

Financial Measures in Nonprofit Organization Research: Comparing IRS 990 Return and Audited Financial Statement Data

Karen A. Froelich
Terry W. Knoepfle
North Dakota State University

Thomas H. Pollak
*National Center for Charitable Statistics
Center on Nonprofits and Philanthropy*

The IRS 990 Return is becoming an increasingly prominent source of financial data underlying descriptions of the nonprofit sector and studies of nonprofit organizations. However, questions about the quality of the data continue to be of concern. This study of 350 nonprofit organizations investigates the adequacy, reliability, and appropriate interpretation of IRS 990 Return data through comparisons of selected entries with corresponding measures from each organization's audited financial statements. Both quantitative and qualitative methods are used to examine and explain the consistency between the two data sources. The study concludes that the IRS 990 Return can be considered an adequate and reliable source of financial information for many types of investigations, but preparers and users of the data need a clearer understanding of its purposes to enable appropriate interpretations.

The study of nonprofit organizations has historically been a daunting task. The nonprofit sector is noted for its tremendous diversity in size, purpose, and formality of organizations. The research challenge has been compounded by a lack of institutionalized mechanisms for sorting nonprofits into homogeneous

Note: We wish to thank the Aspen Institute's Nonprofit Sector Research Fund for support of this study, Joe Galaskiewicz for his skepticism about financial measures in earlier research efforts, Curt Doetkott for statistical expertise, Mike Palmer for data management expertise, Mariya Chuykova for meticulous attention to detail throughout all phases of data collection and analysis, and five anonymous reviewers whose suggestions contributed substantially to this effort. Preliminary results were presented at the 1996 annual Association for Research on Nonprofit Organizations and Voluntary Action (ARNOVA) conference; an earlier version of this article was presented at the 1997 Academy of Management national meeting.



Nonprofit and Voluntary Sector Quarterly, vol. 29, no. 2, June 2000 232-254
© 2000 Sage Publications, Inc.

subgroups and obtaining comparable data across organizations for large-scale, cross-sectional studies (Froelich & Knoepfle, 1996). The IRS 990 Return, a report required annually by the Internal Revenue Service for nonprofits (excluding religious organizations) with at least \$25,000 total revenue, has been an important source of financial information. Accessibility of the IRS 990 Return recently has grown considerably, with data for large samples of organizations available directly from the Internal Revenue Service or the Urban Institute in tape, diskette, and soon, CD-ROM formats. Internet access to IRS 990 information is also growing. For example, Philanthropic Research Incorporated's GuideStar Web site currently contains financial entries from thousands of nonprofit organizations, and some states' charity registration divisions also include IRS 990 Returns on their Web sites. Posting individual returns to nonprofit organization home pages is also encouraged and becoming more common. The quantitative data from the IRS 990 Return is enhanced by the addition of National Taxonomy of Exempt Entities (NTEE) activity codes for classifying organizations by their major purposes or activities. Overall, this vastly improved research infrastructure is spawning increasing numbers of studies relying on financial measures obtained directly from the IRS 990 Return.

A review of the literature shows IRS 990 data used in the study of revenue strategies and expense patterns (Bowen, Nygren, Turner, & Duffy, 1994; Cordes & Weisbrod, 1998; Oster, 1998; Steinberg, 1987; Tuckman & Chang, 1991, 1998; Weisbrod, 1988), financial vulnerability and debt management (Tuckman & Chang, 1991, 1993), and operational efficiency and organizational performance (Chang & Tuckman, 1990; Steinberg, 1987; Tuckman & Chang, 1991). The comprehensive summaries and annual updates from Hodgkinson and Weitzman (1996) of the Independent Sector and the IRS Statistics of Income (SOI) division research reports that are broadly relied on for descriptive and contextual data about the nonprofit sector also are based on IRS 990 data.

In addition to academic research, IRS 990 data increasingly underlie media portrayals, sometimes positive but usually negative, of particular nonprofit organizations or sector trends. Topics of recent interest include revenue composition, especially the proportion received through traditional strategies focused on contributions and grants compared to the more commercial strategies that generate program fees or unrelated sales income, and patterns of expenditures, with primary attention to fund-raising costs and administrative salaries and perks (Young, Bania, & Bailey, 1996). The visibility of these issues has fueled stepped-up activity on the part of oversight groups, both private and governmental, often again relying on IRS 990 entries for purposes of comparing and even ranking organizations on these sensitive dimensions. Foundations and other major funders may also use these entries as they search for broadly comparable measures for screening and evaluating their growing list of funding requests. Finally, current controversies and media coverage may

evolve into public policy discussions, leading to another important role for the IRS 990 data (Hodgkinson, Weitzman, Noga, & Gorski, 1993).

Unfortunately, the IRS 990 data is not without its problems and limitations. Aside from the widely acknowledged skewed sample produced by studying the sector via IRS 990 Returns, which are required only for the roughly 30% of nonprofits meeting the minimum revenue threshold (Hodgkinson et al., 1993), problems associated with failure to file, tracking affiliated or merged organizations, and identifying defunct organizations have surfaced (Bowen et al., 1994; Gronbjerg, 1989, 1994). Concerns about the completeness and accuracy of the information have also been raised (Abramson, 1995; Orend, O'Neill, & Mitchell, 1997; Skelly & Steurele, 1992). Inaccuracies might be caused by outside accountants with limited knowledge of individual organizations and their activities, in-house preparation of returns by nonprofit employees with inadequate accounting background (Froelich & Knoepfle, 1996), or unclear guidelines for IRS 990 entry calculations (Gorman & Tanenbaum, 1993). Inconsistencies between the IRS 990 Return and annual audited financial statements have been identified for variables frequently used in studies and reports including total revenue, gross profit from sales, total program expenses, and total salaries and wages (Froelich & Knoepfle, 1996). Specific revenue categories (Tuckman & Chang, 1991), especially government funding and program fees, seem particularly prone to distortion as considerable confusion surrounds the reporting of fees paid by government agencies (Hodgkinson et al., 1993).

So although the IRS 990 Return is an increasingly prominent source of financial variables in studies of nonprofit organizations, we find that questions about the quality of this data are also increasing. Systematic study of the IRS 990 data is needed to help provide guidance for the use of this information and more confidence in the conclusions and implications resulting from it. Accordingly, this research project was undertaken to investigate the adequacy, reliability, and interpretation of the financial measures obtained from the IRS 990 Return. Briefly, with a sample of 350 nonprofit organizations and a selection of commonly used variables, the study compares entries filed on the IRS 990 Return with the same financial measures taken from each organization's audited financial statement. Both quantitative and qualitative data analysis methods are used to identify patterns of consistency and inconsistency and to help explain discrepancies between the two sources of financial information.

METHODOLOGY

SAMPLE AND DATA COLLECTION

The sampling frame is the list of Minnesota Registered Charities; registration is required of charitable organizations with IRS 501(c)(3) designation, excluding private foundations and churches, that solicit donations in

Minnesota and whose total annual direct and indirect public support is at least \$25,000. The IRS 990 Returns for the sample organizations for years 1988 and 1994 were obtained from the Charities Division of Minnesota's Office of the Attorney General.

Audited financial statements are recognized as another important source of financial data. Because the statements vary in format and are not always available—some organizations do not see a need for or do not have resources to hire an outside independent auditor—they offer a less convenient source of information than the IRS 990 Return. However, because audited financial statements are certified by the accounting firm as an accurate representation of an organization's financial situation according to generally accepted accounting procedures (GAAP), they are widely perceived as more objective and reliable than the IRS 990 Return. Certification implies that the information has been verified; accountants look beyond the numbers provided by the organization and examine additional documentation before coming to their own conclusions. Accountants can be held liable for damages incurred by inaccurate financial statements (e.g., bad loans), so they are careful to verify information before signing off on an audit. In contrast, the risk inherent in the 990 Return is minimal; it is rarely audited, and errors typically result in filing corrections and/or a token penalty. Consequently, contributed information is seldom questioned, less time and attention is devoted to IRS 990 Return preparation, and the return becomes viewed as less accurate than the audited financial statements.

From the Registered Charities listing, a random sample of 933 organizations was mailed a request for their audited financial statements for years 1988 and 1994. Following a second request, a total of 399 responses was received. After adjusting for undeliverable letters and responses reporting dissolved organizations or a lack of audited statements, the sample size becomes 363, or 42% of the available organizations. This sample was subsequently trimmed to 350 to remove distortions caused by very large outliers and organizations with total revenue less than \$25,000.

Although nonprofits from 28 states responded, 82% of the sample is located in the Midwest. No significant differences were found between the sample and the population or the nonrespondents in terms of size, measured by total revenue and total assets as reported on the 1994 IRS 990 Return. With average size of \$6 million in total revenues, more than \$7 million in total assets, and fund balances averaging more than \$4.5 million (even the median fund balance is nearly \$700,000—for organizations with total revenues and total assets around \$1 million), the nonprofit organizations comprising the sample appear to be well established and financially stable.

DATA ANALYSIS

Data from the financial statements corresponding to selected IRS 990 Return entries were coded according to Internal Revenue Service instructions

and entered into the database. The 11 entries selected for analysis (9 entries reflecting revenues or expenses from income statement data and 2 entries from the balance sheet) are those frequently used to describe nonprofit organizations and to examine management- and performance-related issues. Two ratios of interest were also analyzed: the fund-raising cost ratio (fund-raising/total contributions) and the program expense ratio (program service expenses/total revenue).

Prior to statistical testing, the data was inspected for possible miscalculation or data entry errors. Despite widespread suspicion of frequent errors in the IRS 990 Returns, our study uncovered relatively few. Most appeared to be data entry errors involving transposed digits or an extra digit in an entry and were corrected; uncorrectable observations were dropped from the analysis. Examination of the frequency distributions identified the most obvious errors (highly notable outliers). Not only are these the easiest errors to find but also the entries that are most likely to substantially distort a study's results. Computer scans to locate mathematically impossible entries were also used to clean the data. Although more numerous, these errors were also less material, as they typically involved the last two or three digits of an entry and would have negligible effects on results.

The entries on the IRS 990 Return and comparable measures on each organization's audited financial statement were analyzed from a variety of perspectives to investigate the adequacy (completeness), reliability (consistency), and appropriate interpretation of IRS 990 Return data. First, adequacy was explored by examining the percentage of organizations reporting revenue and expense details for each of the two data sources, with higher percentages representing greater data adequacy. Next, reliability was examined via correlations¹ between IRS 990 entries and financial statement entries for years 1994 and 1988 for the sample as a whole and for subgroups based on organizational size and purpose. The closer the correlations are to 1.0, the more consistent is the reporting between the two data sources. To further examine reliability, distributions of differences between the two sources of data were generated. Large proportions of organizations in the low percentage difference categories indicate high levels of consistency between the IRS 990 data and the audited financial statement.

Following the statistical analysis, in-depth phone interviews with persons involved in the preparation of IRS 990 Returns and audited financial statements from a randomly selected subsample of organizations were conducted to help explain the statistical results. A series of open-ended questions probed the respondents' views of the financial picture portrayed by the IRS data, comparisons between the IRS 990 Return and the audited financial statement, and specific entry calculation issues. On referral, professionals from independent certified public accounting (CPA) firms that prepared the IRS 990 Return were also interviewed. Data from the interviews was analyzed for patterns in the responses and insights concerning the appropriate interpretation of IRS 990 Return entries.

RESULTS

QUANTITATIVE RESULTS

Table 1 examines data adequacy by showing the percentage of organizations reporting specific revenue and expense entries for each of the two data sources. It is often assumed that because the structure of financial statements can be adapted to fit the specific activities of each organization, the statements would produce more detailed and complete financial reporting than is possible with the standard 990 Return format. Furthermore, a common lament is the number of omitted entries and resulting lack of component detail on 990 Returns. A more general expectation is that adequacy will improve over time with clarification in reporting guidelines and greater emphasis on financial disclosure.

The analysis reveals that all organizations include total revenue for both years on the financial statement and the IRS 990 Return; inclusion of entries detailing the composition of total revenue varies, however. Nearly all organizations show revenue from contributions, and close to 70% report program service revenue. Not surprisingly, a much smaller percentage indicates rental income or profit from sales. The interesting variation is the percentage reporting each entry on the IRS Return as opposed to the financial statement. For all revenue entries except program service revenue, the IRS Return has a greater percentage of nonzero values, and all are higher for 1994 compared to 1988. The range of difference is not large—from about 2% to 12%—but seems to indicate a higher degree of detail and greater improvements in revenue reporting on the IRS 990 Return for each year examined.

A similar pattern emerges for the expense entries. Although one or two organizations do not include total expenses in either data source, a very high proportion of the sample separates total expenses into the various functional expense components. Again, the IRS 990 Return has a higher percentage of nonzero values, and the percentages increase from 1988 to 1994. It is interesting to note that only about half the sample report fund-raising expenses on the financial statement compared to about 70% on the IRS Return. A value for management expense is also considerably more prevalent on the IRS Return. Little variation is apparent for the program service expense entry. Overall, the IRS 990 Return exhibits a higher percentage of nonzero values for 11 of the 14 comparisons of revenue and expense components and a clear pattern of improved data adequacy over time.

The next two tables display the Spearman correlation coefficients employed to examine the consistency between IRS 990 Return and financial statement entries including separate analyses by size and organizational purpose. It might be expected that common basic entries (total revenue, expenses, assets, and liabilities) would exhibit greater consistency and thus high correlations, whereas less common (rental income and profit from sales) or publicly sensitive (management or fund-raising expenses) entries would exhibit lower

Table 1. Percentage of Nonzero Values on Financial Statements and IRS 990 Returns: Revenue and Expense Variables for 1994^a and 1988^b

Variable	Financial Statements		IRS 990 Returns		Difference ^c	
	1994	1988	1994	1988	1994	1988
Revenues						
Total contributions	92.0	92.7	98.9	97.5	6.9	4.8
Program service revenue	70.5	71.2	68.3	62.0	-2.2	-9.2
Net rental income	13.8	12.3	18.2	14.9	4.4	2.6
Gross profit from sales	10.5	8.2	22.9	19.0	12.4	10.8
Total revenue	100.0	100.0	100.0	100.0	0.0	0.0
Expenses						
Program service expenses	95.0	98.2	97.8	96.4	2.8	-1.8
Management expenses	82.6	83.2	98.3	93.7	15.7	10.5
Fund-raising expenses	53.7	45.5	70.0	63.4	16.3	17.9
Total expenses	99.7	99.1	99.7	99.1	0.0	0.0

a. $N = 350$.

b. $N = 221$.

c. Percentage nonzero values on IRS 990 Returns minus percentage nonzero values on financial statements.

correlations. Also, it is widely believed that small organizations report less reliably than large ones due to resource and expertise constraints and instability of personnel and procedures. Thus, arts organizations might produce lower correlations due to small median size, and human services may have low correlations due to the size and mission variety within this category. Again, it is expected that reporting would become more reliable over time for all groups.

The correlation results for the entire sample are reported in the first two columns of Table 2. Looking first at 1994, we find the correlations clustering between .71 and .88, indicating a high degree of consistency between the IRS 990 Return entries and the audited financial statements for most of the variables examined. Prominent exceptions are the correlations of .35 for gross profit from sales and .54 for net rental income, both infrequently relied-on sources of income that are typically unrelated to the nonprofit mission. Total management expenses also has a relatively low correlation of .61. The nearly identical correlations for 1988 suggest stability in reporting practices over this time period. As predicted, the basic entries (total revenue, total expenses, total assets, and total liabilities) all show a high degree of correspondence between the IRS 990 Return and the financial statements for both 1988 and 1994.

Next, using the bottom and top quartiles of the sample, subgroups representing small and large organizations were analyzed separately, with results also displayed in Table 2. Although some correlations are lower for small organizations than for the sample as a whole, improvements from 1988 to 1994 are evident on 11 of the 13 variables. In 1994, almost two thirds of the correlations for small nonprofits are at least .70. Small organizations, however,

Table 2. Spearman Correlation Coefficients: By Organizational Size

Variable	Entire Sample		Small Organizations ^a		Large Organizations ^b	
	1994	1988	1994	1988	1994	1988
	(N = 350)	(N = 221)	(N = 88)	(N = 72)	(N = 89)	(N = 58)
Total revenue	.87	.84	.87	.70	.65	.56
Total contributions	.83	.81	.83	.66	.65	.73
Program service revenue	.73	.73	.55	.64	.73	.79
Net rental income	.54	.46	.44	.72	.44	.35
Gross profit from sales	.35	.39	.38	.12	.45	.42
Total expenses	.87	.84	.87	.70	.67	.48
Program service expenses	.82	.79	.70	.58	.65	.45
Management expenses	.61	.56	.60	.38	.43	.36
Fund-raising expenses	.71	.73	.76	.51	.78	.82
Total assets	.88	.89	.96	.95	.68	.63
Total liabilities	.88	.86	.73	.66	.69	.55

a. Total revenue < .36 million.

b. Total revenue > 4.1 million.

appear less consistent in tracking commercial forms of revenue—program service revenue, rental income, and profit from sales. Somewhat surprisingly, large organizations demonstrate lower correlations overall. Only about one quarter of the correlations for large organizations are at least .70. Correlations for many entries, including the basic measures of total revenue, expenses, assets, and liabilities, are about .20 below the values for the sample as a whole. For both large and small organizations, generally improved consistency in reporting basic entries and functional expenses is evident.

A look at the consistency between IRS 990 Return and financial statement entries within organizational purpose categories is provided in Table 3. Again, we see high correlations for the basic entries; nearly all are greater than .70 for total revenue, expenses, assets, and liabilities. Correlations for total contributions are also consistently high across all subgroups. Similar to results for the sample as a whole, net rental income and gross profit from sales exhibit generally low correlations, although some variation is apparent.

The highest correlations cluster in human services, where 8 of the 13 entries are greater than .70 for each year, and only 1 correlation falls below .50. However, the correlations in human services appear to be declining over time—8 of 13 entries have lower correlations in 1994 than in 1988. Correlation declines are steeper and more prevalent in the arts subgroup, where all but 2 are lower in 1994. Notably low correlations for fund-raising expenses and the fund-raising cost ratio are also evident in the arts subgroup as well as relatively higher correlations for program service revenue compared to other typically small nonprofits.

The lowest correlations occur most frequently—in fact, for about half the entries—in the education subgroup. Correlations for program service revenue

Table 3. Spearman Correlation Coefficients: By Organizational Purpose

Variable	Arts ^a		Education ^b		Health ^c		Human Services ^d		Public Benefit ^e	
	1994 (N = 24)	1988 (N = 16)	1994 (N = 40)	1988 (N = 28)	1994 (N = 63)	1988 (N = 39)	1994 (N = 126)	1988 (N = 82)	1994 (N = 62)	1988 (N = 39)
Total revenue	.77	.90	.73	.61	.86	.73	.94	.96	.84	.85
Total contributions	.67	.75	.80	.72	.85	.72	.81	.90	.84	.70
Program service revenue	.77	.86	.57	.45	.78	.64	.76	.83	.82	.68
Net rental income	.37	.59	.39	.20	.61	.31	.57	.58	.53	.72
Gross profit from sales	.33	.71	.44	.59	.20	.27	.54	.48	.09	.10
Total expenses	.79	.96	.77	.56	.84	.75	.91	.97	.85	.82
Program service expenses	.76	.65	.77	.65	.78	.64	.86	.96	.79	.67
Management expenses	.71	.82	.65	.42	.38	.31	.60	.67	.71	.59
Fund-raising expenses	.19	.40	.63	.60	.76	.73	.71	.78	.69	.63
Fund-raising cost ratio ^f	.19	.28	.70	.67	.62	.79	.67	.61	.71	.67
Program expense ratio ^g	.61	.39	.74	.56	.53	.48	.69	.61	.78	.55
Total assets	.78	.96	.83	.75	.92	.84	.89	.99	.90	.82
Total liabilities	.70	.88	.90	.85	.89	.80	.93	.93	.83	.79

a. 1994 mean total revenue = \$4.31 million, median = \$.35 million.

b. 1994 mean total revenue = \$3.92 million, median = \$.55 million.

c. 1994 mean total revenue = \$10.96 million, median = \$1.97 million.

d. 1994 mean total revenue = \$4.41 million, median = \$1.28 million.

e. 1994 mean total revenue = \$3.88 million, median = \$.88 million.

f. Fund-raising expenses/total contributions.

g. Program service expenses/total revenue.

are especially low in this category. However, correlations show an increase from 1988 to 1994 for 12 of the 13 entries in education; a similar pattern is evident for the health and public benefit subgroups. Both health and public benefit subgroups exhibit relatively low correlations for gross profit from sales; health organizations also have strikingly low correlations for management expenses.

Table 4 displays the cumulative distribution of differences between financial statement and IRS 990 entries (expressed as a percentage of the IRS 990 value) for the sample as a whole and for the various subgroups. Numbers in the table represent the proportion of observations falling within each difference category, with bold to highlight inclusion of at least 75% of the observations. Thus, the closer a bolded number is to the left, the greater is the consistency between the financial statement and 990 entry. Substantially greater entries on the 990 relative to the financial statements are captured in the <-25% category; similarly, comparatively understated entries appear in the >25% column. Purely from the standpoint of creating the most positive appearance for regulatory scrutiny, one could speculate that reported total contributions and program service expenses might be greater on the 990 Return, and commercial sources of revenue (program service revenue and gross profit from sales) as well as management and fund-raising expenses might be understated.

Consistent with the high correlations reported earlier for the basic entries, close to 60% of the entire sample has only a 1% difference between the two sources of information for total revenue and total expenses; this jumps to 70% of the sample in 1988 and 80% in 1994 for total assets and total liabilities. Beyond the basic entries, more than 50% of the sample appears in the 10% difference category for total contributions, program service revenue, program service expenses, management expenses, fund-raising expenses, and the program expense ratio. However, a substantial proportion of the sample still falls in the 25% difference categories for these entries. Less than 40% of the sample is within 1% for the entries related to more commercially generated revenues: program service revenue, net rental income, and gross profit from sales. Contrary to expectations, reported commercial revenues are more likely to be greater on the 990 Return compared to the financial statements; the same is true of fund-raising expenses and the fund-raising cost ratio.

A higher percentage of observations from small organizations fall within 1% compared to the sample overall for 11 of 13 entries in 1994. The opposite picture is portrayed for large organizations, where a lower percentage of observations appear in the 1% category for 10 of the 13 entries. Large organizations also have a lower percentage in the 1% category in 1988 for 8 entries. Overall, the percentage of both large and small organizations with only a 1% difference in reported values appears to be increasing from 1988 to 1994.

For all organizational purpose categories except arts and education, more than 50% of the sample reports within a 1% difference on the basic entries of total revenue and total expenses. Again excluding arts and education, this generally increases to more than 70% by considering those within 10%. Basic

Table 4. Cumulative Distribution of Differences Between Financial Statement and IRS 990 Entries^a

Variable ^b	Within ± 1%		Within 1% to 10%		Within 25%		<-25%		>25%	
	1994	1988	1994	1988	1994	1988	1994	1988	1994	1988
Total revenue										
Sample (350/221)	.56	.55	.75 ^c	.72	.86	.85	.06	.08	.08	.10
Small organization (88/73)	.60	.55	.77	.70	.88	.78	.03	.11	.09	.11
Large organization (89/37)	.51	.51	.75	.67	.86	.84	.08	.11	.06	.05
Arts (24/16)	.50	.31	.63	.50	.83	.74	.04	.13	.13	.13
Education (40/28)	.45	.43	.65	.57	.79	.64	.13	.18	.08	.18
Health (63/39)	.57	.56	.81	.71	.87	.76	.05	.03	.08	.21
Human services (126/82)	.63	.61	.81	.78	.90	.87	.05	.05	.05	.07
Public benefit (62/39)	.50	.51	.69	.74	.79	.87	.06	.13	.15	.00
Total contributions										
Sample (341/212)	.42	.41	.58	.55	.69	.67	.15	.19	.16	.14
Small organization (88/70)	.49	.46	.71	.60	.80	.70	.06	.14	.14	.16
Large organization (86/37)	.23	.46	.42	.51	.56	.59	.23	.30	.21	.11
Arts (24/15)	.38	.27	.55	.34	.75	.66	.21	.27	.04	.07
Education (40/27)	.38	.37	.58	.52	.72	.59	.13	.22	.15	.19
Health (58/36)	.36	.31	.48	.53	.59	.55	.22	.31	.19	.14
Human services (126/79)	.44	.43	.61	.59	.69	.72	.12	.10	.19	.18
Public benefit (60/38)	.47	.50	.65	.58	.74	.71	.13	.24	.13	.05
Program service revenue										
Sample (241/145)	.37	.32	.52	.49	.60	.59	.23	.22	.17	.21
Small organization (50/40)	.36	.23	.48	.43	.56	.47	.24	.30	.20	.23
Large organization (66/27)	.33	.22	.51	.41	.59	.56	.26	.33	.15	.11
Arts (18/12)	.28	.25	.45	.58	.50	.58	.28	.25	.22	.17
Education (26/12)	.31	.25	.35	.25	.54	.41	.23	.42	.23	.17
Health (45/27)	.49	.30	.69	.60	.74	.63	.04	.07	.22	.30
Human services (97/65)	.39	.37	.55	.49	.63	.60	.28	.20	.09	.20
Public benefit (38/21)	.32	.24	.43	.34	.50	.47	.26	.29	.24	.24
Net rental income										
Sample (63/36)	.37	.36	.37	.36	.37	.36	.49	.56	.14	.08
Small organization (8/5)	.25	.60	.25	.60	.25	.60	.37	.20	.38	.20
Large organization (21/11)	.29	.18	.29	.18	.29	.18	.66	.73	.05	.09
Arts (6/3)	.17	.67	.17	.67	.17	.67	.66	.33	.17	.00
Education (8/6)	.25	.33	.25	.33	.25	.33	.75	.67	.00	.00
Health (8/4)	.50	.00	.50	.00	.50	.00	.50	.75	.00	.25
Human services (22/13)	.50	.54	.50	.54	.50	.54	.36	.38	.14	.08
Public benefit (12/5)	.25	.40	.25	.40	.25	.40	.42	.40	.33	.20
Gross profit from sales										
Sample (78/41)	.21	.17	.21	.17	.21	.17	.71	.72	.09	.11
Small organization (17/10)	.29	.00	.29	.00	.29	.00	.65	.90	.06	.10
Large organization (25/13)	.16	.15	.16	.15	.16	.15	.72	.77	.12	.08
Arts (9/4)	.11	.00	.11	.00	.11	.00	.67	.50	.22	.50
Education (15/8)	.33	.25	.33	.25	.33	.37	.60	.63	.07	.00
Health (13/9)	.08	.00	.08	.00	.08	.00	.85	.89	.08	.11
Human services (19/12)	.32	.42	.32	.42	.32	.42	.58	.58	.11	.00
Public benefit (11/7)	.09	.00	.09	.00	.09	.00	.82	.86	.09	.14

Table 4 Continued

Variable ^b	Within ± 1%		Within 1% to 10%		Within 25%		<-25%		>25%	
	1994	1988	1994	1988	1994	1988	1994	1988	1994	1988
Total expenses										
Sample (350/221)	.60	.58	.78	.76	.86	.84	.06	.07	.08	.09
Small organization (88/73)	.61	.58	.75	.70	.85	.81	.01	.07	.14	.12
Large organization (89/37)	.60	.49	.81	.63	.88	.76	.08	.16	.04	.08
Arts (24/16)	.42	.31	.67	.62	.75	.81	.04	.13	.21	.06
Education (40/28)	.53	.43	.68	.57	.80	.72	.10	.21	.10	.07
Health (63/39)	.67	.59	.81	.69	.88	.76	.06	.03	.06	.21
Human services (126/82)	.64	.61	.82	.81	.90	.86	.05	.05	.05	.09
Public benefit (62/39)	.55	.64	.79	.87	.81	.92	.06	.05	.13	.03
Program service expenses										
Sample (340/213)	.45	.39	.65	.61	.76	.74	.11	.12	.13	.14
Small organization (84/68)	.50	.35	.64	.54	.73	.66	.07	.13	.20	.21
Large organization (89/37)	.43	.35	.65	.57	.77	.73	.13	.16	.10	.11
Arts (23/14)	.30	.14	.52	.50	.61	.57	.22	.29	.17	.14
Education (39/26)	.38	.38	.61	.61	.71	.77	.08	.15	.21	.08
Health (58/37)	.48	.35	.67	.49	.81	.60	.07	.08	.12	.32
Human services (125/82)	.46	.37	.67	.64	.76	.80	.13	.09	.11	.11
Public benefit (60/37)	.38	.54	.61	.68	.73	.75	.12	.14	.15	.11
Management expenses										
Sample (342/207)	.42	.39	.54	.48	.60	.54	.22	.23	.18	.23
Small organization (57/39)	.44	.34	.54	.41	.57	.55	.24	.21	.19	.24
Large organization (89/37)	.42	.46	.53	.54	.60	.54	.24	.30	.16	.16
Arts (24/14)	.38	.29	.46	.36	.46	.36	.25	.21	.29	.43
Education (39/27)	.38	.33	.53	.40	.53	.52	.22	.22	.25	.26
Health (60/36)	.52	.36	.59	.39	.64	.45	.23	.36	.13	.19
Human services (126/79)	.41	.35	.51	.49	.58	.57	.25	.23	.17	.20
Public benefit (59/37)	.37	.46	.56	.51	.66	.56	.15	.14	.19	.30
Fund-raising expenses										
Sample (246/138)	.48	.41	.55	.45	.62	.52	.30	.36	.08	.12
Small organization (57/39)	.53	.28	.57	.31	.61	.36	.28	.49	.11	.15
Large organization (75/35)	.44	.46	.55	.52	.64	.60	.27	.31	.09	.09
Arts (19/11)	.26	.27	.31	.27	.37	.36	.47	.55	.16	.09
Education (30/19)	.50	.26	.53	.31	.63	.31	.27	.37	.10	.32
Health (39/18)	.64	.50	.67	.56	.71	.56	.26	.33	.03	.11
Human services (82/52)	.50	.46	.55	.48	.61	.57	.33	.35	.06	.08
Public benefit (47/26)	.32	.35	.49	.43	.59	.50	.30	.38	.11	.12
Fund-raising cost ratio ^d										
Sample	.26	.23	.39	.38	.51	.47	.37	.39	.12	.14
Small organization	.33	.22	.44	.24	.53	.30	.33	.54	.14	.16
Large organization	.19	.35	.38	.58	.54	.71	.33	.19	.13	.10
Arts	.28	.10	.33	.10	.39	.10	.44	.60	.17	.30
Education	.23	.22	.33	.39	.47	.39	.33	.39	.20	.22
Health	.30	.33	.41	.47	.54	.53	.38	.27	.08	.20
Human services	.22	.17	.39	.35	.49	.54	.42	.42	.09	.04
Public benefit	.22	.25	.33	.29	.46	.37	.37	.38	.17	.25

(continued)

Table 4 Continued

Variable ^b	Within ± 1%		Within 1% to 10%		Within 25%		<-25%		>25%	
	1994 1988		1994 1988		1994 1988		1994 1988		1994 1988	
Program expense ratio ^e										
Sample	.43	.37	.70	.61	.81	.79	.08	.10	.11	.11
Small organization	.45	.29	.69	.59	.76	.75	.07	.10	.17	.15
Large organization	.43	.41	.75	.68	.86	.83	.06	.03	.08	.14
Arts	.30	.21	.61	.57	.74	.72	.17	.21	.09	.07
Education	.36	.31	.69	.54	.80	.73	.05	.19	.15	.08
Health	.48	.38	.69	.62	.79	.78	.05	.03	.16	.19
Human services	.45	.37	.70	.60	.84	.82	.07	.09	.09	.09
Public benefit	.38	.38	.73	.62	.80	.70	.12	.11	.08	.19
Total assets										
Sample (336/212)	.83	.71	.88	.79	.92	.85	.04	.08	.04	.07
Small organization (77/66)	.83	.76	.88	.82	.91	.88	.04	.06	.05	.06
Large organization (87/35)	.76	.60	.83	.71	.86	.83	.09	.17	.05	.00
Arts (23/15)	.91	.87	.91	.87	.91	.93	.05	.07	.04	.00
Education (37/27)	.81	.74	.86	.88	.90	.88	.05	.08	.05	.04
Health (61/38)	.75	.63	.86	.68	.90	.79	.03	.08	.07	.13
Human services (123/80)	.87	.69	.90	.78	.93	.83	.03	.09	.04	.08
Public benefit (59/37)	.78	.73	.86	.87	.90	.90	.07	.05	.03	.05
Total liabilities										
Sample (328/204)	.80	.70	.85	.78	.88	.83	.05	.09	.07	.08
Small organization (70/59)	.86	.75	.90	.80	.93	.81	.01	.12	.06	.07
Large organization (87/35)	.70	.66	.77	.69	.81	.74	.11	.20	.08	.06
Arts (23/15)	.83	.80	.83	.87	.88	.87	.04	.06	.08	.07
Education (34/24)	.85	.71	.88	.79	.91	.79	.03	.08	.06	.13
Health (60/36)	.73	.69	.81	.72	.87	.75	.03	.08	.10	.17
Human services (121/78)	.82	.67	.89	.77	.91	.85	.04	.10	.05	.05
Public benefit (57/36)	.75	.72	.79	.80	.84	.86	.09	.08	.07	.06

a. Expressed as a percentage of IRS 990 value: (financial statement entry – IRS 990 entry)/IRS 990 entry.

b. N in parentheses (1994N/1988N).

c. Numbers in bold highlight where at least 75% of the observations are within that category.

d. Fund-raising expenses/total contributions.

e. Program services expenses/total revenue.

entries from the balance sheet exhibit high consistency across all subgroups, with no less than 63% in 1988 and 73% in 1994 within the 1% range. A greater dispersion of differences is found for the other entries. For the sample as a whole, the percentage within 1% increased from 1988 to 1994 for all entries but net rental income.

Generally, a smaller proportion of both arts and education organizations demonstrate differences within 1% (only about 3 entries per year show at least 50% of the sample within 1% in each of these subgroups), and a higher proportion has differences greater than 25% compared to the sample as a whole. Public benefit organizations exhibit a similar tendency for 1994 only. Arts groups

have an especially high percentage—an additional 15% to 25% compared to the sample overall—in the 25% categories for the functional expense entries in both years. Arts organizations also demonstrate the predicted pattern of comparatively greater reported total contributions and program service expenses on the 990 Return. In contrast, at least 50% of the health organizations report within 1% for 7 entries in 1994; this increases to 10 entries by including those within 10%. For nearly all 13 entries, there is a higher percentage in the 1% difference range in 1994 compared to 1988. The human services subgroup also has a high percentage of organizations in the 10% difference category, and a greater percentage within 1% than the sample overall for 11 of the 13 entries in 1994.

QUALITATIVE RESULTS

Forty-six in-depth phone interviews were conducted with persons engaged in financial reporting for organizations in our sample; 4 were with certified public accountants from the firms hired for audited financial statement and IRS 990 Return preparation, and the remainder were with nonprofit employees (primarily accountants; a few executive directors or assistants when the nonprofit had no accounting staff). Only 12% of the organizations represented in this subsample had no accounting staff; 23% of those with staff did not employ professionally trained (degreed and/or certified) accountants. Also, only about one quarter of the organizations prepared their IRS 990 Return in-house, with most contracting it out to the CPA firm handling the annual audit. However, it is interesting that close to half of the nonprofits without professionally trained accountants on staff prepared their own IRS Return, whereas about 20% of those with professionally trained staff prepared their own return.

When asked about the guidelines from the IRS for 990 Return preparation, professionally trained respondents were the most critical of the adequacy and clarity of the guidance provided. Many said that the entries take a lot of time to calculate and believe that it could and should be less complicated. According to one respondent, “The instructions are pretty detailed, but if you do have a question, it usually is not addressed in the book.” Because of both the complexity and time required, many nonprofits rely on outside CPA firms for accurate preparation of the IRS Return. However, one CPA laughed about the procedure for handling the 990s in his firm. Basically, extensions were filed for all of them so the accountants could concentrate on tax clients until after April 15. Then, the 990 Returns would be assigned to junior staff for summer work when the more experienced were on vacation. The junior accountants would use the previous year’s return and the audited financial statement as guides and do the best they could given their lack of knowledge about any particular organization.

As for general impressions of the IRS 990 Return, the following comments convey the gist of the interviews: “We don’t even look at it”; “We don’t pay

attention to it—the CPA does it”; “No person has ever asked to see it”; “It’s not all that helpful—just a government requirement”; and “It is a major headache and a waste of time.” The audited statement was overwhelmingly favored by respondents as a useful source of financial information about their organization. Compared to the IRS 990 Return, the audited statement was often described as more tailored or specific to an individual situation; because assumptions could be stated and additional facts explained in attached notes, it was seen as more descriptive and representative of the financial situation of the organization, whereas the IRS 990 Return was seen as merely a standard government form. One respondent phrased it this way: “The audited financial statements are useful for management decision making. The 990 Return is just a requirement.” The financial statements are also viewed as more important and credible. This contrasts with one external CPA’s view of the IRS Return:

You just fill it out and get it over with. There is no tax to pay and no likely audit forthcoming. So there is little interest or concern about what is put down—if it sounds about right, it’s okay.

When probed for identifiable differences between the two financial documents, many said that the information is really the same, because the IRS 990 entries come from either the audit or the internal operating statements used to generate the audit. It is widely acknowledged that the varying purposes of the two reports result in different perspectives and focal points. The audited financial statement is seen as more detailed and useful for internal matters, whereas the IRS Return is viewed as a mechanism to protect the donor and to show responsibility to the public. However, the financial statement is still cited as the document far more frequently requested by various outside entities.

A common problem seems to be the expense allocations that are required on the 990 Return, whereby the total expenditure for program activities is listed and can be compared to total fund-raising expenses and/or total management expenses. Translating information from the financial statement, which typically lists discrete expense items, into these three expense categories was frequently mentioned as a principal cause of difficulty for IRS 990 preparers and likely inconsistencies between the IRS Return and the audited financial statement. Professionally trained accounting experts often spoke of the requirements for expense allocation but the lack of adequate guidance for parceling out the expense items across the three categories. Allocations can become forced or contrived either by guessing what to allocate to which category or justifying a particular amount if needed. Many sources of confusion involving management expenses were discussed including treating salaries as direct expense rather than overhead, allocating as much as possible to programs for a better appearance, a lack of attention to this expense item until recently, and unclear definitions (“What is ‘management’ anyway?”, asked one respondent). All of these problems have potential impact on income statement entries. In contrast, the basic balance sheet entries (total assets and total

liabilities) were described as “straightforward” and “cut and dried”; “confirmable, objective numbers, not allocated”; and mainly, “simply basic accounting” or “taken directly from the financial statements.”

The respondents offered much advice for users of IRS 990 Return data. Expressed in a variety of ways, most suggested relying more on the audited financial statements: “Don’t use the 990 information. Practitioners do not take the 990 as seriously as other reports. Nobody ever looks at them”; “Ask for the financial statement—the 990 is not intended to explain financial issues—rather, to meet legislative requirements, which may have nothing to do with accounting”; and “Do not draw any conclusions from it; ask for more detailed financial reports.” Many caveats and cautions were added to any suggested or known uses for the IRS Return. And, one financial manager also offered advice to the designers of the 990 Return: “Make a blank page that says ‘See Audited Financial Statement.’”

DISCUSSION

The results of this study reveal several common misperceptions, useful generalizations, and many yet unanswered questions about data from the IRS 990 Return. As the IRS Return becomes more easily accessible and increasingly relied on for financial measures, such insights about the adequacy, reliability, and interpretation of this data will be increasingly valuable.

ADEQUACY OF IRS 990 RETURN DATA

The widespread perception that financial statements offer a more detailed picture of the financial activity of nonprofit organizations than the IRS 990 Return is inconsistent with results of the quantitative analysis. Investigation of data adequacy discovered a higher percentage of non-zero values on the IRS 990 Return for 11 of 14 comparisons. Specifically, total contributions, net rental income, and profits from sales were more commonly reported revenue entries; management and fund-raising expenses also were more likely to be separately identified on the IRS Return.

Whereas financial statements might report revenues and expenses in a highly aggregated or uniquely tailored format, the IRS 990 Return specifies a breakdown of the totals into predetermined categories. The specific categories are designed to illuminate financial details that indicate if a nonprofit’s activities are consistent with expectations for charitable organizations. Financial statements might be designed for other purposes including loan applications, strategic decision making, or public relations. Variables often of greatest interest to researchers and other nonprofit sector observers may not fit the organization’s purposes and thus might not be included in the financial statements. In conclusion, it appears that the structure of the IRS 990 Return requires a more detailed reporting of revenue and expense components than financial

statements and can therefore be considered a more adequate source of financial information for many research purposes.

RELIABILITY OF IRS 990 RETURN DATA

For entire sample. The series of correlation analyses used to examine reliability, combined with insights from the distributions of differences and in-depth interviews, help reveal general patterns in the results. Across all subgroups, basic balance sheet entries (total assets and total liabilities) from the IRS 990 Return are highly correlated with those taken from each organization's audited financial statement. The correspondingly high percentage of observations exhibiting only a $\pm 1\%$ difference between the two sources of information further demonstrates the reliability of the basic balance sheet entries. Interview respondents commented on the standard methods of calculation involved and expressed confidence in the objectivity of these measures. Basic income statement entries (total revenue and total expenses) also exhibit consistently high correlations, especially for 1994. Although the percentage of observations within the $\pm 1\%$ range is less than that of the balance sheet entries, the percentage exceeding a $\pm 10\%$ difference remains small for the basic income statement entries. The variety of formats for expressing revenues and expenses in financial statements thus do not appear to greatly affect total revenue and total expenses. In general, to the extent total values are being examined as opposed to a finer-grained analysis, researchers can be comfortable with the reliability of IRS 990 Return data for basic entries from both the balance sheet and income statement.

It appears that additional variables displaying at least moderately high consistency between the IRS 990 and financial statement values are those representing the traditional domain of nonprofit organizations: contributions, program, and fund-raising. Both on the revenue and expense side, entries related to these activities demonstrate generally high correlations and substantial percentages of observations within the $\pm 10\%$ difference range in the distributions. Conversely, entries involving activities typically not considered a priority for nonprofits, including management expenses and commercial revenue sources (rental income and profit from sales), are less consistently reported. Program service revenue can also be viewed as a commercial form of revenue; although strong indications of consistency are noted earlier, a relatively high percentage of the sample falls in the $< -25\%$ difference category for this entry. The same pattern is apparent for fund-raising expenses. Ironically, the variables appearing less reliable are often those receiving more intense scrutiny in nonprofit studies and organizational comparisons today. The demonstrated tendency for reported commercial revenues and both management and fund-raising expenses to be greater on the IRS 990 Return relative to the financial statements points to the value of the former for studying such sensitive issues. Financial statements can be structured to paint a more favorable

picture of an organization, whereas the IRS 990 Return is designed for explicit disclosure of these revealing financial activities.

Because few nonprofits have either rental income or profit from sales and only a minute portion of total revenue (usually less than 1%) is generated this way, a lack of confidence in these entries carries little widespread impact. The same cannot be said for management expenses as this variable is often used as an indicator of organizational efficiency—for comparing and ranking nonprofits by regulatory agencies, oversight groups, and funding entities—and to evaluate legitimate use of donated or public funds. Similar issues are also explored via studies of fund-raising and program service expenses. Interview results point to the vagaries of functional expense allocations as an underlying problem. Recent accounting advancements (Financial Accounting Standards Board [FASB] Statements 116 and 117², implemented in 1996) provide more explicit guidance for both revenue and expense reporting; consequently, the functional expense entries should become increasingly reliable as accountants gain experience with the new standards.

For individual subgroups. The analyses by organizational size categories produced somewhat surprising results. Whereas an earlier study found alarmingly low correlations between IRS 990 and financial statement data for small nonprofits (Froelich & Knoepfle, 1996), the findings here show generally higher correlations for small compared to large organizations. The more refined methodology of this study underlies the discrepant results: The prior (albeit a pilot) project relied on self-reported financial statement data rather than obtaining actual financial statements and employed the Pearson correlation coefficient, which can produce misleading results when applied to skewed distributions. With at least 75% of the nonprofits in each size category falling within the $\pm 10\%$ difference range for the basic entries, results of the current study do not lead to any reservations about the use of IRS 990 data for studies involving small or large organizations. Other variables appear somewhat less reliable for large organizations, likely due to greater complexity accompanying multiple revenue streams, more people involved in financial statement preparation, and more sophisticated expense allocations. Interview data suggest that expense allocations can have a marked impact on reported management expenses, which is consistent with the low correlations for this entry in large organizations.

Several interesting patterns emerge from the analyses of organizational purpose subgroups. Although the underlying causes cannot be understood within the scope of this study, identification of the patterns is a first step that may in itself be beneficial. Again, the basic entries appear reasonably stable across the two sources of financial information, implying confidence in the reliability of these variables regardless of NTEE category. The comparatively high correlations in health and human services (the largest nonprofits in the sample, on average) are an unexpected finding considering the lower

correlations for large nonprofits generally. As both categories are frequently studied and considering that human service organizations make up the largest segment of the public charities, the consistency of financial measures for these two groups is encouraging. In fact, the frequent scrutiny of these organizations may contribute to a higher level of care in both 990 Return and financial statement preparation. In addition, voluntary health and welfare organizations have historically had more precise accounting standards according to GAAP, which may also contribute to the greater consistency found here. Recalling the higher correlations for small organizations discussed earlier, the relatively low correlations and more widely dispersed distributions of differences for the typically small nonprofits in arts and education is puzzling. The declining correlations from 1988 to 1994 in arts are also opposite the trend for small organizations. Add the notably high percentage of the subsample exceeding a $\pm 25\%$ difference between IRS and financial statement data for functional expense entries, especially fund-raising expenses, and it appears that many variables of interest should be viewed cautiously in the study of arts organizations.

INTERPRETATION OF IRS 990 RETURN DATA

Understanding fundamental differences between the IRS 990 Return and audited financial statements is useful to facilitate appropriate interpretation of the entries. Three major sources of inconsistency are apparent in the structure and preparation of the documents. First, GAAP allows for flexibility in the format of financial statements. Thus, statements vary across organizations and even within organizations over time depending on the nonprofits' activities and preferred level of reporting detail. The IRS 990 Return, on the other hand, is composed of standard entries required of all filers and changes little from year to year. A second and related difference is the inclusion of entries on the IRS 990 Return that are not commonly specified in financial statements. For example, financial statements may include only a single line for contributions. In contrast, contributions on the 990 Return, depending on their source, could be split among eight different categories (direct and indirect public support, government grants, cash, noncash, dues, special event income, and donated services and use of facilities). The reclassification of financial statement information to these additional required entries can be problematic. Improvements in 990 entry instructions and clearer guidance for reporting contributions (FASB 116) and expense allocations (FASB 117) help reduce inconsistencies, but the potential for confusion and even misrepresentation remain. Finally, there are some key differences in the definitions of financial categories, especially for revenue, between GAAP and the IRS 990 Return. The treatment of government revenue is a prominent example; varying definitions of government grants and program service revenue can cause government revenue to be reported differently on the financial statement and IRS 990 Return, leading to discrepancies in these categories. Recent improvements in

Form 990 (i.e., an added entry for Medicare/Medicaid payments to clarify the source as government rather than program service revenue) address this problem; however, the Form 990 instructions for government grants and program service revenue entries remain notably ambiguous. Various uses of the terms *net* and *gross* are also apparent, creating inconsistencies in entries including net rental income, gross profit from sales, net income from special events, and ultimately, total revenue and total expenses.

As we can see, it is not realistic to expect the IRS 990 Return and the audited financial statements to report identical values for some entries due to varying formats, recorded detail, definitions, and accompanying reclassification complexities. Fundamental differences in the purpose and preparation of the documents underlie the data adequacy advantages of the IRS 990 Return and help us assess potential reliability problems associated with particular entries. Clearly, a better understanding of these differences seems necessary for appropriate interpretation of IRS 990 Return data and studies resulting from it.

CONCLUSIONS

Although the attitudes of many respondents reflected in the in-depth interviews are not complementary toward the IRS 990 Return, their expressed disdain and irritation does not appear to substantially impact the quality of data submitted. Accounting professionals will take their obligations seriously, and even junior staff recognizes that standards of quality must be met on all financial services delivered to the client. Their training and detail diligence facilitates appropriate calculations and ultimately the consistent reporting found in this study. Whereas accountants and nonprofit managers may feel negatively toward the 990 Return and, in fact, may feel so because of the effort needed to publicly report information preferably kept private, it does not follow that they would shirk their obligations in completing this legally required document.

Thus, through findings reinforced throughout the analyses, we conclude that the IRS 990 Return is a reliable source of information for basic income statement and balance sheets entries (total income, total expenses, total assets, and total liabilities). Additional variables of traditional interest to nonprofit organizations, including total contributions, program service revenue, program service expenses, and fund-raising expenses, exhibit somewhat lower but reasonable consistency with the audited financial statements. Variables outside the primary focus of nonprofit organizations, such as net rental income and gross profit from sales, and to a lesser extent, management expenses, should be used with caution and interpreted carefully. In general, small organizations demonstrate greater consistency in financial reporting than large organizations, and human services and health organizations show greater consistency than those in education or arts. Furthermore, initiatives to reduce discrepancies between the audited financial statements and IRS 990

Return appear to be working as the entries examined here display greater consistency in 1994 compared to 1988.

We also find the IRS 990 Return an adequate source of financial information that is potentially more useful than financial statements for study of nonprofit organizations. In addition to the standardized information collected over time and across organizations, precise specification of revenue sources and required allocation of expenses into program, management, and fund-raising categories can provide revealing detail often not available in the financial statements. Given the increasing reliability of the data and the relevant insights it can contribute, an avalanche of studies based on IRS 990 data will not be surprising as greater accessibility is realized.

However, many nonprofits do not seem ready for broader scrutiny of the IRS 990 Return. Current perceptions center on the lack of tax liability and low audit and penalty risk and often lead to inadequate attention to this important document. Relaxed monitoring of 990 filings seems to reinforce counterproductive attitudes. Nonprofit organizations and accounting professionals need to become more aware of the expanded role of this increasingly public source of information about their activities. Similarly, users of the IRS 990 data should realize that inaccuracies due to carelessness, translating financial statement information into 990 entries, or incentives to distort revenue (to avoid taxes on unrelated activities or the appearance of excessive of fee income) and expense (to minimize management and fund-raising expenses) entries are not uncommon.

Considering the importance of developing a solid infrastructure to facilitate the study of nonprofit organizations, additional research is clearly needed. The findings here begin to reinforce confidence in the IRS 990 Return data but are limited both in number of variables examined and geographical scope of the sample. The small size of some subgroups is also problematic, especially for atypical revenue variables. Studies of national samples and additional variables would be useful to enable broader generalization of results. Detailed investigations of particular subgroups (e.g., why are the patterns different in arts organizations?) or individual variables (especially commercially generated revenues) are needed to more thoroughly explain underlying mechanisms driving the patterns identified here. This study was also limited to two time periods; richer panel data to assess consistency of entries over time would provide further indications of data reliability. Another unanswered question is the extent to which FASB 117 may have improved the reporting of functional expenses. It is possible that the desired effects of the tightened procedures are mitigated by growing awareness of management and fund-raising expense comparisons (with potential impacts on organizational reputation and resource acquisition) and accompanying attempts to maximize allocations to the program category. So although we await future studies to clarify and expand the findings here, evidence suggests that the IRS 990 Return can be considered an adequate and reliable source of financial data for examining many important issues in nonprofit organizations today.

Notes

1. Various analytical methods were explored to address the skewed distribution exhibited for each variable examined. Scatterdiagrams of the correlation configurations revealed essentially a clustered normal distribution with a few outliers for each variable. Pearson correlation coefficients inadequately address skewness, and log transformations are more useful if scale rather than outliers is the major issue. Ultimately, the Spearman correlation—which ranks rather than transforms each observation, thus offering more power to control outliers—was considered the most appropriate choice of statistic for the analysis. Accordingly, it is important to emphasize that unlike traditional Pearson correlation coefficients, the Spearman correlation coefficients reported in Tables 2 and 3 do not represent any direct comparison of dollar amounts but merely comparable relative rankings.

2. Financial Accounting Standards Board (FASB) Statement No. 116, Accounting for Contributions Received and Contributions Made, and No. 117, Financial Statements of Not-for-Profit Organizations, established accounting standards for contributions received by nonprofit organizations and standards for their general-purpose external financial statements. Statement No. 116 focuses on accounting for contributions, including pledges; this standard changed how nonprofit organizations identify, document, communicate, and recognize contributions. Statement No. 117 is directed at reporting aggregate financial information on an entity-wide basis; this standard amended how nonprofit organizations present financial statement information and requires three basic statements: a Statement of Financial Position, a Statement of Activities, and a Statement of Cash Flows. The new financial statement presentation under FASB Nos. 116 and should make it easier for the public to compare financial reports of nonprofit organizations.

References

- Abramson, A. J. (1995). Sources of data on nonprofit finance. *Nonprofit Management and Leadership*, 5, 443-451.
- Bowen, W. G., Nygren, T. I., Turner, S. E., & Duffy, E. A. (1994). *The charitable nonprofits*. San Francisco: Jossey-Bass.
- Chang, C. F., & Tuckman, H. P. (1990). Why do nonprofit managers accumulate surpluses, and how much do they accumulate? *Nonprofit Management and Leadership*, 1, 117-135.
- Cordes, J. J., & Weisbrod, B. A. (1998). Differential taxation of nonprofits and the commercialization of nonprofit revenues. *Journal of Policy Analysis and Management*, 17, 195-214.
- Froelich, K. A., & Knoepfle, T. W. (1996). Internal Revenue Service 990 data: Fact or fiction? *Nonprofit and Voluntary Sector Quarterly*, 25, 40-52.
- Gorman, M., & Tanenbaum, J. (1993). New rules proposed for joint activities of NPOs. *Journal of Accountancy*, 176(4), 103-108.
- Gronbjerg, K. A. (1989). Developing a universe of nonprofit organizations: Methodological considerations. *Nonprofit and Voluntary Sector Quarterly*, 18, 63-80.
- Gronbjerg, K. A. (1994). The NTEE: Human service and regional applications. *Voluntas*, 5, 301-328.
- Hodgkinson, V. A., & Weitzman, M. S. (1996). *Nonprofit almanac: Dimensions of the independent sector* (5th ed.). San Francisco: Jossey-Bass.
- Hodgkinson, V. A., Weitzman, M. S., Noga, S. M., & Gorski, H. A. (1993). *A portrait of the independent sector: The activities and finances of charitable organizations*. Washington, DC: Independent Sector.
- Orend, R. J., O'Neill, M., & Mitchell, C. S. (1997). State nonprofit data bases: Lessons from the California experience. *Nonprofit Management and Leadership*, 7, 447-454.
- Oster, M. (1998). Executive compensation in the nonprofit sector. *Nonprofit Management and Leadership*, 8, 207-221.

- Skelly, D., & Steurele, E. (1992). The nonprofit sector and taxes: Invaluable and largely untapped research data bases. *Nonprofit Management and Leadership*, 2, 429-438.
- Steinberg, R. (1987). Nonprofit organizations and the market. In W. Powell (Ed.), *The nonprofit sector: A research handbook* (pp. 118-138). New Haven, CT: Yale University Press.
- Tuckman, H. P., & Chang, C. F. (1991). A methodology for measuring the financial vulnerability of charitable nonprofit organizations. *Nonprofit and Voluntary Sector Quarterly*, 20, 445-460.
- Tuckman, H. P., & Chang, C. F. (1993). How well is debt managed by nonprofits? *Nonprofit Management and Leadership*, 3, 347-361.
- Tuckman, H. P., & Chang, C. F. (1998). How pervasive are abuses in fundraising among nonprofits? *Nonprofit Management and Leadership*, 9, 211-221.
- Weisbrod, B. A. (1988). *The nonprofit economy*. Cambridge, MA: Harvard University Press.
- Young, D. R., Bania, N., & Bailey, D. (1996). Structure and accountability: A study of national nonprofit associations. *Nonprofit Management and Leadership*, 6, 347-365.

Karen A. Froelich is an assistant professor of management in the College of Business Administration at North Dakota State University.

Terry W. Knoepfle is an associate professor of taxation and business law in the College of Business Administration at North Dakota State University.

Thomas Pollak is assistant director of the National Center for Charitable Statistics, a program of the Center on Nonprofits and Philanthropy at the Urban Institute.