

**COMMENTS CONCERNING FORM 990
PURSUANT TO ANNOUNCEMENT 2002-87**

The following comments on the Form 990 represent the views of the members of the Tax and Accounting Interest Group who prepared them and do not represent the position of the Health Law Section or the American Bar Association. Principal responsibility was exercised by Frederick J. Gerhart and Bonnie S. Brier. The comments were reviewed by J.A. (Tony) Patterson, Jr. and Gregory L. Pemberton.

Although members of the Health Law Section who participated in preparing these comments have clients who would be affected by, or have advised clients on the application of, the federal tax principles addressed by the comments, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of the comments. The views expressed should not be construed as representing the position of any government participant in the Section, its Council, or its Interest Group leadership.

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INTRODUCTION

In Announcement 2002-87, 2002-39 I.R.B. 624, the Internal Revenue Service invited comments on possible changes to its Form 990. The following comments do not respond to all of the issues raised in Announcement 2002-87. They are limited to certain aspects of the Form 990 likely to apply to health care organizations described in section 501(c)(3) or section 501(c)(4) of the Internal Revenue Code.

FULLER AND MORE CONSISTENT DISCLOSURE

The purpose of making the Form 990 public is to enable and improve oversight of tax-exempt organizations by the public. To make public oversight effective, there is a need for consistent disclosure and a level playing field for the reporting organizations, so that each organization presents the same full and complete disclosure.

The four comments under this heading deal with four parts of the Form 990 and Schedule A where compensation arrangements are reported, Part V of Form 990, Part I of Schedule A, Part II of Schedule A, and Line 2 of Part III of Schedule A. These comments focus on the need for more consistent and more complete disclosure on these four parts of the form.

A. *Comments on Form 990, Part V*

Part V of Form 990 requires information about the filing organization's officers, directors, trustees and key employees, including their names, addresses, titles, average hours per week devoted to the position, compensation, employee benefit plan contributions, deferred compensation, expense accounts and other allowances. For convenience this discussion uses the term "officer" to include as well a reference to directors, trustees and key employees where appropriate.

The Part V instructions require disclosure of all cash and noncash compensation whether paid currently or deferred. The current instructions require disclosure of compensation paid to an officer indirectly through a management services company, on the same basis as if the compensation had been paid directly, although we note that Announcement 2001-33 has separately requested comment on whether and in what form this information should continue to be requested. Line 75 of Part V and its instructions go further to require disclosure of compensation paid to the officer by any related organization if the officer receives total compensation of at least \$100,000, and at least \$10,000 is paid by a related organization.

One ambiguity in how compensation should be reported on Part V involves persons who serve an organization both as an officer and in some other capacity. A narrow reading of the instructions could lead one to conclude that only compensation paid to the officer for services provided as an officer need be disclosed. Under such a construction, if the officer receives other compensation from the organization for services performed in another capacity, that other compensation may not be disclosed.

For example, assume that a physician sits on the board of directors of a hospital and receives no compensation for services performed in that capacity, but also receives a salary for services provided as the chair of the hospital's radiology department. If the physician served only as chair of the radiology department and was not a director, his or her compensation would not be subject to disclosure because the definition of "key employee" in the Part V instructions excludes "the heads of separate departments ... such as the head of the radiology department or coronary care unit of a hospital..."

It is not clear from the instructions whether this individual's compensation as a director should be reported as zero, or should include compensation received as chair of the radiology department. Some organizations read the instructions broadly and report the compensation received as chair of the radiology department on Part V. Others read the instructions narrowly and do not.

Another example involves an officer who also provides services to the organization as an independent contractor, not as an employee. For example, an attorney or accountant who sits on an organization's board may also provide professional services to the organization as an independent contractor, either individually or as part of a firm. Organizations are less likely to disclose an individual's compensation as an independent contractor than as an employee, but, again, the Part V instructions could be read either way.

We recommend that the Part V instructions clearly state whether the compensation reported for an officer should include compensation paid to that individual for services performed for the organization in another capacity. If such other compensation is to be included, it might be limited to situations where the officer is also compensated as an employee. Broadening the disclosure to officers who receive compensation as independent contractors may be appropriate as well, but would present greater administrative complexity if the officer is part of a large firm and is only one of several individuals in that firm who perform services for the organization.

B. Comments on Form 990, Schedule A, Part I

Part I of Schedule A requires the disclosure of the compensation paid to the organization's five highest paid employees who were paid more than \$50,000, other than the officers, directors, trustees and key employees shown on Part V of Form 990 discussed immediately above. In the interests of consistency and complete disclosure, the information reported on Part I of Schedule A should generally be as broad in scope as the information reported on Part V of Form 990.

Part I contains the same five columns of information for each employee (name, address, title, etc.) that are found in Part V. Moreover, the instructions for Columns C, D and E are the same for both parts. However, there are two important respects in which the two parts differ.

First, Part I of Schedule A does not contain a line similar to Line 75 of Part V, requiring the disclosure of compensation paid by related organizations. Line 75 of Part V

requires this disclosure where the individual was paid more than \$100,000, and more than \$10,000 was provided by a related organization.

Second, Part I of Schedule A does not require the disclosure of compensation paid indirectly. As noted above, the instructions to Part V of Form 990 specifically require the disclosure of information paid through another person such as a management services company. The Part I instructions do not.

In the interests of consistency and full disclosure, we recommend that the same disclosure of indirect payments and payments by related parties required under Part V of Form 990 be required under Part I of Schedule A.

C. Comments on Form 990, Schedule A, Part II

Scope of Professional Services. Part II of Schedule A requires the reporting of the compensation paid to the five highest paid independent contractors for “professional services.” The instructions provide that examples of independent contractors subject to disclosure “include attorneys, accountants, physicians and professional fundraisers.” Some return preparers interpret the term “professional services” narrowly to apply only to the traditional professions such as law and medicine, and go beyond that only to include the “professional fundraisers” specifically mentioned in the instructions. Under that narrow interpretation of “professional services,” amounts paid to independent contractors for public relations or management consulting services would not be reported on Part II. Other return preparers interpret the term “professional services” broadly so that it encompasses what have been traditionally regarded as nonprofessional services.

In the interests of consistent and full disclosure, the scope of independent contractors subject to disclosure on Part II of Schedule A should be more clearly defined. If the Service prefers to limit disclosure to “professional services,” it should provide clearer guidance on what it means by “professional” for this purpose. If, however, the Service prefers to include services that go beyond traditional professional services, it could revise the Part II instructions to refer more broadly to any “services” provided to the organization by an independent contractor, instead of referring to “professional services.”

Expense Reimbursements. The instructions to Part II are not clear about how expense reimbursements should be reported. The instructions state that fundraising fees should not include “reimbursements for amounts paid by the fundraiser to others for printing, paper, envelopes, postage, mailing list rental, etc.” It is not clear whether this applies only to fundraisers, or to other independent contractors as well. In the interest of

consistency, the instructions should extend the same rule to all independent contractors. In addition, the exclusion for expense reimbursements should be limited to reimbursements reflecting the independent contractor's actual cost paid to an unrelated third party, not just any amount paid "to others." This, in turn, would require a definition of "unrelated third party."

Defining Compensation. The Part II instructions do not contain the same broad definition of compensation reflected in the instructions for Part I of Schedule A and Part V of Form 990. For example, both Part I and Part V specifically include cash and noncash compensation and current and deferred compensation, whereas the Part II instructions do not make such broad references. Part II should have the same broad definition of compensation as Parts I and V.

Indirect and Related-Party Payments. Finally, as with Part I of Schedule A, discussed above, Part II does not require the disclosure of payments to the independent contractor by entities related to the organization, of the type required by Line 75 of Part V, and does not require the disclosure of indirect payments. It is our recommendation that the same level of disclosure be required on Parts I and II.

D. Comments on Form 990, Schedule A, Part III, Item 2

Line 2 of Part III, Schedule A, requires the reporting of information pertaining to transactions between the organization and its substantial contributors, trustees, directors, officers, creators, key employees, members of their families, or their affiliated taxable organizations. In addition to compensation, reportable transactions include a sale, exchange or lease of property, a loan, the furnishing of goods, services or facilities, and a transfer of the organization's income or assets. Line 2 requires the attachment of a "detailed statement" explaining any such transaction.

The instructions do not specifically state that the "detailed statement" must include the amount or value involved in the reported transaction and the manner in which the amount or value was determined, and many preparers do not report amounts or values in response to Line 2. To understand the scope and significance of a transaction normally requires information regarding the amount or value involved, and consideration should be given to specifically requiring disclosure of that information in response to Line 2.

Part III, Line 2 requires disclosure if the organization engages in one of the reportable transactions "directly or indirectly." Without more specificity, preparers are free to narrowly interpret the term "indirectly." The instructions should specify that the

reference to indirect transactions is at least as broad as the reference to indirect payments and related-party payments under Part V of Form 990.

Carrying over the indirect-payment and related-party payment disclosure from Part V of Form 990 to Parts I, II and III of Schedule A would improve the consistency of disclosure among the four parts of the return and would be a step toward the kind of full and complete disclosure that would make the Form 990 more effective as a tool for public oversight of section 501(c)(3) organizations.

Comments Regarding Corporate Responsibility

Announcement 2002-87 requests comment on whether measures reflected in recent legislation affecting public disclosure by publicly traded companies, such as the Sarbanes-Oxley Act, should be extended to tax-exempt organizations filing Form 990.

Schedule A, Part III, Line 2. The corporate responsibility portion of Announcement 2002-87 specifically asks whether organizations should be required to provide additional information under Schedule A, Part III, Line 2. Our comments on that point are set forth above.

Conflict Policies/Audit Committees. Announcement 2002-87 also specifically requests comment on “whether exempt organizations should be required to disclose on Form 990 whether they have adopted conflicts of interest policies or have independent audit committees.” The implication of asking such a question is that an organization should have adopted such measures. However, it appears that outside the health care area, the Service has never required either measure as a condition of recognizing tax-exempt status.

It is appropriate to require large tax-exempt organizations to have conflict of interest policies and independent audit committees. In fact, in our experience most large health care and educational organizations have implemented such measures.

However, although we are not aware of any surveys or other hard information on the subject, we suspect that many small tax-exempt organizations do not have formal written conflict of interest policies or independent audit committees. Because the Service has never had a general policy of requiring such measures, those organizations have not gone to the effort of implementing them, even though they may well observe a conflict of interest policy in practice, or be required to do so by state law. We suspect that a great many smaller organizations would answer such a question in the negative.

It would be useful to ask these questions to gather information about how many and what types of organizations have implemented these measures. Moreover, these questions may serve a useful purpose if their mere presence on the Form 990 encourages organizations to adopt such measures.

If asking these questions is a prelude to requiring all or some exempt organizations to implement one or both of these measures, that would represent a significant change of policy by the Service and should require serious consideration regarding which organizations would be subject to the requirement, transition rules, and other issues. For example, is it worth the administrative and enforcement burdens that would result from requiring numerous small tax-exempt organizations with very limited resources, many of whom are not even required to file Form 990, to adopt such policies? In addition, it must be decided what terms would be required for a satisfactory conflict of interest policy. Although the Service has published a model conflict of interest policy for health care organizations, it has not required the exact terms of that policy to be adopted.

Extending the two measures mentioned -- conflict of interest policies and independent audit committees -- to large tax-exempt organizations is a reasonable step to increase public confidence in the integrity of tax-exempt organizations. Asking the proposed questions about whether organizations have adopted such measures is a reasonable first step in that direction.

We have two suggestions to increase the usefulness of the information received in response to these questions. As to conflict of interest policies, consideration should be given to requiring an organization indicating that it has such a policy either to attach a copy of its policy or to answer additional questions describing the policy. Conflict of interest policies can vary widely and a simple "yes or no" question would not confirm that the organization's policy contains the basic elements that the Service might consider essential to an adequate conflict of interest policy.

As to independent audit committees, the question or its instructions should define who the Service considers to be "independent" for this purpose. Definitions of independence vary and it would be advisable to provide preparers with a definition that is consistent with Sarbanes-Oxley.

Providing 990 to Board. An organization's board should be aware of all the information reflected on the Form 990. We suggest adding a question to the Form 990 such as the following: "Do you provide each voting member of your governing board with a complete copy of this Form 990 within 60 days after filing?" In addition, we recommend giving consideration to whether the current statute and regulations give the

Service the authority to require an organization to provide a complete copy of its Form 990 to every voting member of its governing board.

Certifying Financial Statements. Sarbanes-Oxley requires a public company's CEO and CFO to certify the accuracy of its financial reports. Many nonprofit organizations have adopted a "best practices" policy of having the CEO and CFO certify the financial statements to the organization's audit committee. If in response to the question discussed above, an organization indicates that it has an independent audit committee, we suggest adding a follow-up question such as the following: "Do you require your CEO and CFO to certify your financial statements to your independent audit committee?"

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We welcome the opportunity to meet with representatives of the Service to discuss and explore these comments further.