.3
38	Printing and Publications	^b	^b	7.2
39	Travel	^b	^b	2.5
42	Depreciation, depletion, etc.	3.8	6.2	1.6
	Miscellaneous categories ^c	4.8	11.5	9.2
	Line items 30-42, and miscellaneous subtotal	20.3	28.2	32.1
43	"Other" expenses	26.2	22.9	23.7
44	Total	100	100	100

Note: Totals may not add to 100 due to rounding.

^aThese categories are only allocable as program services expenses.

^bLess than 1 percent of total functional category expenses are represented.

^c"Miscellaneous categories" includes the remaining Form 990 object class items not listed above: accounting fees, legal fees, telephone, postage and shipping, equipment rental, conferences, and interest.

Source: Tabulation of data from Form 990: SOI, 1994-98.

Charity Assistance Expenses

“Assistance” describes the amount paid out by a charity in support of its charitable purpose.³ We define assistance as the sum of line items 22 (grants and allocations)⁴ and 23 (specific assistance to individuals), which can only be allocated to the program service expense category. Table 11 describes assistance paid out by charities in 1994-1998.

Table 11: Assistance From Charities, by Filing Year

Dollars in millions					
Year	Grants and allocations	Specific assistance to individuals	Total assistance	Assistance as a percentage of total program service expenses	Assistance as a percentage of total expenses
1994	\$27,217	\$7,629	\$34,845	7.4	6.4
1995	\$27,755	\$3,619	\$31,375	6.0	5.2
1996	\$28,633	\$38,900	\$67,533	12.3	10.7
1997	\$34,044	\$51,124	\$85,168	14.6	12.7
1998	\$37,741	\$6,681	\$44,421	7.6	6.6

Source: Tabulation of data from Form 990: SOI, 1994-98.

Description of Charities by NTEE Code

The National Taxonomy of Exempt Entities (NTEE)⁵ classification system was developed by the National Center for Charitable Statistics (NCCS). IRS uses NTEE codes to categorize charities by 26 major group (A-Z) classifications that are aggregated into 10 broad categories. Because of the difficulties noted above with analyzing the data at a more precise level, we do not present expense, revenue, or asset data on charities at the NTEE level. Tables 12 and 13 describe the NTEE categories.

³ Line item 24, “Benefits paid to or for members” is also allocable only to program services. Since this amount represents assistance paid to members or dependents of members of the charity, we did not include it in our description of assistance.

⁴ Line item 22 is further broken out by “cash” and “noncash” amounts, which SOI does not report separately.

⁵ To see the entire classification taxonomy, visit <http://nccs.urban.org/ntee-cc/index.htm>.

Table 12: NTEE Categories

	Broad category	Major group(s)
I.	Arts, culture, and humanities	A
II.	Education	B
III.	Environment and animals	C, D
IV.	Health	E, F, G, H
V.	Human services	I, J, K, L, M, N, O, P
VI.	International, foreign affairs	Q
VII.	Public, societal benefit	R, S, T, U, V, W
VIII.	Religion related	X
IX.	Mutual/membership benefit	Y
X.	Unknown, unclassified	Z

Source: National Center for Charitable Statistics.

Table 13: Description of NTEE Major Group Categories

NTEE core code (major group)	Description
A	Arts, culture, and humanities
B	Education
C	Environmental quality, protection, and beautification
D	Animals
E	Health
F	Mental health, crisis intervention
G	Diseases, disorders, and medical disciplines
H	Medical research
I	Crime, legal
J	Employment
K	Food, agriculture, and nutrition
L	Housing, shelter
M	Public safety, disaster preparedness, and relief
N	Recreation, sports
O	Youth development
P	Human services
Q	International, foreign affairs, and national security
R	Civil rights, social action, and advocacy
S	Community improvement, capacity building
T	Philanthropy, voluntarism, and grantmaking
U	Science and technology research
V	Social science research
W	Public, society benefit
X	Religion, spiritual development
Y	Mutual, membership benefit
Z	Unknown

Source: National Center for Charitable Statistics.

Description of
Charities by Asset
Category

Table 14 presents descriptive data on assets and expenses by size of charity, which are defined by the amount of reported assets.⁶ Note that in all years, the largest category includes less than 5 percent of all organizations, but accounts for more than 70 percent of all expenses and more than 80 percent of all assets.

⁶ We did not purchase detailed asset data from the Urban Institute.

Table 14: Overview of Charities by Asset Category, by Filing Year

Year	Asset category (millions of dollars segments)	Number of charities	Percent of total charities	Percent of total assets	Percent of total expenses
1994	<1	95,773	70.1	2.4	6.1
	1–5	26,188	19.2	6.0	9.8
	5–10	5,676	4.2	4.0	5.0
	10–20	3,404	2.5	4.8	5.6
	20+	5,585	4.1	82.7	73.5
Total		136,626	100.0	100.0	100.0
1995	<1	99,324	69.6	2.1	5.9
	1–5	27,768	19.5	5.5	10.5
	5–10	6,026	4.2	3.7	4.8
	10–20	3,646	2.6	4.5	5.4
	20+	6,026	4.2	84.1	73.5
Total		142,790	100.0	100.0	100.0
1996	<1	103,025	68.7	2.0	5.9
	1–5	29,599	19.8	5.3	10.3
	5–10	6,575	4.4	3.5	4.8
	10–20	4,142	2.8	4.5	5.7
	20+	6,561	4.4	84.7	73.4
Total		149,902	100.0	100.0	100.0
1997	<1	105,256	67.8	1.9	5.8
	1–5	31,523	20.3	5.0	9.1
	5–10	7,114	4.6	3.5	5.1
	10–20	4,361	2.8	4.3	5.6
	20+	7,076	4.6	85.4	74.5
Total		155,330	100.0	100.0	100.0
1998	<1	109,091	67.1	2.1	5.9
	1–5	33,370	20.5	5.6	9.2
	5–10	7,803	4.8	4.1	5.5
	10–20	4,694	2.9	4.8	6.0
	20+	7,601	4.7	83.3	73.5
Total		162,559	100.0	100.0	100.0

Note: Totals may not add to 100 due to rounding.

Source: Tabulation of data from Form 990: SOI.

Joint-Cost Reporting, Part II of Form 990

IRS recognizes that charities may include a non-fundraising purpose in its solicitation materials (usually an educational component) and directs charities to disaggregate the expenses of a combined fundraising and education solicitation through joint-cost reporting. IRS forbids reporting of

fundraising expenses as program service expenses. Charities that included in program service expenses (Column B—Part II, Form 990) any joint-costs from a combined educational campaign and fundraising solicitation must disclose in a separate section how the total joint-costs of all such combined activities were reported in Part II. The disaggregation of joint-cost expenses is by functional expense category—program services, management and general, and fundraising—and not by amount allocated to educational versus fundraising purposes. Since joint-cost reporting can refer to a combined educational and fundraising campaign, all charities reporting joint-costs would be expected to also report some fundraising expenses. That is not the case, as noted in the last column of table 15. In 1998 and 1999, respectively, 7.7 percent and 8.9 percent of charities reporting joint-costs did not report any fundraising expenses.

Table 15: Joint-Cost Reporting, by Filing Year

Form 990, Part II, Reporting of Joint-Costs					
Year	Number of charities	Number of charities reporting joint-costs	Percent reporting joint-costs	Percent reporting fundraising expenses that reported joint-costs	Percent reporting joint-costs that reported fundraising expenses
1998	153,763	920	0.6	1.7	92.3
1999	163,369	975	0.6	1.7	91.1

Source: The Urban Institute.

Table 16: Joint-Cost Allocation by Functional Expense Category, by Filing Year

Dollars in millions				
Year	Total joint-cost amount	Percent allocated to program services	Percent allocated to management and general	Percent allocated to fundraising
1998	\$ 1,283	60.8	9.7	29.4
1999	\$ 1,096	56.0	5.1	38.9

Source: The Urban Institute.

Appendix III: The Internal Revenue Service's Application Process

Any organization that is able to satisfy the requirements defined by Congress in Section 501(a) of the Internal Revenue Code (IRC) is entitled to exemption from taxation. To obtain recognition of its tax-exempt status, a charity must apply to the Internal Revenue Service (IRS).¹ This appendix describes the steps in the application process for charities to be recognized as tax-exempt organizations.

What are the Steps to Apply for Tax-Exempt Recognition as a Charity?

The steps necessary to obtain recognition of exemption from taxation as a charity involve the submission of written information to IRS. First, the entity makes a decision to meet a charitable purpose as a charitable tax-exempt organization, under the guidelines in Section 501(c)(3) of the IRC. According to the Treasury regulations that underlie section 501(c)(3), “charitable” purposes include:

- relief of the poor, the distressed, or the underprivileged;
- advancement of education or science;
- advancement of religion;
- erection or maintenance of public buildings, monuments, or works;
- lessening the burdens of government; lessening of neighborhood tensions;
- elimination of prejudice and discrimination;
- defense of human and civil rights secured by law; and
- combating community deterioration and juvenile delinquency.

After deciding on its charitable purpose or purposes, an entity must submit its request for recognition by completing forms for recognition of exemption from taxation.² All charitable organizations are required to complete the forms for recognition with three exceptions.³ The forms are:

- Form 1023 (Application for Recognition of Exemption from Taxation).
- Form 8718 (User Fee for Exempt-Organization Determination Letter Request).
- Form SS-4 (Application for Employer Identification Number).
- Form 872-C, which is used for organizations wanting an advanced ruling.

¹ In addition, other types of tax-exempt organizations are required to file for recognition of exemption (e.g., employee benefit organizations).

² Nine pages of instructions and 28 pages of forms.

³ Exceptions include churches, church-affiliated entities, or any organization that is not a private foundation with less than \$5,000 in gross receipts per year.

In addition to the application forms, the organization is required to submit the following documents:

- Organizational documents containing dissolution and limiting clauses,⁴ which limit the organization's purposes to one or more of the exempt purposes in Section 501(c)(3).
- A conformed copy of the organization's articles of incorporation.
- Four years of financial statement information (projected or actual income and expenses).⁵
- The signature of an organizational officer or trustee, who is authorized to sign or another person authorized by the power of attorney to sign and send the forms.
- The appropriate application fee (\$150 fee for organizations with gross receipts of less than \$10,000 and \$500 for organizations with higher gross receipts and for those seeking group exemptions).

To help applicants complete the application forms, the IRS suggests the following texts as guides:

- Publication 557 (Tax-Exempt Status for Your Organization).
- Publication 598 (Tax on Unrelated Business Income of Exempt Organizations).
- Publication 578 (Tax Information for Private Foundations and Foundation Managers).

Proper preparation of an application for recognition of tax-exempt status involves more than responding to the questions. An applicant must fully describe the activities in which it expects to engage, including the standards, criteria, or other means for carrying out the activities, the sources of receipts, and the nature of expenditures. A mere restatement of purposes or a statement that proposed activities will further the organization's purposes does not satisfy this requirement.

⁴ Dissolution clauses define how the organization's assets will be distributed if the organization ceases its operational activities. Limiting clauses define the operational activities to which the organization may engage.

⁵ If the organization has not yet begun operations, or has operated for less than 1 year, a proposed budget for 2 full accounting periods and a current statement of assets and liabilities will be acceptable.

Which IRS Employees Review Applications?

The Exempt Organizations Rulings and Agreements function is in charge of reviewing applications for exemption from taxation. The primary determinations office is located in Cincinnati, Ohio. In addition, staff in six field offices do determinations work.⁶ These staff are determination specialists, most of whom are revenue agents, and as of January 2002 accounted for 207 full-time equivalent positions. Revenue agents review applications in order to approve or deny recognition of exemption from taxation, also known as “making a determination.” The Cincinnati office has 112 revenue agents among 10 determination groups. The other 95 revenue agents are divided among the six field offices. The Washington, D.C., office has 50 tax law specialists who also do determinations work.⁷

How is the Work Assigned?

Once applications are received at the Cincinnati office, a decision is made on where the applications should be sent. Depending on the information contained in the application or other circumstances, the application will be: (1) processed by the Cincinnati office (e.g., applications for group rulings, foreign organizations, and cases to be expedited); (2) sent to any of six field offices; or (3) sent to the national office in Washington, D.C., (e.g., when published precedents are lacking).

Applications are assigned to offices on the basis of a formula that assumes agents will close, on average, five applications per week. Before using the formula method to assign work, IRS assigned cases based on the number of agents in each office. The Cincinnati office assigned cases to other offices after estimating how much work could be done in Ohio. It stopped this practice because it could not control the backlog that occurred in other offices. Now, the office's goal is to process all determinations in Cincinnati, except those that need to go elsewhere.

⁶ Brooklyn, NY; Baltimore, Md; Atlanta, Ga; Monterey Park, Calif.; Denver, Colo.; and Dallas, Tex.

⁷ Forty-one tax law specialists do determination reviews, 4 tax law specialists perform group reviews, and 5 reviewers perform second-level reviews.

What does a Revenue Agent do when He or She Receives a Charity Application?

A revenue agent reviews the application materials submitted by the organization to ascertain if the purpose or purposes match those allowed for charities (also known as a screening). All of the submitted documents should enable the revenue agent to conclude that the organization satisfied or failed to satisfy the particular IRC requirements for charities. IRS, generally supported by the courts, usually will refuse to recognize an organization's tax-exempt status unless it submitted sufficient information on its operations and finances.

How do Revenue Agents make Determinations for Charity Applications?

Generally, revenue agents use the relevant tax law as the basis for approving or denying a charity application. Agents compare the application material to the applicable IRC section to check for conformity. Discussions with other agents and managers are also incorporated.⁸ During a determination screening, the agents use the following tools:

- Title 26, Section 501 and other relevant sections of the Internal Revenue Code.
- Determination Letter Program Procedures (Section 7.4.4 of the Internal Revenue Manual).
- The Handbook on Exempt Organizations.
- The Exempt Organizations Continuing Professional Education (CPE) material.
- Various revenue rulings and revenue procedures.

What Happens after a Determination Is Made?

A revenue agent, with the concurrence of the manager, can quickly determine that the application meets all of IRS's criteria and can close the application on its merit. The application can be processed more rapidly if the articles of incorporation (or articles of organization) include a provision insuring permanent dedication of assets for exempt purposes. Closures on merit can take as little as 10 days, if all information needed is provided during the initial submission of the application materials.

If the documentation does not allow the revenue agent to close the application on its merits, it will receive a further review. This usually occurs when: (1) an application is incomplete, (2) the budget or financial information is inconsistent, or (3) the agent cannot conclude that the

⁸ Manager involvement in the determination can be appropriate at any time in the application process.

organization satisfied IRC requirements for charities. While under further review, the revenue agent is required to request additional information from the applicant. When requesting information, the agent should “correctly determine the appropriate scope and depth of information required for making a proper determination.”

Here are examples of the ways IRS closes determination applications submitted by charities:

- Approved
- Disapproved
- Withdrawn by applicant
- Fee not remitted

If the exemption is granted, IRS issues a favorable determination letter (Letter 1045) to the charity. If the determination is a proposed denial of the tax exemption for any reason (e.g., the organization failed to establish the basis for the exemption), the revenue agent is required to notify the applicant of the proposed adverse action as well as thoroughly explain the consequences and their appeal rights. The organization can submit additional information to explain any discrepancies related to the adverse action. The agent is to carefully review any new information and reconsider the proposed denial. After any denial is finalized, IRS is required to notify the appropriate state regulatory agency of the applicant's denial (including failure to establish the exemption).

Can a Charity Change Its Purpose once a Favorable Determinations Letter Is Sent?

After a favorable determination letter is sent, a charity can undertake additional activities that are consistent with section 501(c)(3) even if it did not mention them in its application. Each letter includes a paragraph stating that the charity should notify IRS of substantial changes in its operations. The purpose is to allow IRS to assess whether the changes affect exemption, private foundation status, unrelated business income tax, excise taxes, etc., and if so, whether IRS needs to begin an examination.

According to an IRS official, IRS would like to be informed of the new activities, however, the law does not require charities to notify IRS of the changes. If a charity does not fully and accurately disclose its activities in the application or does not inform IRS of changes, the charity cannot rely on its determination letter to protect itself in the event of an IRS examination. If IRS determines in an examination that the new activities jeopardize exemption, revocation of exemption could be retroactive to the

date the new activities were undertaken. In contrast, if activities upon which a revocation is based were disclosed to IRS, the charity may qualify for relief under IRC section 7805(b), and any revocation or adverse action will be prospective only. However, if it wants IRS approval in advance of its change to protect itself against a possible retroactive adverse action, it can request a private letter ruling from the national office in accordance with Revenue Procedure 2001-4.

How Long does the Determination Process Take?

Organizations are notified that the determinations process may take up to 120 days. IRS has indicated that the average time to approve an application is currently 91 days. Delays and backlogs can occur for reasons such as

- an application was incomplete or inaccurate;
- taxpayers raised new issues or submitted additional evidence after the proposed determination; and
- a determination letter contained a misspelling of the organization's name or an irrelevant addendum.

In situations involving disaster relief, emergency hardship programs, or other situations where time is of essence, IRS's procedures permit charitable relief organizations to request expedited handling when it applies or during the review of its application. The revenue agent is to fully consider the request, grant it if appropriate, and inform the applicant of the decision. The expedited request and the agent's response should be documented in appropriate work papers. IRS has had expedited request procedures since 1994.

The relief organizations created to address the September 11th tragedies received expedited application processing. From September 11, 2001, to March 20, 2002, IRS approved 262 applications for disaster relief organizations under expedited processing. Although the requirements for exemption were not waived, the average time for processing took approximately 7 days. IRS is planning follow-up reviews of all of these organizations and charities where necessary to determine if they are complying with the requirements that govern tax-exempt charities.

How does IRS Measure the Quality of Decisions and Adherence to Procedures?

To measure the quality of the reviews of applications, IRS uses the Tax Exempt Quality Measurement System. This measurement is based on a sample of determination cases that are closed. It is not used to evaluate the quality of the employee's performance. Rather, the purpose is to measure and improve quality in making determinations on applications. An offshoot of the quality review process is to educate IRS staff involved in the determinations process by highlighting weaknesses that should be corrected.

The six quality standards for determination cases deal with:

- Completeness of the application prior to closing.
- Timely processing.
- Technical issues.
- Work papers support conclusion.
- Case administration.
- Customer relations/professionalism.

Appendix IV: IRS's Process for Examining Forms 990 Filed by Tax-Exempt Organizations

The following describes IRS's processes for examining returns filed by exempt organizations, including charities. The discussion follows IRS's processes from selecting returns through reviewing the results of the examinations. In April 2000, the centralized examination management concept was adopted, and examination-related activities were centralized in Dallas to improve consistency, coordination, and use of resources.

Identifying and Selecting Which Returns to Examine

IRS uses keypunched information to begin the process of identifying returns for examination. All returns (Forms 990) are sent to the Ogden Service Center for processing. When returns are received, Ogden staff keypunch about 20 percent of the line items, such as the tax year, identifying information, and various other data such as program service revenue, contributions, and fundraising expenses. The keypunched information is transferred electronically to the Exempt Organizations Business Master File and, if a return is selected for examination, to the Audit Information Management System (AIMS), which is used to track the status of examinations.

At the conclusion of the keypunching process, the return information is available to be queried by another automated system—the Returns Information and Classification System (RICS). RICS allows for searches of returns on the basis of a variety of criteria, including known compliance problems and the size, location, and type of exempt organization such as charities. IRS uses a variety of ways to select returns for examination, but relies primarily on two methods:¹ analysis of automated IRS data on RICS and referrals from outside the examination group.²

IRS uses RICS to analyze the automated data. RICS applies the criteria selected by the Planning and Program Group to identify returns and line items for potential examination. For example, RICS could be used to identify returns in which charities are reporting political expenditures, allocating expenses to reflect unrelated business income, reporting compensation and wages, but not filing Form 941, and not filing

¹ Other methods used to select returns include the Coordinated Examination Program, where a team of experienced auditors examines returns filed by large exempt organizations and national guidelines that identify certain types of organizations or activities that may warrant examination.

² Although this discussion focuses on charities, IRS also uses RICS and referrals to select returns for examination for other types of exempt organizations.

Form 990-T as required. The Classification Unit is responsible for pulling the returns that meet the criteria, and RICS is used to select a random sample of returns.

Returns identified by RICS are considered to be general casework, which includes 12 conditions identified as “likely to have issues” that will lead to a change in the tax computation or even revocation of a charity’s tax-exempt status. Examination of these returns is intended to be “limited scope” addressing only the issue identified for which the return was selected. However, according to the Manager, EO Classification, revenue agents review the return to check for consistency with the basic exemption requirement for the charity.

Another method used by IRS to select returns for examination is using a referral, that has the highest priority among returns to be examined. IRS receives referrals from parties inside and outside IRS, including the general public, corporations, and private and public sector employees. All referrals are sent to Dallas, where IRS staff input information on each referral into a database that includes the name of the exempt organization, its address, employer identification number, name of informant, and a sequential number. The database includes a paragraph summarizing the potential for an examination and the reason the referral-maker believes an examination is warranted.

Returns Classification Specialists work referrals on a first-in, first-out basis and decide whether to send the referral for examination. Specialists use their knowledge of the law and judgment to determine whether the information referred provides a basis for “a reasonable belief of noncompliance.” Afterwards, the database is updated to note whether the referral is sent for examination.

Referrals that are viewed as “sensitive” require a second review. Sensitive referrals involve churches or media attention; are received from a Member of Congress, the White House, or from IRS in Washington, D.C.; or are otherwise considered as political or sensitive. Beginning in 1999, the second review was required to be done by a three-person committee, which decides whether to initiate an examination.

IRS also receives two other types of referrals. Future year referrals are received from determinations specialists (who review applications for tax-exempt status) and who can request an examination in 2 or 3 years on charities recently granted tax-exempt status. The purpose of these examinations is to determine whether actual charitable activities conform

to what was intended when the tax-exempt application was approved. For these referrals, the database is updated to reflect the year the future return is to be selected for examination. If a return has not yet been filed, the examination is deferred until the return is filed and the future year portion of the referral database is so noted. In essence, the future year record acts as a suspense file, and referrals are later reviewed to determine if they should be sent to examination or given another suspense date.

The other type of referral is a request for collateral examination. All these referrals are received from the Small Business/Self-Employed Division (SB/SE). SB/SE requests these examinations of tax-exempt organizations in connection with its examinations of small businesses that are related to tax-exempt organizations.

Initiating the Examination

To initiate an examination, such as when a group manager (who manages groups of revenue agents) determines that more examination work is needed, a request is sent by e-mail for a specific number of returns at specified revenue agent grade levels. Group managers decide how to distribute the requested number of returns by the specified grade levels in priority order on first-in, first-out basis.

For returns selected by RICS, an IRS employee orders the related returns from the Ogden Service Center, which usually takes 6 to 9 weeks to arrive. All examination cases are entered on the automated system EOICS (Exempt Organizations Inventory Control System) that is used to track their status.

Doing the Examination

The examination is conducted to ensure compliance with the provisions of the IRC relating to qualification, reporting and disclosure, and the excise and income taxes related to tax-exempt organizations. A revenue agent starts by contacting an organization to request information to check compliance for specific issues or lines on the return (Form 990). The agent is to compare that information for those issues to the return as well as to verify whether the organization is operating within its stated purpose.

The number of return issues being examined can vary. Examinations vary in scope, depending on the type of issues, adequacy of the organization's books and records, existence of effective internal controls, and size of the entity. Normally, revenue agents are expected to pursue the examination to the point at which they can resolve the specific issues that led to the examination and reasonably conclude that all items necessary for a proper

determination of tax-exempt status have been considered. In general, when agents have completed examinations, the completed case files are provided to their group managers for review before the cases are closed.

Reviewing the Quality of the Examination

In addition to the group manager's review of the examination, IRS has a separate group dedicated to reviewing the quality of examinations of exempt organizations such as charities. Reviewers are independent of the examination group and are experienced revenue agents. A reviewer is responsible for measuring and reporting on the quality of the examination and efforts to improve the work of the examination function. Examinations can be reviewed in two ways—special or mandatory review.

Special Review

In special reviews, the computer selects closed examinations randomly, so the reviews represent a statistically valid sample. The reviewer completes a check sheet that asks 57 questions about each closed examination. Most of the questions are to be answered yes or no, with yes being the preferred answer. However, some questions may not be applicable to each review. The questions address the examination quality standards and include topics such as the power of attorney requirements, the scope of the examination, and application of the law. The checklist also asks the reviewer to make an overall judgment on whether the action taken by the revenue agent was appropriate in meeting the examination quality standards.

Mandatory Review

In contrast to special reviews, mandatory reviews are done while the examination is still open. Examinations that are required to be reviewed under mandatory review include those in which: (1) the exempt organization disagrees with a revenue agent's decisions; (2) the group manager asks for the review to determine whether the actions taken by the agent were correct and appropriate; (3) the agent proposed revoking or modifying the tax-exempt status of a charity; (4) a final revocation for certain other tax-exempt organizations is made; and (5) technical advice³ was obtained.

³ Technical advice is provided by the Washington, D.C. office on legal issues normally at the request of the examining office and sometimes at the request of the taxpayer.

Like special reviews, the purpose of a mandatory review is to ensure the quality of cases and to provide quality assurance. Mandatory reviewers use the checklist used by special reviewers to review an examination. In addition, mandatory reviewers are to review whether the work papers adequately document the examination. Since the examinations are open, mandatory reviewers can send them back to the examination group for additional work. If this is done, a memorandum is prepared that discusses the results of the review. The group is to decide if it agrees and to notify mandatory reviewers of the decision. More broadly, trends are monitored and if a theme is identified, a memorandum could be sent to the examination group on the findings or concerns.

Data on Examinations

Table 17 provides data on the number of staff available to do examinations.

Table 17: Number of Exempt Organizations Field Technical Staff and Total Staff, by Fiscal Year in FTEs		
Fiscal year	Number of field examination staff	Number of all staff
1996	439	958
1997	411	924
1998	395	891
1999	390	895
2000	324	801
2001	294	811

Note: The number of field staff examination staff is calculated from technical time reported on examinations. Total EO staff is estimated through FY 2000; actual per the Automated Financial System in 2001.

Source: IRS official.

We also reviewed the number of examination hours charged by IRS staff, as shown in table 18.

Table 18: Average Hours Per Charity Examination by Type of Closure, All Examinations, by Fiscal Year						
Type of Closure	1996	1997	1998	1999	2000	2001
Agreed examination hours	132.7	182.9	525.2	378.1	332.4	461.8
Unagreed examination hours	81.3	107.6	121.1	141.8	189.3	420.4
No change examination hours	44.0	53.6	52.9	45.4	59.1	57.3
All examination hours	53.5	69.5	114.3	74.2	103.4	89.9

Source: IRS AIMS.

Because Coordinated Examination Program (CEP) audits may run over several years and take more time, IRS officials suggested that we compare CEP and non-CEP examination hours for charities. Table 19 shows average hours for non-CEP examinations.

Table 19: Average Hours Per Charity Examination by Type of Closure, Non-CEP Examinations, by Fiscal Year

Type of Closure	1996	1997	1998	1999	2000	2001
Agreed examination hours	106.1	177.1	349.6	323.3	169.2	112.4
Unagreed examination hours	81.3	107.6	106.0	82.4	189.3	315.0
No change examination hours	40.3	51.8	48.8	42.9	49.9	55.3
All examination hours	47.5	66.1	84.4	63.1	67.2	62.5

Source: IRS AIMS.

Table 20 shows the examination hours per charity return reported for CEP examinations.

Table 20: Average Hours Per Charity Examination by Type of Closure, CEP Examinations, by Fiscal Year

	1996	1997	1998	1999	2000	2001
Agreed examination hours	254.2	213.4	1,525.6	707.2	644.9	994.1
Unagreed examination hours	^a	^a	1,027.0	616.5	^a	841.8
No change examination hours	116.8	110.0	239.2	281.0	468.3	110.8
All examination hours	152.4	148.5	899.5	526.8	598.0	501.3

^aData not available.

Source: IRS AIMS.

Revocations

IRS can revoke tax-exempt status for all charities. A revocation basically removes the tax-exempt charter for operating. The organization would have to reapply as a tax-exempt organization and start the process over. Table 21 shows the number and reasons for revocations for fiscal years 1996 through 2001.

**Appendix IV: IRS's Process for Examining
Forms 990 Filed by Tax-Exempt
Organizations**

Table 21: Primary Reasons for Revocations by Fiscal Year, 1996-2001

	FY1996	FY1997	FY1998	FY1999	FY2000	FY2001
Delinquent filing of EO return	1	1	1	-	-	-
Discontinued operations	-	-	2	-	1	-
Inadequate records	1	-	2	-	2	-
Inurements	6	5	2	1	1	1
Non-exempt activities	2	-	1	1	11	1
Operating in a commercial manner	1	0	1	1	-	-
Met operational test	3	3	3	1	2	-
Private vs. public	2	1	3	-	-	-
Private use	-	-	-	-	3	-
Others ^a	-	2	9	4	7	7
Total	16	12	24	8	27	9

^aOthers includes revocations for problems associated with grassroots lobbying and unrelated trade or business activities.

Source: IRS AIMS.

Appendix V: Overview of Selected Federal Agencies that Can Oversee Charities

To determine the extent to which other federal agencies oversee charities and if IRS coordinates its oversight of charities with those agencies, we contacted officials at the Federal Trade Commission (FTC), Federal Emergency Management Agency (FEMA), Federal Bureau of Investigation (FBI), United States Postal Inspection Service (USPIS), and Office of Personnel Management (OPM).¹ This is not an exhaustive analysis of all federal agencies that work with charities.

Charities are not specifically under the oversight authority of any single federal agency. In addition, no agencies we spoke with reported ongoing coordination with IRS to identify fraudulent charities or to oversee general charity operations.² In most cases, IRS would only be contacted if its expertise as a tax authority were needed in an investigation, or to verify an organization's tax-exempt status. The following summaries describe the charity oversight activities of the various federal agencies.

FBI

Within its Economic Crimes Unit, the FBI's goal is to reduce the amount of economic loss by national and international telemarketing fraud throughout the United States. Additionally, the mission of the FBI's Governmental Fraud Program is to oversee the nationwide investigation of allegations of fraud related to federal government procurement, contracts, and federally-funded programs. According to FBI officials, the FBI does not have a charity-specific investigation classification. An investigation may involve a charity, but it would likely be due to telemarketing fraud or mail fraud. Since the tragedies of September 11th, the FBI has been scrutinizing some charities for fraudulent activities related to terrorism. An FBI official said the FBI would contact IRS if their tax expertise were needed.

FEMA

FEMA's mission is to reduce loss of life and property and protect critical infrastructure from all types of hazards through a comprehensive, risk-based, emergency management program of mitigation, preparedness, response, and recovery. FEMA coordinates its disaster relief work through

¹ OPM oversees the annual Combined Federal Campaign, which is the "solicitation of employees in the Federal workplace on the behalf of charitable organizations."

² IRS does receive and track referrals regarding charities. In fiscal year 2001, IRS received 13 referrals from other federal agencies, the White House, or a Member of Congress out of 1,096 referrals received.

the National Voluntary Organizations Active in Disaster (NVOAD) organization. NVOAD members are 501(c)(3) organizations that are experienced in disaster relief work. FEMA sometimes works with larger, well-established organizations that are not NVOAD members, such as the United Way. According to a FEMA official, FEMA does not work with IRS to assess charities, but IRS has held two training sessions for FEMA on accounting for disaster donations. In addition, FEMA has neither made referrals to IRS nor received specific information from IRS about fraudulent charities.

FTC

FTC enforces federal antitrust and consumer protection laws.³ FTC attempts to stop actions that threaten consumers' opportunities to exercise informed choices. Recently, within the USA Patriot Act of 2001, under Section 1011, "Crimes Against Charitable Americans," FTC's authority regarding telemarketing and consumer fraud abuse was broadened.⁴ FTC also is a member of an online watchdog site, Consumer Sentinel,⁵ which tracks in a database consumer complaints and investigations relating to fraud. FTC often acts on referrals from state attorneys general, but does not coordinate its enforcement activities with IRS except for occasional work on criminal investigations.

USPIS

The USPIS is responsible for combating mail fraud.⁶ Thus, fundraising solicitations conducted via the mail are under its authority. USPIS also participates in Consumer Sentinel. USPIS does not coordinate investigations of charities with IRS unless an organizations' tax-exempt status is being questioned, or if the tax expertise of IRS is needed. A USPIS official said they would welcome referrals from IRS, as IRS is the appropriate agency to take the lead on charity issues.

³ The "consumer protection" statute is Section 5(a) of the FTC Act, which states, inter alia, that "unfair or deceptive acts or practices in or affecting commerce are declared unlawful" (15 U.S.C. Sec. 45(a)(1)). "Unfair" practices are defined to mean those that "cause or [are] likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition" (15 U.S.C. Sec. 45(n)). www.ftc.gov/ogc/auth4.htm

⁴ FTC officials said they did not yet have an opinion on how the Patriot Act would affect their oversight activities regarding charities. See Public Law 107-56.

⁵ The database is restricted to members, which are primarily law-enforcement agencies. Visit the site at www.consumer.gov/sentinel/.

⁶ See the Mail Fraud Statute at 18 U.S.C. Sec. 1341.

OPM

OPM oversees the annual Combined Federal Campaign (CFC). Charities are selected for CFC through an application process. Selection criteria may be found at 5 CFR, Part 950, or, www.opm.gov/cfc/html/regs.htm. The criteria include:

- Submitting annual audits and annual reports and having a responsible governing board with no conflicts of interest. Audits are only required if the revenue dollar level was over a certain level.
- Fundraising and administrative costs should be no more than 25 percent of total costs, or be “reasonable” with documentation that suggests appropriate justification.
- Less than 80 percent of their funding must come from government sources.

National and international applicants are approved by OPM. At the local level, the Local Federal Coordinating Committee makes the approvals. OPM’s inspector general conducts risk-based audits of regional CFCs to check that funds are being collected and disbursed according to CFC guidelines and according to the intent of donors. According to officials at the office of inspector general, OPM neither audits charities directly nor works with IRS to identify fraudulent charities.

Appendix VI: Comments from the Internal Revenue Service



COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

April 22, 2002

Mr. Michael Brostek
Director, Tax Issues
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Brostek:

I reviewed your draft report on oversight of charities by the public, the Internal Revenue Service, and the states' attorneys general and charity offices. I agree with the general findings of the draft report, and believe they provide useful observations that will assist us in the tax administration of charities. Our comments on the draft report and to your recommendations follow.

Accuracy of Form 990 Data

The GAO is correct in recognizing our role is limited to tax administration, and that regulating the efficiency and effectiveness of charities is outside our current responsibilities under the Internal Revenue Code. However, we do have a responsibility to the public to ensure accuracy in Form 990 data. Your report identifies many of the steps we have taken to improve reporting by exempt organizations. These include:

- Clarifying the instructions for Form 990
- Incorporating educational materials in the 2002 Exempt Organizations Continuing Professional Education text (we also produced two video training conferences on this topic, and invited state regulators to participate)
- Issuing instructions to examiners to check whether charities are properly reporting fundraising expenses, and to impose penalties if they are not
- Adding a checkbox to Form 990 for charities to indicate whether they are following the American Institute of Certified Public Accountants' Standard Operating Procedure (SOP) 98-2
- Asking for public comment on whether we should mandate the use of SOP 98-2 for certain filers
- Convening a taskforce to consider other examination and education projects in the fundraising area

2

Your report correctly concludes we do not know the extent of misreporting by charities. However, we believe our current examination activity, the actions outlined above, and the electronic filing project now underway will help improve the accuracy of reporting by charities. Your report also implies in its "Results in Brief" section that we are not looking at the extent to which charities are properly reporting expenses. We have established a task force to develop examination projects for reporting accuracy (as indicated in our published Implementing Guidelines for this year). We have instructed our examiners to review this issue as part of ongoing examinations. Taken together, we believe these steps will improve our understanding of the extent of misreporting.

Imbalances Between IRS's Charity Oversight Workload and Resources

Your report recognizes the exempt organizations provisions of the Internal Revenue Code are difficult to administer and present significant challenges. It also recognizes our resource constraints. Competing priorities require us to make difficult choices. We have two concerns with this portion of the report: first, we regulate a much wider group of tax-exempt organizations than charities; second, our strategic planning process is not sufficiently reflected in the report.

We understand the GAO's review was limited to charities, and this segment is indeed the largest portion of the tax-exempt community. However, we operate within considerable resource constraints, and have competing priorities in our administration of this area. Tax-exempt organizations other than charities demand a good deal of our time and energy. For example, we recently diverted resources from the regulation of charities to create guidance and prepare for new reporting requirements enacted by the Congress under section 527 of the Internal Revenue Code. Similarly, the report, at Table 2, shows only our determination letter requests from charities. This underreports our determination workload. Our total workload includes requests from non-charities, amendments, terminations, foundation follow-ups, and other items. All workload items totaled over 86,000 in 2001, while Table 2 presents a figure of nearly 59,000.

Our second concern relates to our long term planning efforts for charities, and, in particular, to the GAO's statements that we have not established "results-oriented goals for its oversight of charities against which to measure progress," and that we do not have an "accurate picture of charities' compliance." The report also questions whether our current plans will yield such data. We know we lack a complete measure of the compliance level of the various segments of our regulated community. However, we believe we have established a long-term plan that will provide this information.

The Exempt Organizations (EO) office follows the IRS Strategic Planning process. Under this process, which has been significantly revised in recent years by my office, EO establishes a Strategy and Program Plan (SPP) that provides a roadmap for EO to execute its strategies and programs over the next two fiscal years. As mentioned in the report, a key strategy embedded

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in our SPP is the market segment approach that we intend to use to assess compliance. We do not believe charities are a homogenous population. Rather, under the market segment approach, we recognize the EO community is comprised of many different kinds of organizations with many different characteristics and needs. For example, small volunteer organizations have very different issues and needs than large non-profit hospital systems. We have preliminarily identified 35 segments, many of which contain organizations we recognize as charities.

We will study each identified segment and will collect information outlining the demographics and other characteristics of the organizations in that segment. We believe these studies will help us determine the overall compliance level of these organizations and identify specific areas of noncompliance. The studies will also provide us with compliance risk assessments and will allow us to determine what strategies are necessary for each segment. Our compliance strategies may range from an educational program to more traditional examinations in the area. As noted in the report, we began the process last year and have six studies underway.

We have not yet determined a specific compliance percentage that indicates whether charities as a whole are or are not "sufficiently compliant". However, we believe we have taken the first step, which is to measure current compliance levels. The market segment approach is key to succeeding in this effort. As the process matures, we will be better able to develop objective measures and goals of the type you suggested in the report. We have considered this issue carefully and believe our approach is sound.

Federal and State Information Sharing

Our role is to administer the Federal tax law to ensure that exempt organizations comply with the laws enacted by the Congress. As the report notes, civil and criminal enforcement against fundraising misrepresentation is the role of state charity officials. That said, it is clear information exists that can and should, under present law, be shared with state officials. We are working closely with these officials, within the confines of current law, to develop new procedures to facilitate and improve coordination with the states.

The report notes the Department of the Treasury and state officials are working on expanding the information available to the states. The IRS commends the GAO for the discussion in the report of the competing interests and rights in this area (e.g., due process and privacy). The report also correctly notes that any new information sharing procedures, whether expanding information sharing or otherwise, will have resource implications both for the IRS and the states. Significant changes in the type of data exchanged are only possible through legislation. We note that recent legislation (H.R. 3991) that included a provision supported by the Department of the Treasury expanding information sharing with state charity officials failed to pass the House of Representatives. While this bill has not become law, we will continue working with Congress and the states for possible solutions.

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Response to Recommendations

Recommendation: The Commissioner should ensure (either through the planned market segment studies or other means) that the IRS obtains reliable data on compliance issues (including expense reporting) for the full charity community.

Response: The IRS has established a task force that will develop and implement projects intended to improve data collection and compliance in the fundraising area. We will also continue the market segment approach.

Recommendation: The Commissioner should develop result-oriented goals, strategies (including levels of staffing and other resources to accomplish the goals), and measures to gauge progress in accomplishing those goals when overseeing the charity community.

Response: The IRS has a long-term plan to determine and address compliance levels through its market segment approach.

Recommendation: The Commissioner should develop, in consultation with state charity officials, a procedure to regularly share IRS data with states as allowed by federal tax law.

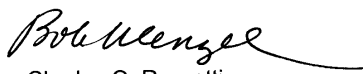
Response: We are currently developing such a procedure and will consult with state charity officials prior to its completion and implementation.

Recommendation: The IRS, in concert with the Department of the Treasury and state charity officials, should identify the specific types of data that may be useful for enhancing state charity officials' oversight of charities, the appropriate mechanisms for sharing the data, the resources needed, and the types and levels of protections to be provided to prevent improper disclosure and misuse.

Response: The IRS has assisted Treasury and the Committee on Ways and Means in drafting legislation that would implement this recommendation.

I appreciate your input on this important program. Please contact Steven T. Miller, Director of Exempt Organizations, Tax Exempt and Government Entities Division at (202) 283-2300 if you have any questions.

Sincerely,

Acting for 
Charles O. Rossotti

Appendix VII: Comments from the Department of the Treasury



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

APR 23 2002

Mr. Michael Brostek
Director, Tax Issues
United States General Accounting Office
Washington, DC 20548

Dear Mr. Brostek:

Recently, you forwarded for comment your draft report entitled *Tax-Exempt Organizations: Improvements Possible in Public, IRS and State Oversight of Charities*. One of the recommendations of the report is that the Internal Revenue Service continue to assist the Department of the Treasury in drafting a specific legislative proposal that would expand state access to selected IRS oversight data, subject to appropriate safeguards.

Treasury supports the overall goal of increasing the information the IRS is permitted to share with state officials who are charged with responsibility for overseeing charities, within certain parameters. Any legislation that permits disclosure of pending application data or examination data, for example, must balance the interests of state charity officials and concerns regarding taxpayer privacy and the impact on federal tax administration. In addition, disclosures of otherwise confidential taxpayer information must be subject to safeguards, consistent with section 6103 of the Internal Revenue Code.

The approach taken in section 410 of the Taxpayer Protection and IRS Accountability Act of 2002 (H.R. 3991) addressed many of these concerns. We look forward to continuing to work with the Congress, the IRS, and state charity officials to develop similar legislation in the future.

Sincerely,

Pamela F. Olson
Acting Assistant Secretary
(Tax Policy)

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E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

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