The Peculiar Language of Form 990, Return of Organization Exempt From Income Tax

By Stuart M. Bordman

A euphemism is defined as “a mild or indirect word or expression substituted for one considered to be too harsh or blunt when referring to something unpleasant or embarrassing.”

Part VI, Section A, line 5 of Form 990 reads as follows “Did the organization become aware during the year of a significant diversion of the organization’s assets? The instructions with respect to this question read as follows “A diversion of assets includes any unauthorized conversion or use of the organization’s assets other than for the organizations authorized purposes.”

Part VI, Section A, line 5 should be rewritten as follows “Did the organization become aware during the year that there was a theft of the organization’s assets?” There is no reason to be indirect.

In 2016 our office was retained by a nonprofit organization in which there was a diversion. The organization lacked adequate oversight by the Board of Directors. Form 990 was prepared internally and no financial statements were prepared. While there were some very loose procedures and internal controls, all were ignored. All of the foregoing, together with other factors, fostered an environment which allowed a diversion.

On schedule O to Form 990 the organization must bare its soul and “… explain the nature of the diversion, dollar amounts and/or other property involved, corrective actions taken to address the matter, and pertinent circumstances… although the person or persons who diverted the assets should not be identified by name.”

In the case of our client, we discovered that the trustees were using the funds of the organization for personal purposes.

The bad news about disclosing the diversion is the organization will most likely be audited and could lose its tax-exempt status retroactively. The good news is that the organization has time to clean up its act before the IRS examination. Cleaning up the act includes the following steps, among others: removing bad actors; replacing accounting personnel, retaining a chief operating officer who is responsible to the board; adopting procedures and internal controls; having audited financial statements prepared and having an engaged Board which meets on a regular basis. A 990 prepared internally and lack of audited financial statements are warning signs of a diversion.

Any professional advisor to an exempt organization should perform adequate due diligence to make certain that there is no “diversion” and if a diversion is discovered, to take appropriate corrective action.