DISCUSSION

Gabriel Rudney, Yale University

The authors of the two nonprofit papers have provided us with an informative discussion of two important Internal Revenue Service studies on private foundations and other tax-exempt organizations. The authors have dealt quite effectively with the historical background of this research, presented many interesting statistical results, and cited, as is appropriate at such meetings as this, the nature of the data's limitations.

In my role as a discussant today, I would like to focus briefly on three improvements that must be made if future work in this area is to be successful: better activity classification, sounder valuation of assets, and elimination of the double counting of receipts.

ACTIVITY CLASSIFICATION

Most users of exempt organization data are expected to be interested in data about a specific activity. As I see it, there is much less interest in aggregate figures representing the vast heterogeneous population of many types of activities brought together only because the organizations are tax-exempt and nonprofit. The greatest interest will center on philanthropic organizations. The philanthropic organizations differ in purpose and operations from other types of organizations such as membership organizations which benefit members rather than the general public. The nonprofit financial organizations have additional purposes and rationales for tax-exemption. Included also are such differing organizations as cemetery associations, veterans organizations, and the political parties. As one can see, many organizations serving different goals are included under the cloak of "tax-exemption." Generally, any interest in these organizations overall is related mainly to Treasury tax policy issues. Most users are expected to be interested in parts of this large heterogeneous universe.

Now the key to the parts is the "activity classification." But the activity classification has serious deficiencies, as described by the authors [1]. I would like to suggest that in future exempt organization studies, special effort be made to improve the structure of the activity classifications. The 1977 Census of Services made an important effort in this respect, and the same type of effort should be reflected in future SOI studies [2]. I suggest this with full realization of costs and limited resources. On that point, I believe the statistical community would prefer a smaller sample, but well stratified by activities. Certainly, the costs of better activity classification should be supported by trade-offs, such as reduced samples.

ASSET VALUATION

At present there is an allowance of flexibility in the reporting of the value of assets in the balance sheet information. Such flexibility is a serious statistical limitation. One cannot really justify aggregation of values which are both book and current values for the same types of assets or for different assets, such as physical assets and financial holdings. The extent to which such aggregation occurs in the data is unknown. If it is extensive, then the usefulness of the IRS balance sheet data is questionable. If the practice is small, perhaps it can be ignored or adjusted. Some indication of the extent of the problem is warranted.

I would like to suggest in future exempt organization studies that the IRS report form require strict adherence to the reporting of either book value or current value for the detail of the balance sheet. The total assets figure should be reported both in book value and in current value.

DOUBLE COUNTING OF RECEIPTS

The problem of double counting is also serious. The problem occurs because certain tax-exempt organizations function as fundraisers for other tax-exempt organizations. As a consequence, there is double counting of receipts because the same funds are reported by the fundraisers and by the recipient service organizations. It is a problem which the 1977 Census of Services recognized in planning of the tax-exempt section of its Census [2]. The 1977 Census tried to avoid double counting of receipts by collecting information on operating expenditures of tax exempt organizations instead of receipts, on the assumption that receipts just cover expenditures in nonprofits. Consequently, the user of the data, particularly in the philanthropic area, must seek to adjust for double counting in receipts.

I suggest that in the future a mechanism be built into the 990 studies which would permit an adjustment for double counting. This mechanism could be specific identification of major fundraising entities in the activity classification and the specific reporting of intra-activity transfers which create double counting aggregation of receipts.

REFERENCES

[1] Two classification schemes were included in the paper as originally presented: Statistics by the Subsection Code upon which the exemption was based, and by the "type of activity" in which the organization was engaged. For the

Proceedings, type of activity was dropped since this information is featured in the Fall issue of the SOI Bulletin describing how the classification is structured and reported.

[2] U.S. Department of Commerce, Bureau of the Census, 1977 Census of Service Industries, Part 4, West Region, Other Service Industries, U.S. Government Printing Office, January, 1981.

REJOINDER

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This reply is in response to the comments made by Gabriel Rudney, which dealt with limitations of the data in the two nonprofit studies. Specifically, these topics are: activity classification, asset valuation, and double counting of receipts.

ACTIVITY CLASSIFICATION

For the 1974 private foundation study and the 1975 other tax-exempt organization study, three activity codes were picked-up directly from the return form. In only the latter case, however, were the filers told to rank the activities according to predominance. In the 1977 and 1978 Master File studies (for both private foundations and other tax-exempt organizations), the activity codes were no longer on the return form, so the activity code specified on prior return forms or the organization's application for exemption was used. In all of these studies, the activity that was predominant was assumed to be the principal activity. This is a limitation for organizations engaged in multiple activities, since all expenditures were attributed to this one activity. Thus, the activity codes in the nonprofit studies are considerably less than ideal.

While changes in the activity codes along the lines of the 1977 Census of Services (to make them more like the SIC) are beneficial, the most needed improvements in this area are better identification of an organization's activities and a methodology to split the activities of those organizations that engage in multiple activities. Both of these improvements require better information on the organization's return form (or supplemental forms which can be matched, such as the private foundations annual report). Improvements in these areas, however, will be difficult. We are a long way from being able to determine the actual amount of contributions paid for each type of activity. Nevertheless, improvements in the activity classification are a high priority.

ASSET VALUATION

Most organizations report the original cost (minus accumulated depreciation, if applicable) of an asset at its book value. However, for certain assets such as securities, we suspect that market valuation is commonly used. Therefore, the balance sheet probably contains both book and market valuations. While this situation is discomforting because it is conceptually inconsistent, book valuation is itself of questionable value, particularly in periods of rapid price change.

Nearly all private foundations are required to file an annual report (return form 990-AR) which includes an itemized statement of year-end asset holdings with both book and market valuations. This information can be used to evaluate the procedures that foundations employ to value assets. Furthermore, these data provide the only information on asset composition with market values. In general, we believe that utilization of the 990-AR asset information is the most-promising short run approach to a better understanding of the asset valuation situation.

The choice of the appropriate asset valuation method is by no means clear cut. While most analysts would agree that market valuation is the preferred method, the detailed balance sheet data on the return form are all (or predominantly) in terms of book values. Therefore, the examination of asset composition by size of assets is more meaningful in terms of book values. This situation has no easy solution. For foundations, a third asset measure, total average (as opposed to year-end) market value of assets not used for charitable purposes is available. Since this component is both a market value measure and is actually used in the determination of the mandatory distribution, it is the best asset measure for examination of the foundation payout data.

Tabulations by asset size classes of book and market values have been made for private foundations (1974) and other tax-exempt organizations (1975). (This latter comparison appears below as table 1). In both cases, organizations included in a book value asset size class also generally appear in the same market value size class. However, since the ranges within these size classes are fairly broad, and since the book value asset total (which is the sum of the asset detail on the balance sheet) probably includes some market valuations, it is difficult to speculate on the magnitude of the differences between book and market valuations.

DOUBLE COUNTING OF RECEIPTS

Double counting in the receipt data is also a problem that has no easy solution. An adjustment for double counting based on the Census of Services data is better than no