Financial Transparency for Nonprofit Organizations: Taxes and More

Financial transparency can offer profound benefits to nonprofits, including the opportunity to tell a story about your organization.

By Madeleine Monson-Rosen | Updated on June 6, 2019

The importance of financial transparency for nonprofits

Nonprofits must observe both legal and ethical standards of financial transparency. In the United States, specific IRS-required legal obligations stem from the tax-exempt status of nonprofits. Ethical obligations are less strict, intended to honor the public trust poured into nonprofits.

Legal transparency

Most nonprofits are required to publicly disclose current tax forms and other financial information. The IRS refers to these as "required disclosures," including:

- Annual returns for up to three years after the due date, including Forms 990 (or 990-EZ or 990-N), 990-PF and 990-T (filed after August 17, 2006, including extensions)
- Form 990 schedules (except portions of Schedule B), including attachments and supporting documents
- Application for tax-exempt status (Form 1023) and all supporting documents
- The determination letter from the IRS stating your organization's classification as a public charity
- Receipts and acknowledgements for donors
- Details of quid pro quo exchanges, where the donor makes a purchase and can therefore deduct only the amount of the donation above the true cost of the purchase — for example, a donor who buys a $40 ticket for $100 is allowed to deduct $60

As public information, these documents must be made available in a timely fashion to anyone who requests them. In the old days, this meant printing hard copies (although whoever made the request had to pay the printing costs). Today, it's typically easiest to make the information available online.

Ethical transparency

The public disclosures required by the IRS have set a standard of public accountability for nonprofits that extends beyond basic tax requirements. In the current nonprofit landscape, ethical transparency is also a requirement.

Bob Carlson, who investigates claims of financial misconduct against nonprofits, makes the case for transparency as an open-books practice in all financial dealings and accountability at all levels of the organization, from volunteers on the ground to executives and the board of directors. Charity Navigator defines transparency as an obligation or willingness to publish and make available critical data about the organization.

Carlson writes in The Chronicle of Philanthropy about one instance in which he found the appearance of a lack of transparency, even though there was no actual evidence of wrongdoing: "At the end of the day, I never found out if Missouri's laws on nonprofit transparency had been violated, but the perception of the nonprofit's actions were so bad, it simply could not continue."

The role of annual reports

An organization's annual report is typically the main vehicle for transparency. It should include the public disclosures required by the IRS, plus a full picture of your organization's financial situation. A robust and detailed annual report demonstrates to stakeholders and potential funders that:

- Your finances make sense
- Your income and spending are in proportion
- Funds are being used to deliver maximum impact

Benefits of transparency

Beyond legal compliance and ethical standards, the disclosures necessary for financial transparency can actually offer profound benefits to nonprofits. After all, disclosures offer an opportunity to tell a story about your organization. You can highlight the impact donations make, the expertise of your staff and board, and your history of service.

Better yet, it can feel entirely natural. For example, a required disclosure to a donor provides an opportunity to communicate the impact of a donation. In a thank you note or other acknowledgment, you might say: "Your gift purchased school supplies for 100 children."

Putting transparency to work

To go beyond the legal requirements and make transparency work for your organization, consider these suggestions from Guidestar and the National Council of Nonprofits:

- **Tell your story to donors.** Clearly communicate to donors how their gifts are being used.

- **Involve the board.** Make sure the board reviews all financial reports, including each year's Form 990 (or 990-EZ or 990-N), prior to filing. The board should also be involved in approving all compensation packages.
- **Adopt — and regularly review — policies and procedures.** These include a clear conflict of interest policy, expense and reimbursement policies, and an executive compensation policy.
- **Implement internal controls.** This helps ensure staff accountability.
- **Use your organization's website as a transparency tool.** Regularly update program and evaluation information. Feature names, titles and brief biographies for board members and key staff. Publish annual reports, tax returns, executive compensation figures, audited financial statements and your IRS letter of determination (proving tax-exempt status).

This article draws on the expertise of Grace Davies, a Minneapolis-based attorney with special interest in product liability, medical malpractice and employment discrimination.

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