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THE NEWSLETTER OF THE BDO NONPROFIT & EDUCATION PRACTICE

NONPROFIT STANDARD

NEW GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB) PRONOUNCEMENTS

By Patricia Duperron, CPA

THIS ARTICLE SUMMARIZES SOME OF THE NEW GASB PRONOUNCEMENTS THAT WILL BE EFFECTIVE IN FUTURE YEARS.

GASB Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements (SCA) will apply to governments that have another entity operating a public asset. An SCA is an arrangement between a transferor (a government) and an operator (governmental or nongovernmental entity) in which (1) the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset, (2) the operator collects fees from third parties and is compensated by fees, (3) the transferor determines what services the operator is required to provide, to whom and at what price and (4) the transferor is entitled to significant residual interest in the service utility of the asset at the end of

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the agreement. Examples include toll roads, convention facilities or a parking garage.

The transferor will continue to report the facility as its capital asset. If a new facility is created, it is reported by the transferor at fair value along with a liability for any contractual obligations. A deferred inflow of resources is also recorded equal to the difference between the asset and liability and amortized over the term of the agreement. Examples of contractual obligations are obligations for capital improvements or required maintenance or a requirement to maintain a specific level of service.

For governments that are operators of a facility, an intangible asset will be reported and amortized over the term of the agreement. The pronouncement is effective for years ending Dec. 31, 2012.

GASB Statement No. 61, The Financial Reporting Entity: Omnibus amends GASB Statements No. 14 and 34 regarding the assessment of potential component units to be included in the reporting entity. Certain organizations are required to be included as component units because they are fiscally dependent on the primary government. In addition to fiscal dependency, the pronouncement now requires that a financial benefit or burden be present between the primary government and the potential component unit in order for it to be included in the reporting entity of the primary government. Just because an organization is fiscally dependent on the primary government doesn't necessarily imply there is a financial benefit or burden to the primary government. Also, there exists the potential for dual inclusion as an organization may be fiscally dependent on more than one government. The inclusion of this second requirement could cause some current component units to be disassociated with the primary government.

The pronouncement also changes and adds new criteria for determining whether a component unit should be blended or discretely presented. The new rules specify that when a component unit has debt (including leases) outstanding that will be repaid by the primary government it must be included as a blended component unit. This pronouncement will be effective for years ending June 30, 2013.

INSTITUTE PROFESSIONAL PROFILE

PATRICIA DUPERRON

Pat is a director in the Grand Rapids office of BDO USA, LLP. She has more than 20 years of experience in public accounting and has worked extensively with townships, cities, counties, schools and other governmental entities, as well as various businesses and nonprofit organizations. She has significant knowledge in federal programs and single audit compliance, auditing a variety of federal programs for different agencies. Pat is also the leader of the Governmental/Nonprofit Services Group in West Michigan and technical A&A lead for BDO's national Government industry group.

Pat also has vast experience with transit authorities, public utilities, airports, convention/arena authorities, biosolids authorities, governmental pension plans and various tax increment financing authorities. She also has knowledge in real estate, including affordable housing, such as HUD, Rural Development and MSHDA projects and regulations.

She was recently appointed to the American Institute of Certified Public Accountants (AICPA) State and Local Government Expert Panel (Panel) for the fiscal year beginning on Oct. 1, 2012 to Sept. 30, 2013. This Panel is responsible for identifying state and local government financial reporting issues and working with appropriate bodies for resolutions benefiting the public interest. This includes conducting liaison activities with the Governmental Accounting Standards Board (GASB) and other regulators, such as the U.S. General Accounting Office and the U.S. Office of Management and Budget, and applicable industry associations and advising them on the development of AICPA products and services related to state and local government audits.

Pat is a graduate of the University of Michigan with a BBA degree in accounting. She is a licensed CPA in Michigan and is a member of the AICPA and the Michigan Association of Certified Public Accountants (MACPA). She is also a member of the Association of Government Accountants, Government Finance Officers Association and the Michigan School Business Officials.

Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-Nov. 30, 1989, FASB and AICPA Pronouncements incorporates into the GASB's authoritative literature certain accounting and reporting guidance that is included in original (excludes subsequent amendments) FASB, APB and ARB pronouncements that were issued on or before Nov. 30, 1989, which does not conflict with or contradict GASB pronouncements.

This statement also eliminates the election provided in paragraph 7 of GASB Statement No. 20 for enterprise funds and business-type activities to apply post-Nov. 30, 1989, FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. In practice, this option was seldom elected. This pronouncement will be effective for years ending Dec. 31, 2012.

GASB Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position expands on the two new concepts that were introduced in GASB Concepts Statement No. 4. Deferred outflows are consumptions of net assets that are applicable to a future reporting period (these are not assets). Deferred inflows are acquisitions of net assets that are

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applicable to a future reporting period (these are not liabilities). Prepaid rent and deferred revenue are not considered deferred inflows or outflows because net assets have not been consumed or acquired.

This pronouncement introduces the concept of *net position* which replaces net assets and represents the difference between all other elements (assets plus deferred inflows less liabilities and deferred outflows). Net assets invested in capital assets should include deferred outflows/inflows attributable to those assets. When the pronouncement was issued, there were only two examples: changes in fair value of qualified hedging derivatives (GASB No. 53) and qualifying SCA arrangements (GASB No. 60). However, GASB Statement No. 65 (see below) adds several more items. The pronouncement is effective for years ending Dec. 31, 2012.

GASB Statement No. 65, Items Previously Reported as Assets and Liabilities requires certain items that are currently reported as assets or liabilities to be reclassified as deferred outflows or deferred inflows. Based on the definitions in Concepts Statement No. 4, the GASB reevaluated certain assets, liabilities, revenues and expenditures and reclassified several items.

For debt refunding, the difference between the reacquisition price and the net carrying value of the old debt should be reported as a deferred outflow or deferred inflow and recognized as a component of interest expense over the shorter of the life of the old or new debt. This is currently reported as an asset or liability in full accrual statements. However, issue costs (except prepaid insurance), which are currently capitalized will be expensed and require an adjustment to net assets when the pronouncement is first implemented.

Property taxes received before the levy period will be classified as deferred inflows, instead of the current reporting of deferred revenue (liability). The sale of future revenues will be reported as deferred inflows. Loan origination fees should be recognized as revenue in the period received, while points received will be reported as deferred inflows.

In addition, the term “deferred revenue” is no longer allowed on financial statements. The use of the term “deferred” is limited to items that qualify as deferred inflows or deferred outflows. There are other items related to leases and lending activities that were also reclassified by the pronouncement, which is effective for years ending Dec. 31, 2013.

GASB Statement No. 67, Financial Reporting for Pension Plans addresses reporting for state and local government pension plans that are administered through trusts and replaces GASB Statement No. 25 for those plans. While the financial statements will be very similar to current statements, the pronouncement provides for enhanced note disclosures and new Required Supplementary Information (RSI) schedules. The new RSI consists of (1) schedule of changes in net pension liability and related ratios; (2) schedule of employer contributions (if actuarially determined); and (3) schedule of investment returns. Each schedule should be for the most recent 10 years.

The statement also requires the net pension liability to be measured as the total pension liability less the amount of the plan’s net position and specifies the approach to measuring the liability. The pronouncement will be effective for years beginning July 1, 2013.

GASB Statement No. 68, Accounting and Financial Reporting for Pensions establishes requirements for governments that provide their employees with pensions through a trust and replaces GASB Statement No. 27 for those government employers. The most significant change is that governments will now be required to recognize their net pension liability (NPL), which is the difference between the total pension liability (the portion of the present value of projected benefit payments that is attributed to past periods) and the value of pension assets available to pay pension benefits. Additional note disclosures and the first two RSI schedules from GASB 67 will be required (see above). This requirement also applies to cost-sharing, multiple-employer plans and will be effective for years beginning July 1, 2014.

The statement requires immediate recognition of more pension expense than is currently required. Most changes in the NPL will be included in current period expense. Other components, such as changes in economic assumptions will be recognized over a closed (not open) period. Differences between expected and actual investment rate of return will be recognized in expense over a closed five-year period.

All governments must use the entry age, as a level percent of payroll allocation method. The discount rate will continue to be based on the long-term expected rate of return but only to the extent that the projected plan net position exceeds the projected cash payments. Once the assets are depleted, governments must use the 20-years tax exempt AA or higher municipal bond rate.

Many states and local governments have not fully funded their pension plans and, in the current economic environment, have not made their required annual contributions. According to several studies, the gap between the promises states and local governments have made for public employees’ retirement benefits and the money they have set aside to pay these benefits is at least $3.57 trillion. By requiring governments to record this liability on the financial statements, GASB 68 highlights the issue to readers of the financial statements.

For more information, contact Patricia Duperron, director, at pduperron@bdo.com.

POLITICAL ACTIVITIES BY TAX-EXEMPT ORGANIZATIONS

By Sandra Feinsmith, CPA

AS WE ENTER THE HOME STRETCH TO ELECTION DAY ON NOV. 6, INTERNAL REVENUE CODE (IRC) SECTION 501(c)(3) ORGANIZATIONS WILL BE SPEAKING OUT ON ISSUES THAT ARE IMPORTANT TO THEIR CHARITABLE MISSION.

As part of this, however, 501(c)(3) organizations need to keep in mind that they are prohibited from engaging in any type of political campaign activities. In this article, we will discuss a brief background on the prohibition of political activities by 501(c)(3)organizations, prohibited political activities, penalties for being involved in prohibited political activities, permissible activities and things organizations can do to maintain compliance with the rules during the election process.

▶BACKGROUND

Section 501(c)(3) of the Internal Revenue Code states organizations cannot "participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office." Treasury Regulations Section 1.501(c)(3)1(c)(3)(iii) states "the term 'candidate for public office' means an individual who offers himself, or is proposed by others, as a contestant for elective public office, whether such office be national, state or local." The prohibition regarding political activities applies to all types of private foundations and public charities including religious organizations.

The rules disallowing political campaign intervention were added to the Internal Revenue Code in 1954 as an amendment to the 1954 Revenue Act sponsored by Sen. Lyndon Johnson. Sen. Johnson believed an opponent of his was using a 501(c)(3) organization to finance his campaign. Without these rules in place today, imagine how many campaigns and political organizations would form or use 501(c)(3) organizations to attract donations.

▶PROHIBITED POLITICAL ACTIVITIES

The IRS has some excellent information and publications on its website regarding political campaign intervention by tax-exempt organizations, charities and churches with regard to politics, including questions and answers regarding prohibited and permissible activities. One of the best references can be found in IRS Revenue Ruling 2007-41 (http://www.irs.gov/pub/irs-drop/rr-07-41.pdf). In this ruling, the IRS lists examples of items that are permitted and not-permitted forms of campaign involvement. Here are some items that are not considered to be permitted or, in certain circumstances, can become prohibited political activities:

- Charitable organizations cannot publish statements endorsing or opposing candidates for public office on their social media sites, websites, via email or in any written materials. Organizations need to be careful to ensure that any links from the organization's website to other websites do not contain political campaign content at any time during which the link exists. The organization is considered to be responsible for the linked content irrespective of whether it has control over the other organization.
- Speaking at official functions or forums of the organization as a candidate is permitted under certain conditions. It can occur as long as no campaign items and activities occur at the event, the organization does not support or oppose one candidate over another and no mention is made about the upcoming election. If the organization is sponsoring a debate or forum, all candidates for the same office must be given equal opportunity to attend. Questions must be addressed in a nonpartisan manner with unbiased wording and cover a large area of issues. The event must be conducted as an educational event to the public.
- Leaders of the organization cannot endorse candidates on behalf of the organization. They should not express any type of political views in a manner that could be linked back to the organization. Political statements should not be made at the organization's official events or in newsletters. Leaders of the organization can express their own political beliefs – just not in a situation where it could be linked back to the organization. In expressing their own political beliefs, leaders of the organization should clearly state that their views and comments are their own personal beliefs and are not intended to represent the views of the organization. Organizations should also be careful to educate their employees that any use of the organization's personnel or facilities for political activities could be attributed back to the organization and, therefore, are prohibited activities.
- Organizations need to be careful of the types of business activities they might be involved in with a candidate. The organization may be considered to be involved in political activity if it is providing services, goods, office space or loans to a candidate at different terms than it does to a member of the general public or to another candidate. For instance, if I rent office space to one candidate at a lower rate than another, my organization would then be considered to be involved in political campaign intervention. To be safe, if something is offered to one candidate, it

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POLITICAL ACTIVITIES

should be offered to all candidates with the same terms.

- Organizations can speak out and take public policy positions on issues. However, if the issue comes out right before an election, candidates have a clear position on the issue and it differentiates them from each other, taking a position on the issue could be viewed as indirectly opposing or supporting a particular candidate for office. Even if the organization does not tell others to directly vote against or for a particular candidate, it could be considered political intervention if it is implied that they should vote for one candidate over another. For example, using code words, such as "pro-life, pro-choice, liberal, conservative, etc." instead of the candidate's name could be seen as endorsing one candidate over another.

▶PENALTIES FOR INVOLVEMENT IN POLITICAL CAMPAIGN ACTIVITIES

Punishment for violation of the rules is severe. The IRS can revoke the tax-exempt status of the organization. In addition to the potential loss of exempt status, under IRC Section 4955, an organization that violates the rules can face a 10 percent excise tax on political expenditures incurred or paid. The excise tax on the political expenditures can increase to 100 percent if the expenditure is not corrected within a certain timeframe. An additional excise tax can also be imposed on any managers who knew about the expenditures.

▶PERMITTED ELECTION TIME RELATED ACTIVITIES

So, what types of items are 501(c)(3) organizations allowed to participate in related to elections?

- Voter education activities conducted in a neutral and nonpartisan manner. Examples of this include publishing a compilation of voting records, voter guides or responses to candidate questionnaires where a wide range of activities are addressed and published results show no bias for or against any candidate.
- As discussed earlier, candidates speaking at forums, debates or meetings sponsored by the organization if they meet the criteria of being impartial, all candidates are invited to participate, and no bias is exhibited for or against any candidate.

ELECT
VOTE
VOTE

- Voter registration and "get-out-the-vote" drives, provided that these drives are neutral, nonpartisan and not identified by the organization with any political party or candidate. However, private foundations need to be careful when it comes to this area. If a private foundation spends funds for a voter registration drive that does not meet the requirements under IRC Section 4945(f), it will be subject to tax.

▶TYPES OF THINGS YOU CAN DO TO KEEP YOUR ORGANIZATIONS COMPLIANT

Here are some suggested items to help keep your organization out of trouble during this election season:

- Monitor your social media sites, websites and links from your websites to other websites. Review content and links for any potential political materials as the underlying content changes.
- Prohibit the use of the organization's materials, supplies, resources, email and time by personnel for any type of political activity.
- Avoid political expenditures.
- Leaders of the organization who choose to write or speak about their own political views on their own time should clearly inform the audience that these are their own views and not those of the organization which they lead.
- If business is conducted with candidates, it should be done on the same terms with all of the candidates.
- Written policy and education for all employees regarding what is permitted and what is prohibited.
- Religious organizations should think very carefully about certain types of planned political activities. Known as Pulpit Freedom Sunday since 2008, ministers across the U.S. have been making political campaign statements endorsing political candidates from the pulpit. The participants send to the IRS DVDs of their sermons in order to get the IRS to act. Participants in this event are looking for this issue to be taken to court and viewed as a freedom of religion and speech issue versus a tax issue. *The current silence of the IRS on this issue should not be taken as a sign that the IRS does not intend to investigate or enforce the rules regarding the prohibition of these types of activities by all 501(c)(3)organizations, including religious organizations, during this election cycle.*
- Do not permit campaign signs on the organization's property.
- Set up a 501(c)(4) social welfare organization to conduct political activities. These organizations are allowed to conduct political activities to the extent that they are not its primary activity. The organization's primary activity must be the promotion of social welfare. However, given the recent activity regarding 501(c)(4)s by the IRS in this area, organizations should be very careful in setting up this type of entity.

For more information, contact Sandra Feinsmith, senior director, at sfeinsmith@bdo.com.

PAY BIAS IN THE BOARDROOM

By Michael Conover

I've had a couple of experiences this summer that set the stage for this short piece. While preparing to kick off a client project, the board chair informed me that several of his board members questioned the need for a pay study ("Are we making a much bigger deal of this than we need to?"). He went on to say that these same individuals just didn't feel it was necessary to "pay a lot of money" for an individual to run this organization ($20 million operating budget, staff of 200+).

The other situation came up when I was interviewing a contractor to do some work on my house. He concluded with an estimate that surprised me. I told him I didn't expect it to be so expensive. He replied, "Based on what? How much you hoped it would cost? How much you can afford? Other estimates?" I hesitated to admit it, but my reaction was not based on anything more than what I thought ('hoped') the cost would be and there was absolutely no factual basis for it at all.

Both of these experiences got me thinking about conversations I've had in many boardrooms, particularly in tax-exempt ones, where it was quite obvious that a bias was clearly part of the conversation. The speaker asking a question or making a point clearly indicated a belief that was brought to the meeting and was often not based on any more facts than my reaction to the contractor.

Please don't jump to the conclusion that the bias I am referring to is strictly limited to lowering pay because it is not. There have been many, but fewer, instances of board members equally biased toward raising pay with just as little basis of support for their belief. Sometimes board members may sincerely want to 'take care of someone' or simply 'leave a mark' of their impact on the organization.

In fairness, compensation is not a subject with which most individuals are extremely familiar, with the exception of their own pay (no bias there, eh?) Furthermore, to the degree that any individuals do have some knowledge of compensation, it is probably specific to the particular business/background from which they come. Accordingly, it is likely that many board members arrive at the compensation committee meeting less than completely "open minded" about pay for the organization they serve.

I'll offer a couple of examples of how this pay bias can be manifested in two very different boardroom settings. In the first instance, a very large and highly diversified charity, the board was focused on the compensation of the executive director. This individual was a highly respected and long-tenured employee running an organization with many millions in annual revenue, many hundreds of employees and a variety of different housing, healthcare and other human services entities. A competitive compensation analysis indicated there was a considerable gap between this individual's pay and the most conservative interpretation of a competitive wage. As the board discussed the implications of the study, a retired military officer on the board openly questioned the need to do anything. "Didn't this person realize he accepted low pay when he decided to enter the nonprofit world?"

The other example is a membership association for highly specialized individuals, the most successful of whom make millions annually. Several unusually successful members serve on the board of directors and prior to a competitive compensation analysis suggested that the executive director of their very modestly sized organization should be paid more. One board member suggested, "Let's pay him about one-half of what we get, so $1 million a year sounds right to me."

In both these situations, a board member revealed a personal bias about their executive director's pay. The first didn't see the need to reach competitive levels of pay for a position that managed a very large and incredibly complex organization simply due to its not-for-profit status. The other director used his own compensation as a benchmark from which he could estimate his executive director's appropriate pay.

I do not believe these directors acted out of a particularly miserly or munificent motivation. Each simply spoke from the particular point of view (i.e., bias) they brought to the discussion. Left unchallenged or without authoritative

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PAY BIAS

information to the contrary, it is easy to imagine two very different extremes of pay that might result.

I believe this topic of pay bias is worth exploring because, to some degree, I believe it is a factor in many different boardroom discussions of pay. Board members drawn from interested people associated with one charitable/service mission or another are very likely coming to the compensation committee meeting using their personal pay level or other information from their "day job" as the basis of their input to the discussion. It might even impact their ability to readily accept outside information from peer organizations or pay surveys. I've had many lengthy discussions with individual board members who were "stunned", "surprised", "unaware", etc. that "had no idea this is what this job gets paid."

Not-for-profit organizations can be every bit as large, complex and demanding as their for-profit counterparts. In addition, most of these organizations are not held to a lower standard of performance excellence but frequently are held to an even higher standard of service quality and fiscal responsibility. Consequently, it is somewhat unrealistic to assume that the competitive value of the expertise required to fulfill these expectations is unrelated to the external marketplace for executive resources.

Those organizations insisting on an arbitrarily low "cap" on compensation may find themselves unable to recruit the caliber of talent needed to properly manage their affairs. Others who excessively compensate executives may find themselves subject to embarrassing and expensive penalties for engaging in arrangements that are enriching a recipient rather than responsibly paying for the job actually being performed.

The takeaway here is some fairly straightforward advice for those engaged in the governance of compensation for nonprofit organizations. To properly perform this important role for the organization which you serve, please "check your pay bias" at the door. You owe the organization, your fellow board members and yourself a duty to be unbiased and informed about compensation for the organization and positions under your purview. When you are so equipped, you can then engage in discussion and decision making about compensation from an informed point of view.

There are numerous sources of information (e.g., articles, white papers, surveys, etc.) that are applicable to all types of nonprofit organizations. Associations, trade groups and consultants specializing in various types of organizations are actively collecting and disseminating information about pay. Any person serving on a board and dealing with pay issues should identify good sources of information and stay abreast of developments in compensation over the course of his/her service. With the benefit of this background information, a board member is then well-prepared to ask specific questions from the organization's outside advisor in order to arrive at the best decision for the matter at hand.

Continuing to carry a personal pay bias into the compensation committee meeting will continue to produce the same results – "Wow, that's not what I thought it would be!" – and yet another lengthy explanation to remove that bias so a productive discussion can begin.

For more information, contact Michael Conover, senior director, Specialized Tax Services – Compensation and Benefits, at wconover@bdo.com.

Effective Audit Committees
for Nonprofit Organizations
Tools, Resources and Information for the Nonprofit Community
New Interactive Online Guide

The professionals of the BDO Institute for Nonprofit Excellence^{SM} and Nonprofit & Education practice are pleased to announce the launch of a new, interactive online version of our guide, *Effective Audit Committees for Nonprofit Organizations*. The online guide, accessible on the Nonprofit Standard Blog, offers a comprehensive overview of the functions and responsibilities of an audit committee, along with best practices, tools and downloadable worksheets to help organizations build or improve their own audit committees.

As nonprofit organizations adjust to changing giving practices and to the realities of a challenging economic environment, proper financial management is key. Audit committees are vital to the health of any nonprofit, be it large or small. The audit committee and its individual members are crucial partners in the safeguarding of integrity, mission and, ultimately, success.

We encourage you to refer to this guide frequently as you consider your organization's financial needs and progress, and to contact us with any questions or comments. Explore the Effective Audit Committee Online Guide.

AUDIT/FINANCE COMMITTEE REVIEW FOR FORM 990 – KEY CONSIDERATIONS

By R. Michael Sorrells, CPA

WITH THE TRANSPARENCY AND PUBLIC AVAILABILITY OF THE "NEW" FORM 990, REVIEW OF THE FORM 990 BY AUDIT OR FINANCE COMMITTEES (AND SOMETIMES THE ENTIRE GOVERNING BODY) HAS BECOME A BEST PRACTICE ADOPTED BY MOST NONPROFIT ORGANIZATIONS.

This has been made almost mandatory with the Form 990 requiring a description of the review process. It is also important to note that the IRS, in a preliminary study of audited charitable organizations, has concluded that nonprofits with a review process are more likely to have better tax compliance.

The following is a non-inclusive list of questions that we believe a governing body or committee should clearly be asking in its review process:

- Is the mission statement on the Form 990 accurate?
- Do the program descriptions really reflect what the organization has done in the past year? Do they contain enough information so that the reader can see the extent of the organization's programs?
- If there are significant increases or decreases in year-to-year comparative line items on the page one summary, what is the reason for the changes?
- Does the checklist of required schedules contain answers that are a surprise?
- Do the questions on governance, management and disclosure contain answers which indicate that the organization is well governed and has the proper policies in place? Are all required descriptions for this page included on Schedule O and are they accurate and complete?
- Is the listing of officers, directors, key and highly compensated employees complete and accurate reflecting anyone who served on the governing body or as an officer at any time during the year?

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AUDIT/FINANCE COMMITTEE REVIEW

- Does the overall compensation for the highest-paid individuals appear reasonable and in line with your understanding of what those individuals are paid?

- Is the amount of gross unrelated business income disclosed on page one and in the statement of revenue a significant percentage of total revenue? If so, this can be a possible exemption issue and should be discussed with your financial or legal advisor.

- If the nonprofit is a 501(c)(3) or 501(c)(4) organization, does the total of program expenses in relation to total expenses create the appearance of a well-run organization which efficiently utilizes its funding on its mission? Are fundraising expenses too high in relation to program expenses? Or do fundraising expenses appear too high or too low in relation to the amount of contributions reported?

- If the nonprofit is a 501(c)(3) publicly supported organization, is the public support percentage on Schedule A comfortably above the 33 1/3 percent level required to maintain public charity status? Has it shown a dramatic decline from the prior year? If required to complete Part III, is the investment income percentage well below the required 33 1/3 percent level?

- If your organization receives audited financial statements, is the note from the financials about uncertain tax positions included in Schedule D, Part IV? Does the note contain any disclosure of uncertain tax positions?

- If your organization is involved with foreign activities or grant-making, has Schedule F been prepared and does it look reasonable? Is there a note that describes a good monitoring process for foreign grants, if applicable?

- If you know of any transactions between the organization and various insiders or their companies, has Schedule L been prepared to disclose these transactions?

- In addition to various required notes on Schedule O, do you feel that there are any additional disclosures that should be made on this schedule to further explain any items on the return? Schedule O may be used for any note you may wish to include.

- Is there any disclosure anywhere on the return, including attachments, that contains personal information about individuals, including Social Security numbers? The IRS has reported that a fairly high percentage of Forms 990 have been found to include such information.

Of course, there may be many other questions that a board or committee member may wish to ask about the Form 990, depending upon the organization's circumstances and the information presented on the form. We have found that many organization boards, committees and management benefit from having their outside accountants present a draft of the Form 990 either in a live meeting or conference call. The accountants are usually very familiar with the form and the details of the various disclosures and can answer most of the questions which the participants might have.

The following links contain further information about review of the Form 990 including some checklists:

http://www.journalofaccountancy.com/Issues/2010/Sep/20102725.htm

http://apps.americanbar.org/buslaw/committees/CL580000pub/newsletter/201104/sydnor.pdf

http://www.healthcarereforminsights.com/2010/02/01/a-board-member%E2%80%99s-guide-to-reviewing-the-form-990/

http://www.networkwilliamsburg.com/images/990%20review%20-%20checklist%5B1%5D.pdf

For more information, contact Michael Sorrells, national director, Nonprofit Tax Services, at msorrells@bdo.com.

IRS SAYS "TMI" ON PERSONAL INFORMATION ON FORM 990

By R. Michael Sorrells, CPA

At recent nonprofit conferences, IRS speakers have noted that a fairly high percentage of nonprofits are disclosing personal information about individuals on their Forms 990 which are, of course, subject to public inspection and posted on the Internet (Guidestar.org). Of particular note, the IRS stated that a high number of Forms 990 contain Social Security numbers. This has most often appeared on attached lists or lists that are imported into the tax return software. In this era of identity theft, such disclosure is a major concern and could expose the organization to significant liability. Preparers should also not be disclosing their Social Security numbers when signing, but rather utilizing their required Preparer Tax Identification Number (PTIN).

IRS.GOV WEBSITE REDESIGN

By Joyce Underwood, CPA

IN CASE YOU HAVEN'T HAD A CHANCE TO VISIT THE INTERNAL REVENUE SERVICE (IRS) WEBSITE (IRS.GOV) RECENTLY, YOU MAY BE SURPRISED TO FIND A DISTINCTLY DIFFERENT SITE ON A NEW PLATFORM WITH ADDED FEATURES.

explore
http://www.

Toned mostly in blue and orange, you'll find the site's navigation has changed as the site is designed around the most frequently requested information based upon the results of the IRS evaluating its user's needs. The IRS calls it "intent-driven." Although some old uniform resource locator (URL) links will not work, most will redirect you to the page's new location on the redesigned site. Also, URLs are now typically phrased in plain language, for example www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations will take you to tax information on Charitable Organizations on the Charities & Nonprofit section. The website redesign is part of the IRS' planned 10-year, $320 million overhaul of its web services to better meet the growing demand for online resources.

The main page has – and will contain – the most frequently visited pages on the IRS website. A promotional banner section provides timely information, updates and tools. News and updates run on a rotating spotlight which can operate on its own or be paused or navigated by the user through tabs. The IRS is also leveraging social media to share the latest information. You can watch IRS features on YouTube or download an IRS podcast. The IRS website pages provide easy access to social media with icons for bookmarking, sharing and an updated printing feature.

The top of each page provides: consolidated and easy access to subscriptions for News, Alerts and Tax Tips; options to view information translated in up to five languages; and a drop-down list of "Information for . . . " Individuals, Businesses, Charities & Nonprofits, Government Entities, Tax Professionals, Retirement Plans and Tax Exempt Bonds, which is said to mirror the old IRS website's structure. The website's footer will be a consistent section on all pages with links to IRS and other sites about resolving issues, IRS careers and IRS organization and performance metrics. A link to the site map has been removed from the header, but can be found at www.irs.gov/uac/Site-Map.

The IRS.gov search engine now provides dynamic links to the Forms, Instructions and Publications on a sidebar with search results in the center sorted by date or relevance. The search engine is expected to evolve as the site is used and information is gathered from user experiences. The IRS says that analysis of IRS.gov usage has and will determine the current and future modifications to the site, with the intent of making it easier for users to find the most frequently searched for items, such as information about filing, payments, refunds, credits and forms.

As noted in a revised Privacy Policy at http://www.irs.gov/uac/IRS-Privacy-Policy, although the site will not collect personal information about you, the IRS is collecting statistical information about visitors to its website. Statistical data includes items such as Internet Protocol (IP) addresses and types of browsers and operating systems. They are also expanding the use of cookies. More information is at http://www.irs.gov/uac/Statistical-Information-on-IRS.gov. The IRS states that "data is retained for a minimum of 90 days to comply with federal record-keeping requirements, and then deleted."

The IRS says these site changes are just the beginning so it will be interesting to see what happens in the future. For a current user it will take a little time getting used to, but it appears the new site will be more interactive and dynamic. Take some time to check it out! http://www.irs.gov.

For more information, contact Joyce Underwood, director, at junderwood@bdo.com.

NONPROFIT RISK MANAGEMENT
(What is it and whose job is it?)

By Michael E. Batts, CPA

Now more than ever before, nonprofit leaders must recognize the importance of risk management as an inherent part of organizational oversight and leadership. But what does proper risk management look like, and whose responsibility is it? Many nonprofit boards assume that the CEO and management have the "bases covered" and board involvement is often limited to reacting to flare-ups. Such an approach to risk management is problematic and dangerous for multiple reasons.

The members of management in a nonprofit organization are typically consumed with day-to-day operating activities and decisions – the "tyranny of the urgent." As a result, they frequently do not have or take the time to step back and proactively assess organizational risks and address them proactively. If that is the case, and the board is operating under the assumption that management "has it covered," the organization may be a ticking time-bomb for obvious reasons.

A collaborative approach involving both the board and management

A key area of responsibility for the board is to ensure that the organization maintains an adequate approach to risk management in carrying out its programs. While the actual conduct of risk management activities is the responsibility of management under the authority of the CEO, the board should evaluate the organization's risk management strategy since the board has ultimate responsibility for oversight.

An effective risk management plan is a holistic one – one that addresses risk in all aspects of the organization's activities. The risk management plan should also be proactive rather than reactive – identifying risks before they become liabilities and taking appropriate steps to mitigate them.

In order to effectively carry out its responsibilities, the board may wish to establish a standing committee to oversee the organization's risk management strategy and to provide reports and recommendations to the full board – a "risk management committee."

The board or risk management committee should work with the CEO to ensure that:

- Risks are identified and assessed as to likelihood of occurrence and severity
- Risks are prioritized
- Management has determined the extent to which identified risks have been mitigated
- Appropriate steps are taken to reduce identified risks to acceptable levels

Reducing risk by implementing preventive measures is, of course, different from insuring against such risks.

In addition to overseeing the adequacy of risk mitigation, the board should ensure that the organization maintains adequate insurance coverage with respect to applicable risk areas.

Areas of risk to consider

In addressing the organization's overall risks, some key risk areas that warrant attention include, but are not limited to:

▶ Read more on next page

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NONPROFIT RISK MANAGEMENT

- Corporate structure (e.g., whether the organization's activities and assets should all be in one legal entity or perhaps separated to insulate from excessive liability)
- Governing documents (e.g., whether the articles of incorporation and bylaws contain all appropriate provisions and whether the organization's actual governance practices conform to the governing documents)
- Policies and policy manuals (should be addressed for the same reasons that apply to the governing documents)
- Tax-exempt status and compliance
- Financial condition and financial controls
- Adequacy of insurance coverage
- Human resources (personnel)
- Child molestation (for organizations that serve children, as further described below)
- Key operational areas
- Public relations
- Physical safety
- Leadership succession

Board members are not expected to be experts in the various risk areas listed above. Rather, the board should ensure that all relevant risk areas are adequately addressed by management under the leadership of the CEO. The organization may engage experts in various disciplines (legal counsel, tax advisors, insurance agents, physical safety experts, etc.) to assist in addressing each area as needed.

Child molestation risk

For organizations that serve children, child molestation risk warrants special attention due to the severity of the damages that can occur. In recent years, an increasing number of high-liability claims have been made against nonprofit organizations that serve children due to actual or alleged child molestation. Claims of that type can be devastating not only to the victims but also to an organization and its leadership, both reputationally and financially. Several sizable nonprofit organizations in the United States have filed for bankruptcy protection in connection with child molestation claims and numerous other organizations have experienced significant claims. The board of a nonprofit organization serving children should carefully evaluate the nature of the risks as well as prevention strategies and insurance coverage maintained by the organization. A variety of very good published resources are available on this topic.

Insurance coverage

One significant aspect of risk management includes ensuring that the organization has adequate insurance coverage for its significant risks. The evaluation of insurance coverage should include consultation with both legal counsel and highly experienced insurance agents. Specific coverage types to evaluate should include, but not be limited to:

- Property and casualty (for fire, theft, flood, vandalism, etc.)
- Employee theft
- General liability
- Sexual misconduct (including child molestation for organizations that serve children)
- Director and officer liability
- Employment practices (for claims of discrimination, wrongful termination, sexual harassment, and other such matters related to employment practices)
- Fiduciary liability (for claims by employees related to the administration of employee benefit plans, particularly retirement plans)
- "Key man" life or disability (for financial remuneration to the organization in the event of the death or disability of a key leader – useful where the organization could be adversely affected financially in the event of such an occurrence)

Additional resources for addressing risk management

Some additional sources of information that may be helpful to organizations addressing overall risk management include:

Nonprofit Risk Management Center
(www.nonprofitrisk.org)

Reducing the Risk (Child Safety Resources)
(www.reducingtherisk.com)

ChurchSafety.com
(www.churchsafety.com)

This article is adapted from the book Board Member Orientation – The Concise and Complete Guide to Nonprofit Board Service *by Michael E. Batts, managing partner, from Batts Morrison Wales & Lee, an independent member of the BDO Seidman Alliance. For more information, contact Mike at batts@nonprofitcpa.com.*

IRS PROVIDES GUIDANCE ON DEDUCTIBILITY OF CHARITABLE CONTRIBUTIONS TO DOMESTIC DISREGARDED ENTITIES

By Paul E. Hammerschmidt, CPA, MS (Taxation) and Christina K. Patten

On July 31, 2012, the Internal Revenue Service (IRS) released Notice 2012-52 which confirms the position that charitable contributions to domestic single-member limited liability companies (SMLLC) that are wholly owned and controlled by U.S. charities such as 501(c)(3) organizations are deductible as charitable contributions. A limited liability company (LLC) can either be treated as a separate corporation or as a pass-through entity that is not taxed. If the LLC is treated as a pass-through entity, then the owner or member of the LLC is taxed on its income. If there is only one owner, the SMLLC can be disregarded for federal tax purposes and treated as part of the parent charity (i.e., branch or division), allowing a charitable contribution deduction under the Internal Revenue Code (IRC). [1]

BACKGROUND

▶WHY CREATE A SMLLC?

It is a common practice for U.S. charities to create a SMLLC to receive, hold and manage real estate or a business with the possibility of reducing the potential risk of liability to the parent. If the real estate or business is subsequently sold, the cash proceeds may be then distributed to the charitable parent (member).

Wyoming was the first state to recognize the LLC in 1977 but required two or more members. Charities' use of SMLLC's is fairly recent and in 1993 only Arkansas and Texas permitted a SMLLC. Now all states recognize the SMLLC.

The regulations regarding business entity classification under IRC § 7701 provide that a domestic SMLLC is presumed to be a disregarded entity unless it makes an affirmative election to be treated separately from its owner. [2]

The IRS initially interpreted these rules as it concerned exempt organizations in Announcement 99-102 to mean that if the sole member of an LLC is an organization exempt from tax under section 501(c)(3) of the IRC, then the activities of the disregarded entity are treated as if conducted through a branch or division of the single owner. In addition, any assets owned or income received by the LLC are treated as if owned or received by the exempt member, and the LLC's finances and operations must be reported on the charity member's annual Form 990 or Form 990-T if the activity would be an unrelated activity if operated directly by the charity. [3]

In its 2000 Exempt Organization training materials the IRS stated a disregarded entity was treated as part of its IRC 501(c)(3) parent for purposes of employment tax reporting. [4]

The IRS concluded at that time that it had "more questions than answers regarding LLCs as 501(c)(3) organizations" and stated that because of the new "check the box" regulations, "the Service will not issue letter rulings involving a disregarded LLC whose sole member is an exempt organization."

In its 2001 Exempt Organization training materials the IRS stated that it had determined that "an LLC can be exempt as a disregarded part of an exempt organization that is the sole owner of the LLC." The IRS stated that it was still considering whether the disregarded entity is to be treated as part of its exempt owner for purposes of the charitable deduction under IRC 170 and indicated, "guidance on this issue will be forthcoming in the near future."

▶2001 THROUGH ISSUANCE OF NOTICE 2012-52

Many practitioners concluded over the years that contributions to a SMLLC owned and controlled by a U.S. charity would be deductible under the assumption that for federal tax purposes the SMLLC is disregarded as an entity separate from its owners under Reg. §301.7701-2(c)(2)(i).

In January 2012 the Tax Section of the New York State Bar Association issued a 52-page comprehensive report stating, "in our view, under current law, a contribution to a DRE (Disregarded Entity) owned and controlled by a charity is treated as a gift to the charity and is deductible under Section 170(a) to the same extent and subject to the same conditions and limitations as a gift to a branch of the parent organization." [5] The group encouraged the IRS to issue a ruling or other guidance confirming its conclusions.

▶ Read more on next page

[1] IRC 170(b)(1)(A)(vi)
[2] § 301.7701-3(b)(1)
[3] http://www.irs.gov/pub/irs-tege/a99-102.pdf
[4] Richard A. McCray and Ward L. Thomas, "Limited Liability Companies as Exempt Organizations," 2000 Exempt Organizations CPE Text available at http://www.irs.gov/pub/irs-tege/eotopich00.pdf
[5] Report on Tax Deductibility on Contributions to disregarded Entities owned by Charities," dated January 12, 2012, Report No. 1254 available at http://www.nysba.org/Content/ContentFolders20/TaxLawSection/TaxReports/1254correctedReportonTaxDeductibilityofContributions.pdf

▶CONTINUED FROM PAGE 13

DISREGARDED ENTITIES

▶ISSUANCE OF NOTICE 2012-52 AND ITS EFFECT

U.S. charities have long advocated for tax deductibility on contributions to disregarded entities and have finally received confirmation upon the release of Notice 2012-52 (Notice). The Notice provides good news, providing a helpful additional confirmation of deductibility of charitable contributions to domestic disregarded entities. The guidance provides that, if all other requirements of Code Section 170 are met, the IRS will treat a contribution to a disregarded SMLLC that was created or organized in or under the laws of the United States, a United States possession, a state, or the District of Columbia, and is wholly owned and controlled by a U.S. charity, as a charitable contribution to a branch or division of the U.S. charity.

▶AVOID UNNECESSARY INQUIRIES BY THE IRS

Notice 2012-52 encourages charities to disclose, in the acknowledgment or another statement, that the SMLLC is wholly owned by the U.S. charity and treated by the U.S. charity as a disregarded entity. The limitations of IRC Section 170(b) apply as though the gift were made to the U.S. charity.

▶EFFECTIVE DATE

Although effective for charitable contributions made on or after July 31, 2012, taxpayers may rely on Notice 2012-52 prior to its effective date for taxable years for which the period of limitation on refund or credit under IRC Section 6511 has not expired.

For more information, contact Paul E. Hammerschmidt, director, at phammerschmidt@bdo.com, or Christina K. Patten, associate, at cpatten@bdo.com.

INSTITUTE MEMBERS ON THE MOVE

Lee Klumpp, director, BDO Institute for Nonprofit Excellence,^{SM} has been selected for a two-year Financial Accounting Standards Board (FASB) Industry Fellowship Program. In this role, Lee will act as a project manager focusing on implementation and emerging practice problems in the nonprofit industry. His work will include making recommendations to the FASB on technical issues and developing and drafting statements, interpretations, FASB staff positions and Questions-and-Answer implementation guides. In addition, Lee will draw from his research and analysis of the nonprofit community to lead board discussions on accounting issues affecting nonprofit organizations.

OTHER ITEMS TO NOTE....

2012 OMB Final Circular A-133 Compliance Supplement

The Office of Management and Budget (OMB) released the long awaited final 2012 OMB Circular A-133 Compliance Supplement (the Supplement) on July 24, 2012. As you are aware from the Summer 2012 *Nonprofit Standard*, OMB had previously released a draft of the Supplement for planning purposes. Appendix V, List of Changes for the 2012 Compliance Supplement, identifies the major change areas in this edition of the Supplement and should be reviewed to determine if they affect you. Additionally, regardless of whether you have expended funds related to the American Recovery and Reinvestment Act of 2009 (Recovery Act), you should also review Appendix VII, Other OMB Circular A-133 Advisories, which includes critical matters related to the major program determination process due to the Recovery Act and other non-Recovery Act guidance. You can access the full 2012 Supplement at http://www.whitehouse.gov/omb/circulars/a133_compliance_supplement_2012.

IRS FTS Program for Tax-Exempt and Government Entities

The IRS launched a pilot Fast Track Settlement (FTS) program for the Tax-Exempt and Government Entities (TE/GE) Division in 2008, and although the pilot program expired Nov. 30, 2010, it was continued on an unofficial basis by the IRS. However, effective Sept. 4, 2012, the TE/GE FTS is permanent.

FTS is available for TE/GE cases when the issues are fully developed, the taxpayer has stated a position in writing and there are a limited number of unagreed issues involving the following types of items:

- Income tax
- Exclusion of income from interest paid on municipal obligations
- Employment tax
- Estate and gift tax
- Foundation or qualification issues
- Other TE/GE functional issues, as appropriate

There are limitations to the cases that can be handled through the FTS system.

The benefits to the FTS system are that the taxpayer and TE/GE representatives meet with an IRS Appeals Official and the process uses alternative dispute resolution techniques to promote case or issue resolution with the goal of completing the process in 60 days. The FTS Appeals Official may propose settlement terms for any and all issues presented. If the parties resolve any of the disputed issues, they will sign the FTS Session Report and a final settlement will be reached after the standard IRS post-settlement procedures are completed. For more details please see the following link: http://www.irs.gov/irb/2008-48_IRB/ar14.html.

CONGRESSIONAL FOCUS ON TAX-EXEMPT ORGANIZATIONS

By Laura Kalick, JD, LLM in Taxation

As part of the tax reform debate, one area of congressional focus is the tax-exempt sector. And why not? The nonprofit sector is a very substantial part of the economy with 10 percent of the workforce being employed by the sector and assets of over $2.5 trillion.[1] On May 16, 2012, the U.S. House Ways & Means Subcommittee on Oversight (Subcommittee) held the first in a series of hearings on tax-exempt organizations.[2] The focus of the hearing was to discuss current issues affecting tax-exempt organizations, including lower tax revenue as a result of the growing tax-exempt sector, new requirements for tax-exempt hospitals, good governance standards and the Form 990. The second hearing was held by the Subcommittee on July 25. On the same day the Senate Finance Committee held a hearing on education tax incentives and tax reform.[3] Higher education is one of the largest segments of the nonprofit sector.

The Difficulty of Regulating Tax-Exempt Organizations

The second House Oversight hearing had as a witness IRS Deputy Commissioner Steve Miller, who spoke about the diversity of the exempt sector, its growth (citing more than 50,000 applications for exemption per year) and the diminishing resources of the IRS in the exempt organization area. He indicated that one of the reasons that the area is difficult to regulate is because there are not many bright-line tests. Also, the use of revocation of exemption as an enforcement measure for breaking the rules is so draconian that it becomes an empty threat.

Unrelated Business Income

Panelists expounded upon the difficulty in enforcing issues when it comes to unrelated business income (UBI). They explained that net unrelated income is subject to tax and, second, if there is too much unrelated business activity an organization could lose its tax exempt status. In order to be an unrelated trade or business activity, the activity must be (1) a trade or business (usually requires a profit motive); (2) must be regularly carried on; and (3) must not be substantially related to the organization's tax-exempt purposes. The third requirement is based on a facts and circumstances test and is one of the reasons why the area is so difficult to enforce.

If the tax-exempt organization is concerned about threatening its tax-exempt status because it is conducting too much unrelated activity, the organization might transfer the activity to a taxable subsidiary. Then the complexity really begins with sharing employees and other resources. So an organization might be making decisions for tax purposes as opposed to business purposes. But the question is how much unrelated activity is too much. There are no clear rules on this. One witness suggested that organizations should be able to engage in unlimited unrelated activities so long as the profits went to further exempt purposes and the organization's charitable program was commensurate with its resources.

Complexity of Exempt Organization Structures

Although many exempt organizations still operate through one 501(c)(3) entity, many organizations are part of multi-entity groups that include tax-exempt parents, taxable subsidiaries to avoid the "too much" UBI issue, limited liability companies, partnerships, etc. Also, many 501(c)(3) organizations have related tax-exempt affiliates including 501(c)(4), (5) and (6) organizations that can engage in unlimited lobbying and political activity, if it is not a primary purpose. And some groups have related section 527 organizations or Political Action Committees (PACs).

These complex structures create another regulatory enforcement difficulty for the IRS. The tax code allows the affiliates to enter into different activities such as lobbying and political activities. Organizations must have truly separate identities in order to make this work and not allow abuses such as where charitable contributions are going to fund lobbying or political activity. Organizations must document their positions or else the IRS may assume the worst.

Form 990

Finally, the hearing focused on the Form 990 and whether it solved the issues of transparency or was overly burdensome. The Form 990 had not been revised comprehensively since 1979 but the tax-exempt sector had changed radically since that time. The IRS revised the Form 990 in an attempt to try to make some of the above listed relationships more transparent. The new Form 990 attempts to provide information related to the complex structures and operations of exempt organizations. Panelists agreed that the new Schedule R (Related Organizations) has made these complex structures more transparent.

Panelists were asked to discuss whether the form was overly burdensome. The consensus of the panelists was that the public is starting to master the form, even though there was a sharp learning curve. However, it was suggested that the form could use some simplification and that the IRS do more educational outreach. Two recommendations of a panelist were to (1) streamline or eliminate schedule F, Statement of Activities Outside the United States, because gathering the information required is so burdensome and the value of it is questionable; and (2) to eliminate the requirement for 501(c)(3) and (c)(4) organizations to breakdown functional expenses into categories of program, fundraising and management and general because the categorization is so subjective and, again, may not provide value.

Conclusion: It is significant that both branches of Congress are looking closely at tax-exempt organizations, their role in the overall economy and how to sculpt a new tax code that may address some of the concerns in this sector. This is an area that definitely requires continued attention by the tax-exempt sector.

For more information, contact Laura Kalick, national director, Nonprofit Tax Consulting, at lkalick@bdo.com.

[1] http://waysandmeans.house.gov/news/documentsingle.aspx?DocumentID=294777

[2] Written testimony from the hearing is available at: http://waysandmeans.house.gov/Calendar/EventSingle.aspx?EventID=294783

[3] http://www.finance.senate.gov/hearings/hearing/?id=16f8c6bf-5056-a032-52e8-40c42f7c9a5f

AVOIDING A TROUBLESOME AUDIT

By Randy Gregg, CPA

AUDITS ARE A LOT OF WORK IN THE BEST SITUATIONS, BUT SOMETIMES THEY CAN BE DOWNRIGHT PAINFUL.

Nonprofit audits can be delayed and deadlines missed if support for some accounting issues is not carefully planned. Here are a few of the areas that can cause delays and give all involved a case of heartburn.

▶VALUATION OF INVESTMENTS

Depending on what type of investments your nonprofit organization carries, this can be simple or quite difficult. Debt and equity securities should be recorded at fair value. Fair value for stocks and bonds traded on a national exchange is easily determinable, but if you have investments in hedge funds, private equity funds, funds of funds or bank common/collective trust funds — collectively termed "Alternative Investments" — it can be more difficult.

In 2006 the AICPA issued a practice aid called Alternative Investments – Audit Considerations to help auditors determine how to audit the fair value of these so-called alternative investments. It is important to keep in mind that the fair value determination should be made by management and not the auditor. The trouble can come when management relies solely on investor statements. The practice aid requires auditors to dig deeper and understand what the underlying investments of these investment vehicles are, and how the investment fund is determining fair value. These considerations should be discussed with your auditor in advance, but management should plan on contacting the investment fund or an investment advisor to request audited financial statements of the alternative investment and an SOC-1 Report (Service Organization Controls Report), if available. The combination of these documents will provide information on how the underlying investments are valued and evidence that they are in accordance with generally accepted accounting principles (GAAP). Other investments may present similar issues if your organization has a policy of recording at fair value. Oftentimes, these other investments consist of real estate. You will need evidence to support this value, which will consist of appraisals or a broker's opinion of value. Plan to get this information in advance of the audit.

▶NON-CASH GIFTS

Similar issues may occur when you receive non-cash gifts. These gifts should be recorded at fair value on the date of the gift and can consist of real property, private company stock or, in some cases, an entire business. Valuations should be planned well in advance to avoid delays. Also, it is wise to discuss the qualifications of the chosen appraiser with your auditor so they are comfortable relying on this specialist.

▶DEFINED BENEFIT PLAN PENSION ASSUMPTIONS

If your organization has a defined benefit pension plan, it is important to discuss the discount rate you and the actuary determine with your auditor. If the auditor disagrees with this rate after the actuary has completed a report, that report may need to be redone, causing delays and additional cost.

▶INCOME TAXES

Don't forget about income taxes. The pesky unrelated business income tax rules can be complex and are easily overlooked. There have been some recent changes in IRS regulations and some things you may have assumed are not taxable may indeed result in taxable income. Discussing all of your organization's activities in advance with a tax professional should prevent issues from arising in the future.

While many aspects of an audit can be troublesome, adequate planning and close contact with your auditor can go a long way to prevent surprises.

For more information, contact Randy Gregg, partner, at rgregg@bdo.com.

MORE FAQs ON AUTO-REVOCATION

By Joyce Underwood, CPA

In June 2012 the Internal Revenue Service (IRS) released an updated document, *Automatic Exemption Revocations for Non-Filing: Frequently Asked Questions* (FAQ), summarizing issues that organizations face when losing their exemption for failing to file 990-series forms for three consecutive years. This FAQ summarizes many of the points made in earlier releases and contains some particular items of note:

- A donor's contributions to an automatically revoked organization become nondeductible once the IRS publishes an announcement that contributions are no longer deductible. Up until such time a person that is unaware of the change in status may deduct his/her contributions. Once exemption is reinstated, contributions become deductible again.

- The IRS will not post names of revoked section 501(c)(3) organizations on the Internal Revenue Bulletin, but the names will be placed on the auto-revocation list, updated monthly, on the IRS website. Once an organization is placed on the auto-revocation list it will remain even after it is reinstated. Confirm current exemption status with a determination letter dated after loss of exemption, with IRS's Master File Data list, or by calling IRS Customer Services at 877-829-5500.

- Organizations under a group exemption will lose their exemption if the parent/central organization fails to file 990s and is revoked. An organization under a group exemption that fails to file 990s and is revoked cannot be added back to the group exemption, but must file its own application for reinstatement. If qualified, the former group member will not need to be placed under the group exemption because it will have its own individual tax exemption.

- A private foundation that appears on the auto-revocation list for failure to file 990-PF for three consecutive years automatically loses its tax-exempt status. This can be worrisome as a "terminating" private foundation can be subject to a termination tax. However, loss of exemption does not mean loss of foundation status or necessarily cause a terminating event. Such an organization remains classified as a private foundation, must continue to file 990-PF each year and is subject to applicable excise taxes. It may also be required to file a corporate or trust income tax return (Form 1120 or 1041), and pay applicable income taxes. A nonexempt private foundation can only terminate under section 507 of the Internal Revenue Code.

- The IRS has decided not to impose late filing penalties against organizations for any of the three consecutive years they failed to file or for any prior periods. Most organizations will not need to file any Forms 990, 990-EZ or 990-N that were delinquent at the time of revocation; however, certain larger organizations must submit delinquent filings, including the three consecutive years they were revoked for, along with their application for reinstatement. (See guidance under IRS Notice 2011-44.) An organization will be liable for all income, excise or other taxes and penalties that may have been owed at the time of automatic revocation, and will be liable for any future tax liabilities that accrue after loss of exemption.

- Current law does not allow the appeal or undoing of automatic revocation, but if an organization can prove it has a letter from the IRS dated prior to loss of exemption stating it does not have an annual filing requirement, or has documentation proving it met its filing requirement for one or more years of the three year period, the IRS will remove it from the auto-revocation list.

▶OTHER CONSEQUENCES OF AUTO-REVOCATION:

- Section 403(b) retirement plans require the sponsor to be a 501(c)(3) organization so revocation may result in an eligibility failure requiring correction.

- The IRS does not give advice on the consequences at the state level regarding loss of exemption so an organization should consult with the relevant state(s).

- Revocation can impact an organization's ability to be a borrower of tax-exempt bonds in that a 501(c)(3) organization that loses its exemption may not meet the required criteria to be an owner or primary user of the bond-financed property. Also, if the tax-exempt bond issuer fails to take an appropriate remediation the tax exemption for interest on the bonds could be affected.

The revocation and reinstatement process remains complex, and now that the initial three-year period for loss of exemption has passed, an organization should take care to monitor its status. An organization that filed one of three years' returns and avoided the first round of revocation could easily accumulate a three-year delinquency if it is not remaining current in filing. Certain provisions afforded to the first round of lost exemptions may not be available for future organizations seeking reinstatement. The IRS has stated that it is surprised by the number and size of organizations that lost their exemption and are seeking reinstatement. They continue to review reinstatement applications. If faced with a pending or lost exemption, it is best to immediately consult with your legal and tax advisors. For the full FAQ see http://www.irs.gov/pub/irs-tege/auto_rev_faqs.pdf.

For more information, contact Joyce Underwood, director, at junderwood@bdo.com.

BDO INSTITUTE FOR NONPROFIT EXCELLENCE℠ IN THE NEWS

Members of the Institute are requested to speak on a regular basis at various conferences due to their recognized experience in the industry. The following is a list of some of the upcoming events where you can hear BDO Institute professionals speaking. In addition to these external venues, BDO offers both live local seminars, as well as webinars, on various nonprofit tax and accounting topics. Please check BDO's website at www.bdo.com to register for these events and find details for other upcoming local events and webinars.

OCTOBER

Laura Kalick will be speaking at the 2012 Annual Association Law Symposium sponsored by the American Society of Association Executives in Washington, D.C., on Oct. 5.

Laura will be presenting a session entitled "UBIT Issues for Today's Healthcare Organizations – The Basics & Beyond" at the American Health Lawyers Association Tax Issues for Healthcare Organizations meeting on Oct. 15 and 16 in Arlington, Va.

Laura will provide a tax update at the Destination Marketing Association International CIO and CFO Conference, Oct. 24 in Raleigh, N.C.

Lee Klumpp will be presenting a webcast session entitled "2012 Not-for-Profit Accounting, Auditing and Tax Update" on Oct. 24 for the Accounting CPE Network.

Dick Larkin will be presenting a session on operating reserves at the American Institute of Certified Public Accountants National Governmental & Not-for-Profit Industry Training Program on Oct. 23 in Las Vegas, Nev.

NOVEMBER

Dick will be presenting a session entitled "Nonprofit Accounting and Auditing Update on Nonprofits" at the Virginia Society of CPAs 42nd Annual Virginia Accounting & Auditing Conference on Nov. 15 and Nov. 16 in Virginia Beach, Va.

DECEMBER

Dick will be presenting two courses on Dec. 7 at the Illinois Society of CPAs Not-for-Profit Conference in Springfield, Ill. He will present one course providing updates in accounting and auditing for nonprofits and a second on the topic of measuring success for nonprofit organizations.

Dick and **Lee** will be presenting a course discussing hot topics for nonprofit organizations at the 24th Annual Greater Washington Society of CPAs (GWSCPA) Not-for-Profit Organizations Symposium on Dec. 13 in Washington, D.C.

Mike Sorrells will also be presenting a course entitled "Sponsorships versus Advertising" at the GWSCPA conference on Dec. 13 in Washington, D.C.

UPCOMING INSTITUTE EVENTS

The BDO Institute for Nonprofit Excellence℠ will be hosting the following Institute meetings at the University Club in Washington, D.C.

Oct. 18
Effective Audit Committees for Nonprofit Organizations
This session will discuss reasons nonprofit organizations should have an audit committee, the role of the audit committee and how audit committees can achieve their goals. **Dick Larkin** and **Tammy Ricciardella** will be the presenters.

Nov. 8
Charitable Registration – Best Practices
This session will discuss best practices for organizations to follow with regard to complying with the intricate details of charitable registrations. Seth Perlman from Perlman & Perlman will be the presenter for this session.

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For 100 years, BDO has provided services to the nonprofit community. Through decades of working in this sector, we have developed a significant capability and fluency in the general and specific business issues that may face these organizations.

With more than 2,000 clients in the nonprofit sector, BDO's team of professionals offers the hands-on experience and technical skill to serve the distinctive needs of our nonprofit clients – and help them fulfill their missions. We supplement our technical approach by analyzing and advising our clients on the many elements of running a successful nonprofit organization.

In addition, BDO's Institute for Nonprofit Excellence^{SM} (the Institute) has the skills and knowledge to provide high quality services and meet the needs of the nation's nonprofit sector. Based in our Greater Washington, DC Metro office, the Institute supports and collaborates with BDO offices around the country and the BDO International network to develop innovative and practical accounting and operational strategies for the tax-exempt organizations they serve. The Institute also serves as a resource, studying and disseminating information pertaining to nonprofit accounting and business management.

The Institute offers both live and local seminars, as well as webinars, on a variety of topics of interest to nonprofit organizations and educational institutions. Please check BDO's web site at www.bdo.com for upcoming local events and webinars.

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