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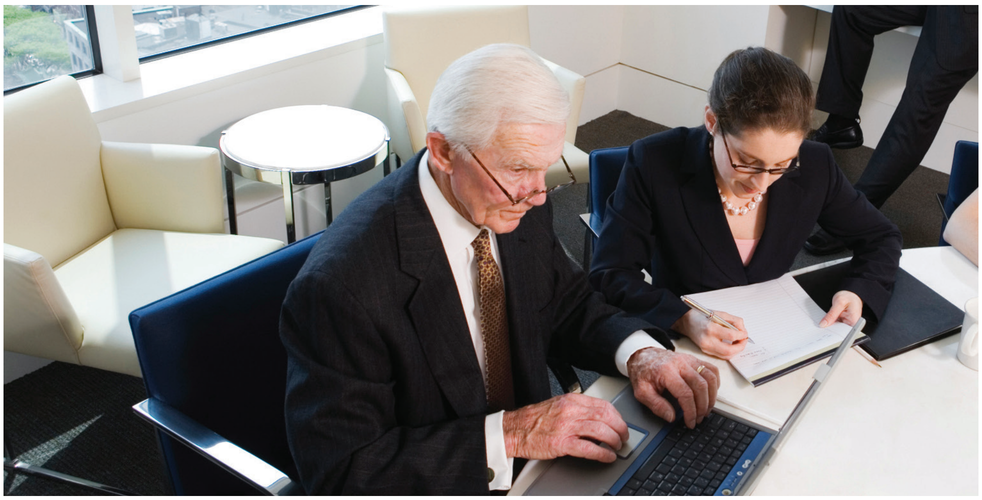
NONPROFIT STANDARD



THREE THINGS EVERY NONPROFIT BOARD MEMBER SHOULD FOCUS ON IN 2013

By Laurie Arena Rocha, CPA

Nonprofit boards, regardless of an organization's size and scope, play a vital role in the overall success of a nonprofit. With overwhelming economic uncertainty and increased scrutiny, boards are required now more than ever to effectively govern their nonprofits.

There are several key factors that nonprofit boards should be keenly aware of in 2013:

EXECUTIVE COMPENSATION

For several years now, expanded disclosures about nonprofit executive compensation practices have been publicly available through the filing of the Form 990. Best practices dictate that an organization have a process in place for determining the compensation of the CEO, officers and key employees that includes review and approval by an individual independent of the process, comparing salary and benefits to data available from comparable organizations, and documentation of the deliberations and decisions that are made to substantiate the compensation provided.

As a board member, you should know how the organization answers the questions about executive compensation on its Form 990. More importantly, you should understand the process that the organization has in place to assess executive compensation, and be confident that the organization is doing more

Read more

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CONTACT:

WILLIAM EISIG, CPA
National Director of Nonprofit & Education Practice/National Director, BDO Institute for Nonprofit Excellence℠
Greater Washington, D.C.
301-634-4923
weisig@bdo.com
www.bdo.com
http://nonprofitblog.bdo.com

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THREE THINGS

than just "checking the box" to answer "yes" to these questions.

For more information about what your organization should be doing, visit this article, "Executive Compensation: Did We Do the Right Things?" by Mike Conover on page 7 of BDO's Winter 2011 *Nonprofit Standard* newsletter.

▶RISK ASSESSMENT

How comfortable are you that management has critically assessed the risks the organization faces? If management has never shared its assessment of the financial and reputational risks that threaten the organization with the board or a committee of the board then you should ask about it.

A comprehensive risk assessment includes identifying risks, evaluating the likelihood and severity of the risk and the steps taken to mitigate the risk. Ideally the assessment should be updated annually. Identifying risks should be done broadly and should include financial and compliance risks, as well as reputational risks. Some of the risks that nonprofits face include fraud or misuse of assets, violations of laws and compliance requirements, economic risks that could impact revenue streams or the sustainability of the organization's programs, risks associated with chapters or affiliated organizations and risks associated with the use of volunteers or protecting the individuals who benefit from the organization's programs such as youths, the elderly or the mentally ill. Once the risks are identified and an assessment is made of the likelihood and severity, the board should ensure that management has a plan for addressing the high threat/high impact risks to the degree possible within the organization's means.

▶U.S. DEBT REDUCTION DEBATE

Although the "fiscal cliff" issue was addressed at the last minute when Congress passed "The American Taxpayer Relief Act of 2012," the uncertainty over reducing the size of the U.S. debt and the impact upon government spending and tax reform still looms. One thing is certain: the debate is far from over and its impact on the nonprofit sector will be far reaching and difficult to measure.

There are two areas where nonprofits are likely to be impacted: decreased government spending on discretionary programs, which could increase demand on the nonprofit sector's resources and programs; and tax reform that impacts charitable deductions, which could reduce contribution revenue. As a board member, you should ensure that management is focused on the impact these possibilities pose to the organization, and is considering ways to mitigate these risks.

What key focal areas will your board be focusing on this year?

For more information, contact Laurie Arena Rocha, partner, at lrocha@bdo.com.

INSTITUTE PROFESSIONAL PROFILE

LAURIE ARENA ROCHA

Laurie has more than 18 years of experience in all phases of client service and accounting practices. Her professional focus lies in auditing nonprofit organizations, including public charities, trade associations, private foundations, colleges and universities, governmental entities and employee benefit plans. Laurie serves as a leader in the nonprofit industry practice helping to shape the strategic direction of the group.

Based on her extensive experience in the field, Laurie serves as an Employee Benefit Plan Office Coordinator within BDO as well as a technical resource for employee benefit plans within the Atlantic region. Laurie speaks regularly at internal and external seminars on topics including nonprofit audits, employee benefit plans, and single and compliance audits. She is a regular speaker for organizations such as the American Institute of Certified Public Accountants, Maryland Association of College Business Officers and the Greater Washington Society of Certified Public Accountants. She also serves as a financial expert to the audit committee of a national charity. She is BDO's regional leader for the BDO Women's Initiative. Laurie received her B.S. in Accounting from the University of Maryland.

IRS RELEASES 2013 EXEMPT ORGANIZATION WORKPLAN – *A ROADMAP FOR IRS HOT ISSUES AND INITIATIVES*

By R. Michael Sorrells, CPA

On Jan. 25, the Internal Revenue Service (IRS) Exempt Organizations Group (EO) released its FY 2012 Annual Report and FY 2013 Workplan (http://www.irs.gov/pub/irs-tege/FY2012_EO_AnnualRpt_2013_Work_Plan.pdf). The annual report is a look back at EO accomplishments, results of some prior year initiatives and developments within the group. The workplan contains descriptions of ongoing and new projects that EO will be concentrating on in the current year.

Significant highlights of the 2013 Workplan include:

- Continuation of compliance checks on organizations that did not file Form 990 or 990-EZ. Under relatively new rules, organizations that do not file a 990 series return for three years will automatically lose exempt status.
- In 2012, a project was started to study changes made in 2006 to the unrelated business income tax rules under IRC Sec. 512(b)(13) for controlled entities such as subsidiary corporations. A spreadsheet was developed for use in examinations and about 3,000 were completed. EO is now analyzing the results and will ultimately report findings and recommendations to the Treasury Department. The findings and recommendations may ultimately result in changes to these rules.
- As part of a three-year national project affecting all types of entities, EO will be completing 2,500 employment tax examinations in the final year of the initiative.
- International activities will continue to be the subject of projects at EO, with the focus shifting from FBAR reporting to examinations of organizations with high amounts of foreign grant expenditures. An examination project started last year of large private foundations with international activities as well as organizations with significant gift-in-kind programs will be completed this year.
- In 2012, the IRS developed a questionnaire for central organizations with group rulings (http://www.irs.gov/pub/irs-tege/F14414.pdf). In early 2013, these questionnaires were sent to some 2,000 organizations. The data from these will be analyzed for the purposes of learning about the relationship between central and subordinate organizations and ways that filing requirements can be satisfied. The group exemption has increasingly been a concern with the IRS, so the results of this project may impact future rules for subordinate group filings and compliance.
- Many non-charitable organizations can operate as tax exempt without filing an exemption application (Form 1024). In 2012, the IRS developed a questionnaire for such "self declarers" identified as 501(c)(4),(5), and (6) organizations to determine if they have properly classified themselves and are complying with the applicable rules. In 2013, EO will send out questionnaires to organizations that "self-declared" on Form 990 for the 2010 or 2011 tax years. On Mar. 21 EO sent out requests to complete an online questionnaire (http://www.irs.gov/pub/irs-tege/Letter4953.pdf) to some 1,300 organizations that "self-declared" on Form 990 for the 2010 or 2011 tax years.
- Several years ago, a college and university project was started by EO with some 400 questionnaires being sent to a variety of institutions. To date, only a preliminary report has been issued. EO hopes to issue a final report in 2013 which will include results from examinations resulting from the project. The final report should be interesting to a variety of nonprofits since unrelated business income and executive compensation were key areas in the questionnaires and led to more than a few examinations.
- A number of projects have been generated from a long-term study which focuses on data gleaned from the Form 990:
  – A charitable spending initiative examining small organizations will be changing focus to examination of medium and large organizations with large fundraising amounts in comparison to charitable program expenditures and also to organizations with significant fundraising income but little or no fundraising expense being reported.
  – 200 examinations in the area of executive compensation will begin in 2013 based on information gathered in 2012.
  – From Form 990 data, some 300 organizations were identified as having indicators of possible non-compliance in the area of political activity. This information is being sent to a committee of career civil servants for determination of whether examinations are warranted. The same committee will also evaluate referrals from outside sources alleging political campaign intervention in the recent election year.
- EO is developing an interactive version of the Form 1023 exemption application for charitable organizations which will feature pop-up explanations for various lines on this form. This product should be available in 2013.

Last and certainly not least: Perhaps of greatest importance to a large number of organizations, EO will continue on its Unrelated Business Income (UBI) project. In 2013, focus will shift from organizations with UBI that did not file Form 990-T to organizations that have reported "substantial" gross UBI for three consecutive years but have reported no income tax due. A statistically valid sample of such organizations will be examined. We see many organizations in this situation. Many have valid and defendable reasons for the losses, while others may find an expensive surprise if selected for this examination project.

We urge organizations and their advisors to review the entire annual report and workplan for additional information that may be applicable to their organization(s). It is easily digestible and written in plain English.

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

UPDATE ON 2012 FORM 990: THE IRS IS WATCHING!

By Joyce Underwood, CPA

In February 2013 the Internal Revenue Service (IRS) released the last of the 2012 forms and instructions for the 990-series forms. The release was later than usual due to delays resulting from the late passing of "The American Tax Relief Act." The 2012 990 changes are relatively minor, however it's a good time to revisit your Form 990 and make sure you have properly addressed key areas of reporting such as compensation, transactions with related people and entities, excess benefit transactions, tax-exempt bonds and foreign reporting. A fresh look can improve the quality of your filing and fine-tune your presentation to the outside world. Also, the IRS has stated that many organizations selected for examination might not have been audited if they had accurately prepared their Forms 990. Because of the new ways the IRS is analyzing return data and selecting cases, it is more important than ever to completely and accurately prepare the form and follow the instructions.

Some of the key changes to note for 2012 are as follows:

- The net asset reconciliation in the core form, Part XI, is expanded to include the itemization formerly on Schedule D for net unrealized gains (losses) on investments, donated services and use of facilities, investment expenses and prior period adjustments. Therefore, the IRS eliminated Schedule D, Part XI, Reconciliation of Change in Net Assets and renumbered the Schedule D Revenue and Expense reconciliations from "financial statement" to "990 amounts" as Parts XI and XII.
- Part IX, Statement of Functional Expense now requires line 11g, All Other Expenses, to be further itemized on Schedule O when 11g exceeds 10 percent of total expenses.
- The IRS has added a second line to Part VII, Schedule A, column (B) to report average hours per week worked for related organizations. This eliminates the need to detail the hours worked for related organizations on Schedule O and places these hours below the hours worked for the filing organization.
- The reporting of Schedule K-1 (Form 1065) data on the 990 forms has proved to be too complicated so the IRS has dropped the requirement to report assets and income based on Schedules K-1 on Form 990, which was made voluntary after it was introduced in 2010. You are no longer required to report your share of assets and revenue of joint ventures and other partnerships using Schedule K-1; rather, you can report according to your books and records. Be careful though. This can result in discrepancies between the total unrelated business revenue reported on Part I, line 7a of Form 990 and that reported on the 990-T. You will need to decide whether to have a variance between the two that could trigger an IRS inquiry or add a book-to-tax adjustment so you can include the unrelated business revenue from the K-1 under Revenue on Part VIII of the 990.
- The IRS clarifies that any amount shown as loans receivable to interested persons on line 6 of Part X, Balance Sheet, must be detailed on a Schedule L.
- Instructions for Part VI clarify what information to provide regarding management companies: describe the services they provided to the organization; list any of the organization's current or former officers, directors, trustees, key employees and highest compensated employees who were compensated by the management company or companies or other person(s) during the calendar year ending with or within the organization's tax year; and list the amounts of compensation they received from the management company or companies or other person(s).
- Instructions for Part VII, Section A provide examples of how to report benefits under self-insured medical reimbursement programs.
- The IRS clarifies that all income from S corporations must be treated as unrelated business income, and that related S corporations should be included in Schedule R, Part IV along with related C corporations.
- The instructions clarify that payment card and third party network transactions reported on the new Form 1099-K should be reported based on the nature of the payments as there is not one specific line on Form 990 on which to report them.
- The questions regarding financial statements being compiled, reviewed or audited and consolidated or separate have been reworded under Part XII, Financial Statements and Reporting.
- The IRS also provides clarification about reporting of short period returns, and reminds us that Social Security numbers should never be included on a 990 due to its public disclosure.
- Important changes to definitions in the Glossary include: the definition of "Disqualified person" is revised to clarify that if the five-year disqualification period ended within the organization's tax year, it may treat the person as disqualified for the entire year; the definition of "Grants and other assistance" deletes "Program-related investments;" and the definition of "Professional fundraising services" includes preparation of applications for grants or other assistance.

The IRS is pleased with the improvement in transparency and compliance created by the redesigned Form 990. The new form has provided the agency with a rich supply of data on exempt organizations which it has been using to develop risk models to assess the likelihood of noncompliance by organizations which enables the IRS to better use its resources. The new Form 990 has also given the IRS a great deal of information about organizational governance practices. The IRS will be using this data to look at connections between certain governance practices and tax compliance.

And remember, exempt organizations required to file a 990-series form will lose their tax exemption after a third consecutive year of nonfiling. Although there is no penalty for not filing an annual 990-N, some small organizations take this to mean they can get away with filing once every three years. This is dangerous. Many small organizations have lost their exemption this year because they were just a few days late on that third year. The organizations that lose their tax-exempt status have to reapply for exemption.

So, take some time to revisit your 990. Reread the instructions and get familiar with the reporting that came upon the industry as such a burden a few years ago. Investigate best practices considering what key areas your organization has regarding compliance and transparency, and how best to report them to try and keep the IRS from looking at your organization.

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

GROUP RULINGS – UNDER THE MICROSCOPE AT THE IRS

By Paul E. Hammerschmidt, CPA, MS (Taxation)

THE BASICS OF GROUP RULINGS

The Treasury and the Internal Revenue Service (IRS) have established the group exemption process to reduce overall compliance efforts for both the IRS and the tax-exempt sector. The process relieves tax-exempt organizations that operate as chapters or subordinates of a central organization from having to separately file an Application for Recognition of Exemption (Form 1023 or 1024) and, at the central organization's discretion, from having to file an annual Form 990, although subordinates always have the option of filing their own, separate Forms 990. (The central organization, sometimes referred to as the parent, is required to file its own Form 990, separate from the Form 990 group return that may include any subordinate organizations.) The IRS is relieved of the burden of having to review multiple applications for exemptions from entities that were organized and operate for a common purpose under the control and supervision of a central organization that has established its tax-exempt status.

A nonprofit organization that qualifies as exempt from federal income tax under section 501(a) and has two or more separately organized subordinate entities under its general supervision or control may apply for a group exemption on their behalf. All of the subordinates must operate for a common purpose described in Section 501(c) of the Internal Revenue Code (IRC or Code) (for example Section 501(c) for an educational group), although the parent can have a different category from its subordinates. The group may not include private foundations or foreign organizations. Although members of the group may have different tax year-ends, all the subordinate organizations included in a group return must have the same tax year-end.[1]

Each subordinate must be organized as a legally distinct entity having its own governing instrument and Employer Identification Number (EIN). If the parent intends to file a group return, the IRS will require them to obtain a separate EIN for the group. [2]

To request a group ruling the central organization must write a letter to the IRS and provide the applicable information and attachments as well as the user fee (currently $3,000).[3] After approval of the group exemption application, the IRS will issue a four-digit GEN (Group Exemption Number).

There is no provision of the Code or regulations that permit the filing of a group return for Form 990-T. Each subordinate therefore has the responsibility of filing Form 990-T if it has $1,000 or more in gross unrelated business income.

IRS SIGNALS POTENTIAL CHANGES TO GROUP TAX EXEMPTIONS

There are several indications that signal that the IRS has concerns about group rulings issued to tax-exempt organizations:

- The Advisory Committee on Tax-Exempt and Government Entities (ACT) issued a report in June 2011 which recommended that the IRS eliminate the option of filing group Form 990 returns. Up to 700 organizations currently file a group return, which means that any change to the group exemption process would have a huge impact in the nonprofit world.

- In October 2012 the IRS began contacting more than 2,000 randomly selected tax-exempt organizations with group rulings, asking them to complete a lengthy questionnaire. See the questionnaire at the following link: http://www.irs.gov/pub/irs-tege/F14414.pdf.

1 Reg. 1.6033-2(d)(3)
2 IRM 25.7.3.6(9)
3 Rev. Proc. 80-27

Read more

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UNDER THE MICROSCOPE AT THE IRS

The lengthy, detailed questionnaire has nine parts and contains 80 questions, some with subparts. The following topics are covered:

– Information about the central organization
– Information about all subordinates
– Communications with subordinates
– Relationships with subordinates
– Services provided for subordinates
– Inclusion of subordinates in the group exemption ruling
– Form 990-T filing information
– Annual information returns and group returns
– Annual group exemption updates
– While completing the questionnaire is technically voluntary, organizations that fail to do so may be inviting a more formal and intensive IRS examination. The form must be completed online.

- The 2013 IRS Exempt Organization Workplan that was issued on Jan. 25, 2013, announced that that they would be taking a look at subordinate groups which are exempt under a group ruling. The *Nonprofit Standard* reported in the Winter 2012 issue that there was concern about transparency and compliance in this area, especially with regard to filing group returns.

▶NOW IS THE TIME FOR THOSE WITH GROUP EXEMPTIONS TO REVIEW THEIR DOCUMENTATION

Due to the extensive nature of the IRS questionnaire and the IRS interest in how organizations have been filing Forms 990, it is reasonable to conclude that the IRS is closely scrutinizing existing group exemptions and group exemption applicants. Associations, charities, and other tax-exempt organizations that fit into this category should look closely at their current processes and documentation and see where improvements can be made with an eye toward better compliance.

▶CENTRAL ORGANIZATION RESPONSIBILITIES

The central organization assumes a number of responsibilities to maintain the exempt status of its subordinates:

Update of Affiliate Information

Annually, at least 90 days before the end of the accounting period, the central organization must submit information to update the master list of its subordinates with the IRS. Information would include:

- Subordinates that have changed their names or addresses during the year
- Subordinates no longer to be included in the group exemption letter because they have ceased to exist, disaffiliated or withdrawn their authorization from the central organization
- Subordinates to be added to the group exemption letter because they are newly organized or affiliated or they have newly authorized the central organization to include them

If no changes have occurred, this "90-day notice" must state this fact. This letter must be submitted to the IRS every year, regardless of whether there are any changes and regardless of whether the central organization intends to include them in filing a Form 990 group return.

If a central organization has newly admitted subordinate organizations, they should immediately notify the IRS to allow them to update their records. This letter would include the four-digit GEN, the new subordinate's name, address, EIN and the effective date of the inclusion.

Central Organization Form 990 and 990-T

The central organization must file its own Form 990 that includes only its own activities and financial information (assuming it is not exempt from filing a return that would be applicable for churches and other religious organizations). Form 990 of the central organization should include the Group Exemption Number on page one of Form 990, header box H(c).

Affiliated organizations may file a separate return for themselves or be included in a group return. A group Form 990 is filed by the parent by combining the financial information for two or more (or all) of its subordinates.

Each subordinate must declare (in writing under penalty of perjury) that it authorizes its inclusion in a group return and that the information it submits for inclusion is true and complete.

Central organizations should exercise care in answering Form 990, Part VI, Section B, question 10a concerning whether the organization has local chapters, branches or affiliates. (All central organizations with group rulings should answer "yes.") Question 10b asks whether the organization had written policies and procedures governing the activities of such chapters, affiliates and branches to ensure their operations are consistent with the organization's exempt purpose. All central and subordinate organizations under a group ruling should have these policies and procedures in place to allow them to answer "yes."

These policies and procedures might be contained in each group member's bylaws or a manual or other document created by the central organization that requires each subordinate entity to follow specific guidelines or procedures. Because group exemption is awarded only to central organizations whose subordinates are subject to its general supervision or control, it is important that central organizations are able to document this to be able to answer this question in the affirmative.

▶SUBORDINATE ORGANIZATIONS' RESPONSIBILITIES

Subordinate organizations included in a group ruling are generally subject to the organizational and operational rules of the type of organization under which they obtained group exemption. For example, subordinate organizations under IRC Section 501(c)(3) are strictly prohibited from conducting any political activities.

Similar to other tax-exempt organizations, subordinate organizations with unrelated business income are subject to income tax under IRC Section 511. In addition, if they have paid employees, they are subject to

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UNDER THE MICROSCOPE AT THE IRS

employment tax withholding, payment and reporting.

New group member subordinates created after the issuance of the IRS group exemption letter report only to the central organization for recognition of exemption, not to the IRS. These subordinates are required to be organized and operate for a common purpose under the control and supervision of the central organization. Subordinates that wish to join a group exemption generally must submit their authorization to the central organization within 27 months from the date it is formed in order to be treated as tax-exempt as of the date of formation. The central organization must be sure to include new subordinates in its next 90-day notice filed with the IRS.

As mentioned above, a subordinate organization is annually required to declare (in writing under penalty of perjury) that it authorizes its inclusion in a group return and that the information it submits for inclusion is true and complete. In addition, the subordinate organization must provide the central organization with financial and other information required to enable the central organization to file a complete group return (Form 990), along with a penalties of perjury statement, signed by an officer or director of the organization, stating that the information submitted is true and complete.

Each member of the group to be included in the group return must also provide information to the central organization to enable it to answer the questions on Form 990 that include information relating to officers, directors, key employees, transactions and relationships between "disqualified persons," lobbying activities and list of contributors.

If the central organization decides not to include a subordinate in the Form 990 group return or if the central organization decides not to file a group return, each subordinate is responsible for filing a separate Form 990 if that organization is otherwise required to file (e.g., churches and other religious organizations are not required to file Form 990). The subordinate filing its own Form 990 would file under its own EIN and would identify itself as a member of the group by including its Group Exemption Number on page one of Form 990, header box H(c).

▶EXEMPTION-REVOKED GROUPS

Subordinate organizations included in a group exemption were particularly impacted by the Pension Protection Act (PPA) of 2006 that required most exempt organizations (including associations, membership organizations and charities), even modest-sized ones, to file an annual information return or notice with the IRS for the first time in 2007.

If a central organization's tax exemption is automatically revoked for failure to file Form 990 for three consecutive years, the group exemption letter ceases to have effect regardless of whether the subordinates filed their own returns or the parent/central organization filed a group return on behalf of the subordinates. The continued effectiveness of a group exemption letter as to a particular subordinate is based on continued qualification of the central organization.

If the group exemption is no longer in effect, the subordinates may be required to file income tax returns. A subordinate that wishes to be recognized as tax-exempt by the IRS must file an application for exemption. The IRS has provided guidance in the form of Frequently Asked Questions.

▶TIME TO REVIEW DOCUMENTATION AND COMPLIANCE WITH GROUP EXEMPTIONS

Now that the IRS has signaled potential changes to group tax exemptions, it is recommended that subordinates review their organizing documents to ensure that they can demonstrate that they are organized and operate for a common purpose under the control and supervision of the central organization. Central organizations and subordinates should be sure to address their responsibilities outlined above.

For more information, contact Paul E. Hammerschmidt, director, at phammerschmidt@bdo.com.

NONPROFIT FACTS

Did you know?

- **Did you know the charitable deduction is one of the 10 largest tax expenditures in the Internal Revenue Code?**
- **Forming a nonprofit audit committee is recommended by the IRS and the AICPA and provides many benefits to your organization.**
- **According to Idealist.com, one-in-12 Americans work in the nonprofit sector.**
- **There are 1,565,497 tax-exempt organizations operating in the United States according to the National Center for Charitable Statistics (NCCS).**
- **There is one nonprofit in America for every 175 Americans, according to the Nonprofit Almanac 2012.**
- **Mobile giving is on the rise: 25 percent of respondents to a new Pew study said they preferred to donate via text message.**
- **Charitable giving in the U.S. grew 1.7 percent in 2012, due in part to Hurricane Sandy relief efforts.**
- **Stanford University is the first school to raise over $1 billion in a single year.**
- **Gifts to U.S. colleges rose 2.3 percent in 2012, narrowly outpacing inflation.**
- **According to NACUBO, endowments are down .3 percent for fiscal year 2012 among 800 colleges and universities in the United States.**

EXECUTIVE COMPENSATION IN NONPROFITS – RISKY BUSINESS

By Michael Conover

HOW TIMES HAVE CHANGED. IN THE PAST EIGHT TO 10 YEARS, THERE HAS BEEN A SIGNIFICANT SHIFT IN THE GENERAL PUBLIC'S ATTITUDE ABOUT COMPENSATION.

The meltdown of the financial markets and market turmoil that followed provided an unusually stark background against which some spectacular instances of executive compensation excess were spotlighted for all to see. These few instances of "lottery ticket winners" in the midst of the general public watching their own economic situations horribly erode may not have been just the most recent insult to sensibility, they could be the last.

Significant new disclosure requirements and mandatory shareholder votes (non-binding … at least to this point) on executive pay were included in the Dodd-Frank financial reforms. The Occupy protests further solidified sentiments against corporate greed, excess, etc. Finally, the 2012 general election campaign exploited the public's hostility toward the "top 1 percent or 2 percent."

These developments in the for-profit world have largely been responsible for conducting more and more of executive compensation in full view of shareholders and the general public. At least one commissioner of the SEC observed that these changes are *to "affect the behavior of companies and boards rather than to provide information that investors would find useful."*

Over the years, the nonprofit sector has adopted many pay practices found in the for-profit sector. The focus on being competitive, more sophisticated approaches to pay, etc., have become a routine topic of boardroom discussions. Outside board members have undoubtedly introduced some of these changes and the competition for management talent has also prompted these developments. Similarly, changes to Form 990 requiring more disclosures about executive pay as well as instantaneous access to these forms online have provided a window for the public to see almost as much as any publicly held company would reveal in its proxy.

I'm observing what I believe is an end to some of the similarities for the nonprofit group and that is what prompts the "risky business" title to this short article. As noted in several of my previous *Nonprofit Standard* articles, I believe that nonprofit organizations have long been held to a different and higher standard than those in the for-profit sector. The general public believes that the "nonprofit" designation means more than simply exemption from tax. Many believe it implies low or no compensation regardless of the complexity of the organization and accountabilities associated with its management.

So, you might ask … "What's risky? What's my point?"

I am referring to some developments and potential developments at the state level that set limits or a "cap" on pay for executives. Often in response to the same types of bad examples we've discussed here in the past, some states have enacted or proposed to enact legislation that will place a limit on how much an executive may be paid and even a prohibition on any compensation for a board member.

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EXECUTIVE COMPENSATION

While Florida, New Jersey and Massachusetts have proposed limits on compensation for certain nonprofit executives in their states, New York has enacted legislation that sets a cap of $199,000 in New York state funds for all forms of compensation paid to any executive in a social service organization receiving the majority of its funding from the state or by virtue of being state-certified. (On Mar. 13, New York announced yet another postponement of the implementation of this legislation until July 1, 2013. They have invited more public comment until May 6, 2013.) The regulations make provisions for higher compensation in some situations, but the process for doing so is complex and will require annual activity on the part of the organization to continue the higher pay.

In New York and the other states mentioned, a fixed cap amount has been set as a limit for pay with little or no consideration of the size, type or complexity of the organization nor the requirements of an individual qualified to capably manage it. Where the specific amount comes from is not clear; perhaps it is some other reference point like the highest paid appointed official in the state or just a number (e.g., $200,000) which is "all that anybody needs to be paid."

The risk here might not be obvious to state officials or many in the general public. Placing a cap, especially an arbitrary one, on executive pay impedes an organization and, in extreme cases, I would submit could harm the organizations the government aims to "help." Past experience and human nature generally suggest that the introduction of any new regulation imposes time and cost pressures on those organizations affected as they assimilate, apply, interpret and in some cases develop ways to escape or minimize any inconvenience or impact that might be produced.

Another type of risk that might be encountered is a limitation on the type or caliber of individual that can be attracted to an organization to manage it. Please understand, I am not suggesting that compensation is the only consideration when an individual makes a decision about joining an organization. It is not. Nor am I suggesting that paying more always attracts individuals that are more qualified or more capable. It does not. There is, however, some correlation between pay and qualification that cannot be overlooked. There are those highly accomplished and well-to-do individuals who can work for a "dollar a year," but they are few and far between. I have also seen organizations with impassioned employees dedicated to their mission start to experience high levels of turnover as "maturity" and family responsibilities start to make financial demands no longer satisfied by low pay.

One state, Massachusetts, has proposed legislation that no board member of a nonprofit organization be allowed to receive compensation. When the state's largest health insurance organization, a multibillion dollar organization, resumed paying its board members, the message from the state was that no "public charity" should pay its board.

Hospitals and higher education institutions are also being cited more frequently as examples of organizations with leadership pay levels viewed by some as excessive for a nonprofit. Both types of organizations are under considerable scrutiny for increasing costs. Pay becomes an easy target for those looking to find causes or scapegoats for them.

It is not unreasonable to believe there is a demand for capable management in the nonprofit sector just as there is in the for-profit sector. And these capable individuals distinguish themselves in their ability to achieve better results by delivering more or higher levels of service from similar resources and innovating new and different ways to accomplish objectives and fulfill the mission. There is competition for these individuals and, at some point on some level, reasonable expectations about compensation must be met.

The risk here is that arbitrary caps or onerous regulations on pay will eventually cap the caliber of talent that can be attracted to manage the organizations upon which so many people depend to do good. The governing bodies of all nonprofit organizations must be ever more diligent in their stewardship of the organization's pay practices, especially for leadership positions. Compensation is a critical component of the organization's management system and must be managed as diligently as any of the organization's key systems. The board needs to create a tailored program for compensation that is fully aligned with and supportive of the organization's mission.

Compensation committees and board meetings are excellent forums for discussions of how to structure pay and how much to pay for leadership positions. Outside advisors and information sources offer a good context for deciding what is best or right for a particular organization to do. Detailed meeting minutes and explanations in Form 990 offer excellent opportunities to communicate the rationale to interested parties outside the organization. Organizations that make the best use of these will assuredly fare better in their efforts to manage pay well.

Simply trying to pay the most is no more defensible than paying the least. Competitive conformity, doing what everyone else does, is equally reprehensible. Rest assured, those who do not thoughtfully manage their pay practices will have it managed for them as the government is always "willing to help."

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

WHY NONPROFIT ORGANIZATIONS NEED EFFECTIVE FINANCIAL DASHBOARDS

By Adam B. Cole, CPA

NOW MORE THAN EVER, MANAGEMENT AND THE BOARDS OF DIRECTORS OF NONPROFIT ORGANIZATIONS NEED TO EVALUATE KEY FINANCIAL PERFORMANCE INDICATORS ON A REGULAR BASIS.

Management needs a timely way to evaluate key information at a high level in order to make informed decisions on the performance of the organization, a segment, a contract or an initiative or all of the above at the same time.

In the for-profit world this summary report of key performance indicators is called a "dashboard." Many organizations are beginning to adopt these reports as a standard component of the reporting package. The dashboard report summarizes key financial data, sets benchmarks for the organization and allows users to quickly view their performance. In addition, this process gives users an idea of how well the organization compares against goals and expectations set by management and the board.

In facing the challenges of shrinking funding from federal, state and local governments, nonprofit boards need to develop a similar dashboard to better monitor and evaluate financial performance on an ongoing basis. The traditional monthly reporting packages, which usually include the statement of financial position, statement of activities, statement of functional expenses and a cash flow forecast, do not always highlight the key indicators that would show whether an organization is off course and heading for trouble, or if it is in a financially stable position. Since traditional reports are only provided monthly, they are not offering time-sensitive information as would a dashboard, which is typically set up to be generated daily.

Dashboards come in many shapes and sizes. As a guiding rule, it is best to develop a dashboard based on a combination of key financial data and industry benchmarks. In setting your organization's benchmarks, first determine how the organization is evaluated by others. Funding sources, lenders and trade associations are all good indicators. Next, determine what goals you have set for your organization to achieve, such as capital reserves, working capital, productivity of staff and/or staffing ratios. Use these goals as the standards to benchmark performance against. For example, if an organization has a loan covenant set by its lenders to meet certain financial metrics such as working capital (current assets over current liabilities); this could be incorporated into the dashboard. A deteriorating working capital ratio is usually one of the first indicators that the performance of an organization is not headed in the proper direction. The dashboard can also help if the organization has quarterly or semi-annual requirements to report these covenants to its lenders.

Dashboards can also include program specific performance, such as outcome levels and productivity. While not necessarily a financial measurement, these ratios could measure program performance, which may be an indication of whether or not a funder may renew a program, or if the reputation of the organization may be put at risk. For example, an organization may be funded to operate a program with a certain staffing ratio, such as for every 15 children in its care there will be one full-time-equivalent (FTE) social worker. Now due to staff turnover and the inability to hire replacements, the organization is operating at a staffing ratio of 30 to 1. Financially, the organization may be operating at a surplus and that will be indicated in certain financial benchmarks. However, this benchmark may be an indication of a bigger problem and a risk to the organization. As with all benchmarks created for a dashboard, their purpose should be to ensure management

▶ Read more

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FINANCIAL DASHBOARD

and the board of directors understand how the organization got to where it is at that time and to decide whether or not action is warranted or whether or not deviations from the benchmark need to be corrected.

The process for developing the dashboard must be a partnership between management and the board of directors, the underlying principle being that you need to develop how much content is to be presented, how often and to what depth. External reporting requirements, funding source criteria and time-sensitive data will all factor in. The IT department may have to be brought in to help develop and maintain these reports for finance.

An organization needs to establish this process upfront when establishing a dashboard; otherwise there is no process in place to ensure it is updated and utilized. The effort may be time-intensive to develop but then many of the items can be automatically pulled from your accounting system and the formulas will do the calculations. However, you should assign a responsible team member to review the output and make sure any updates in the accounting system are rolled into the dashboard.

As you can see by the detail of the data in the sample dashboard, it serves many purposes to those that read it. Most importantly it drills down beyond the data that has historically been reviewed each period by management and the board of directors to look for trends, both positive and negative, and make sure that all stakeholders have full awareness of the direction of the organization.

The following is a sample dashboard for a nonprofit organization:

For the six months ending Dec. 31, 2012				
Amounts in (000's)	Actual	Budget	Variance	Annual
Revenue	**YTD**	**YTD**	**YTD**	**Budget**
Program service fees	$ 18,000	$ 17,500	$ 500	$ 35,000
Government contract revenues	6,700	6,500	200	13,000
Other program revenues	300	325	(25)	650
Total Program Revenues	**25,000**	**24,325**	**675**	**48,650**
Expenses:				
Program services	21,100	20,900	200	41,650
Administration	2,020	2,050	(30)	4,000
Fundraising	175	175	-	350
Total Expenses	**23,295**	**23,125**	**170**	**46,000**
Change in net assets before other items	**1,705**	**1,200**	**505**	**2,650**
Special events, net	–	–	–	1,250
Contributions	400	375	25	750
Investment income, net	300	500	(200)	1,000
Change in Net Assets	**$ 2,405**	**$ 2,075**	**$ 330**	**$ 5,650**
Benchmarks:				
Liquidity ratios:				
Current ratio	2.2:1	2.0:1	0.2:1	2.0:1
Quick ratio	1.7:1	1.5:1	0.2:1	1.5:1
Primary Reserve Days	120	90	30	90
Cash to Payroll	8	6	2	6
AR DSO	40	45	-5	45
AP DSO	55	60	-5	60
Key Data:				
Cash on Hand	$ 9,200	$ 6,500	$ 2,700	$ 1,000
AR % Greater than 90 Days	10%	16.67%	-6.67%	16.67%
Line of Credit Outstanding	$ –	$ 400	$ (400)	$ –
Debt service coverage	1.8:1	1.25:1	.55:1	1.25:1
Program Data:				
Children served- Current	345.00	300.00	45.00	320.00
Children served- New	42.00	42.00	–	50.00
Social Worker Ratio	15.0:1	15.0:1	–	15.0:1
Child Care Ratio	1.20:1	1.0:1	.20:1	1.0:1

For more information, contact Adam Cole, partner, at acole@bdo.com.

IT'S GOING TO COST HOW MUCH? – THE TRUE COST OF YOUR STRATEGIC PLAN

Perspectives in Higher Education

By Tom Gorman, CPA

In the Winter 2012 edition of the *Nonprofit Standard*, author Michael Batts began to explore the new normal of strategic budgeting. In this edition, we explore another sometimes overlooked aspect of budgeting – how much would it cost to fully implement your institution's strategic plan? Where will those resources come from and what do those resource allocation decisions tell us about institutional priorities?

▶BUSINESS PLAN APPROACH

Many of our colleagues in the for-profit world are accustomed to presenting and defending business plans. There is a culture that supports managing by the numbers and making decisions based on seemingly cold calculations. Higher education is often more about building consensus and having an inclusive process that at times strains to say no even when the numbers support that position.

Yet we must remember that although most colleges and universities are nonprofit organizations, the realities of positive cash flows and self-sustaining programming are universal. Stepping back and viewing the decision from a different perspective is often needed. Too often the silos and fiefdoms that exist exert so much pressure that it is hard to change course. Implementing a balanced approach that combines business planning activities to support and inform the consensus building processes will go a long way to improve decision making. The strategic plan is no exception.

▶PLANNING IN HIGHER EDUCATION

It seems like college administrators are in a constant state of strategizing – either preparing, updating or debriefing the latest iteration of their institution's strategic plan. It seems that all too often strategic plans become nothing more than a wish list of grand dreams and aspirations. In reality, the strategic planning process is an opportunity to assess the stark realities of mission and resources.

At the core of any organization, but perhaps most true in higher education and nonprofits, is the mission. Without a mission the organization would be wandering aimlessly. The strategic plan should grow out of and support the mission. The strategic plan is an opportunity to reinforce what works, but also to embark in new directions. An effective strategic plan should also be the foundation for the annual budget process. Each annual budget should in some fashion be a reflection of management's priorities and how it intends to achieve the institution's mission. There is an annual measuring stick in the form of financial statements to assess progress; at some level, the financial results are merely a representation of how well management executed on the strategic plan. Linking the strategic plan to financial results is a key step.

From there, monitoring procedures can be put in place to measure performance against the plan and, ultimately, performance in achieving your institution's mission.

▶MIND THE GAP – THE STRATEGIC FUNDING SHORTFALL

I have read far too many college and university strategic plans that call for growth in student headcount, research funding, study abroad programs and countless other programmatic directives. Oftentimes these strategic plans focus on the top line revenue impact – an ever growing source of funding – but miss the mark on fully projecting the true costs of pursuing the initiative.

Failing to project the full cost of your strategic plan can result in not only a budget shortfall but a more meaningful strategic shortfall.

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HIGHER EDUCATION

When an institution finds it necessary to change because of outside forces, this strategic shortfall can cause it to miss opportunities to transform or put it at a disadvantage due to the misalignment of priorities.

The strategic planning process should include requirements to fully and completely estimate the cost of implementing each objective of the plan. As noted above, using a business plan format will help focus attention on the key cost drivers. Care should also be taken to include consideration of how progress will be measured and monitored, with specific due dates. These monitoring steps often take the form of metrics and benchmarks.

▶MONITORING PROGRESS

Once an institution has embraced the notion that it must manage its strategic plan, not only in terms of goals and outcomes, but also in dollars and cents, developing the right metrics is a must. As discussed in Adam Cole's article on page 10, "Why Nonprofit Organizations Need Effective Financial Dashboards," the metrics developed to monitor progress toward achieving your strategic plan can be incorporated into a broader set of dashboard metrics. The challenge is not to allow the strategic plan to overwhelm the governing board's overall responsibility to monitor the institution.

A set of metrics that includes the five to seven items of highest importance is likely sufficient to allow those charged with governance to effectively manage progress in achieving the objectives of the strategic plan. These may be both financial and non-financial in nature. However, as my premise states, the strategic shortfall that could result from mismanaging your strategic plan would argue in favor of financial metrics.

For more information, contact Tom Gorman, director, at tgorman@bdo.com.

STATE NEXUS CONSIDERATIONS FOR NONPROFIT ORGANIZATIONS

By Jeremy Migliara, CPA

A common misconception in the nonprofit tax arena is that nonprofit organizations are not subject to state taxes. While it is true that the exemption from federal income taxation extends to state income taxation as well, today's nonprofit administrator has to understand the ins and outs of state taxation for other taxes, including but not limited to unrelated business income taxes, sales taxes, non-income taxes and property taxes. The state taxation landscape for nonprofit organizations has been changing in recent years due to several factors. First, there has been a trend whereby nonprofit organizations are generating additional revenues from increased activities with their chapters and membership. Second, fairly recent accounting pronouncements require nonprofits to address the need for state tax accruals within the audited financial statements. Finally, states have become more aggressive in expanding their tax base to include nonprofit organizations, especially in the area of sales taxes.

The first step in identifying potential state tax issues for a nonprofit organization is to better understand where the organization has established nexus. Nexus can be defined as a certain amount or degree of business activity that must be present in a state before the state can impose any tax liability and reporting requirement upon a business. Nexus is predominantly established through a physical presence in a state, by either employees or independent contractors. However, there is a recent trend whereby states are adopting economic nexus standards, where nexus is created by the purposeful direction at a market in a state with significant sales or benefits derived from these activities. While nexus may be created in many ways, some of the more common methods include:

- Presence of real or tangible personal property, whether owned or rented, in a state
- Home-based or telecommuting employees
- Independent contractors or employees performing services on behalf of the organization
- Offering of seminars or other trainings
- Attendance at trade shows
- Regular and systematic travel into a state (i.e., solicitation activities)

Once a nonprofit organization has established nexus in a state, it will be subject to the tax laws, registration and filing requirements in that state. Each state has different rules and requirements related to the taxation of nonprofits. As discussed above, the identification of where state nexus has been established is the first step in identifying the potential state tax issues for the organization. The evaluation process continues in a systematic fashion by addressing the following questions:

- What state taxes can be imposed on the organization once nexus has been established?
- Is there a need to register as a tax-exempt organization or apply for a separate state exemption determination?
- How are the state taxes computed?

▶SUMMARY

Even though generally exempt for income tax purposes, a nonprofit organization should not overlook the applicability of other state taxes. Understanding in which states the nonprofit organization has established nexus is the first step in evaluating the state tax obligations of the organization, which may include state registrations, applications to obtain state exemptions, collecting and remitting taxes, and filing applicable state tax returns. A state nexus review is a service available to assist nonprofit administrators with performing a nexus evaluation.

For more information, contact Jeremy Migliara, senior director, State and Local Tax, at jmigliara@bdo.com.

COMMISSION ON ACCOUNTABILITY & POLICY FOR RELIGIOUS ORGANIZATIONS SUBMITS REPORT TO SENATOR CHARLES GRASSLEY

Report Represents Collective Recommendations of Leaders from Virtually Every Major Faith Group in America, the Broader Nonprofit Sector and Legal Experts to Enhance Accountability for Religious and Other Nonprofit Organizations

By Michael E. Batts, CPA, Commission Chairman

On Tuesday, Dec. 4, 2012, the Commission on Accountability and Policy for Religious Organizations (the Commission) presented a 91-page report to Sen. Charles Grassley (R-Iowa) addressing nonprofit tax and regulatory issues related to clergy, congregations and other nonprofit organizations. Leaders from multiple faith groups, including mainline and evangelical Protestant, Catholic, Jewish, Muslim, Hindu and Seventh-day Adventist, joined legal experts and leaders from the broader nonprofit sector in providing the comprehensive study of national tax policy relating to religious and other nonprofit organizations. The full report can be downloaded free of charge at ReligiousPolicyCommission.org.

▶BACKGROUND

In January 2011, following a three-year inquiry into the financial practices of six Christian media ministries, Grassley's staff issued a 61-page report raising a number of questions about tax and policy issues for religious and other nonprofit organizations. Grassley asked the Evangelical Council for Financial Accountability (ECFA) to coordinate a national effort to provide input on the accountability and tax policy questions raised by his staff and other relevant issues. Grassley specifically asked for ECFA's help to facilitate discussion on whether these issues can be addressed without legislation, writing, *"I believe that legislation should be the last resort. However, ideas for reform often inspire informed and thoughtful discussions which, in turn, lead to self-correction and eliminate the need for legislation."* ECFA then created the Commission (www.religiouspolicycommission.org) including panels of legal experts, religious sector representatives, and nonprofit sector representatives.

The Commission is composed of some of the most respected religious and nonprofit leaders in the country. Additionally, there are three panels working with the Commission in developing its recommendations. Panel members include leaders from virtually every major faith group in America, top attorneys experienced in the areas of exempt organization law and constitutional law with a specific concentration in the arena of religious freedom, and leaders from some of the most respected organizations providing thought leadership and guidance to the U.S. nonprofit sector.

When the 80 leaders comprising the Commission and its Panels were first assembled, we had no idea what degree of consensus or discord might result from the process. After a highly transparent process that involved multiple meetings of the Commission and its Panels, media communications, public input, position papers, presentations at national conferences, and a virtual town hall meeting, the Commission developed the recommendations included in the report with an extraordinarily high degree of agreement among those participating. Along the way, many of us developed new friendships across faith lines and in sectors other than our own.

The Commission's report offers 43 specific recommendations and responses to the Grassley staff report that it believes will enhance accountability by religious and other nonprofit organizations while avoiding excessive legislation or regulation that would be harmful or burdensome to them.

The recommendations are provided along nine topical lines:

- Executive compensation and excess benefit transactions
- Clergy housing exclusion
- Churches, accountability, and donor engagement
- IRS advisory committee for religious organizations
- Independent accreditation and ECFA's model
- Religious organizations and third-party oversight
- Examinations of church leaders
- "Love" offerings
- Public disclosure of highly sensitive information

The report highlights the Commission's belief that the key to enhancing accountability in the religious and broader nonprofit sector is a combination of improved administration of existing law, better education and guidance about the law, proactive and verifiable demonstration by religious and other nonprofit organizations of their commitment to financial integrity, and a higher level of donor engagement in the giving process.

As I noted in "A Message from the Chairman" in the report, *we cannot allow the behavior of a few outliers in the religious and nonprofit sector to threaten the freedoms of those who are not the problem—those who are doing the good work. Federal policy should continue to encourage the public to financially support such organizations and it should not burden them with harsh or excessive legislation or regulation*.

The Commission notes that federal laws (and penalties) are already in place, prohibiting excessive compensation and benefits for nonprofit leaders, and that these laws should be effectively enforced. The Commission further recommends clearer published guidance and forms from the IRS and Treasury Department addressing key areas of existing laws followed by an education effort about the law and the penalties for noncompliance.

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COMMISSION ON ACCOUNTABILITY & POLICY

Additionally, the Commission noted that the IRS needs to rectify a current technical issue involving the IRS's restructuring, which caused a federal court to rule that the IRS was not properly handling inquiries of churches.

The Commission does not believe more restrictive laws are needed but believes there are other effective ways to improve compliance and accountability. The Commission calls on religious and other nonprofit organizations to adopt robust policies and practices in the areas of executive compensation and related-party transactions—and to make those policies available to donors.

The Commission further urges nonprofit organizations to verifiably demonstrate commitment to financial integrity and accountability. Finally, it recommends a concerted effort to inform donors about the importance of knowing the organizations they support. *"Robust and appropriate engagement by donors would likely have a very significant impact on the practices of 'outlier' organizations that would otherwise have little interest in self-regulation,"* the report states.

In an area of particular interest to many religious nonprofit organizations, the Commission addressed an issue not dealt with in Grassley's staff report: public disclosure by the IRS of highly sensitive information in an organization's Form 990 tax filing or Form 1023. There are many cases where such disclosure exposes people or organizations to considerable risk. The Commission recommends that the IRS modify these forms to permit the filing organization to identify sensitive information that should be redacted from public disclosure, and that Congress adopt legislation prohibiting public disclosure by the IRS of such information in Forms 1023 and 990. This issue affects organizations working in sensitive areas of the world or engaged in sensitive social outreach such as operating shelters for victims of domestic violence.

I personally believe that the value of the message in the report will manifest itself in a variety of ways, but that the greatest value will reveal itself in the future, when lawmakers and regulators consider their proper reaction to some new scandal in the religious or nonprofit sector. When such a development inevitably occurs, it will be reassuring to know that in December of 2012, leaders from across virtually all of America's major faith groups, the broader nonprofit sector, and legal experts collectively shared with Congress, the IRS, the Treasury Department, charitable and religious organizations, and the giving public their views on the relevant issues.

While the issuance of the Commission's first report is a significant milestone, our work is not yet finished. In the coming months, the Commission will address the increasingly controversial topic of political expression by religious and other nonprofit organizations. After appropriate deliberations, the Commission plans to issue a report on that topic later this year.

Michael Batts, Commission Chairman is the managing partner of Batts Morrison Wales & Lee, an independent member of the BDO Seidman Alliance. For more information, contact Mike at batts@nonprofitcpa.com.

OMB PROPOSES REVISIONS TO OMB CIRCULAR A-133

The Office of Management and Budget (OMB) has issued proposed guidance, titled "Proposed OMB Uniform Guidance: Cost Principles, Audit, and Administrative Requirements for Federal Awards," which proposes broad revisions to OMB Circular A-133 as well as the various cost circulars.

This is a continuation of the ongoing discussion that the OMB and federal agencies have been conducting regarding how the guidance can be reformed to increase the efficiency and effectiveness of the audit process. This proposed guidance is the culmination of this information gathering process that began in early 2012.

The following is a summary of some of the key areas of the proposed guidance:

- Single audit threshold proposed to increase from $500,000 to $750,000
- Revise the minimum threshold for Type A/B program determination from $300,000 to $500,000
- Change the criteria for Type A programs to qualify as high-risk
  - The proposed changes would require that a Type A program must have had the following in the most recent period to be considered high-risk:
    - Failed to receive an unqualified opinion
    - Had a material weakness in internal control
    - Had questioned costs exceeding 5 percent of the program's expenditures
- Reduce the number of high-risk Type B programs to be audited as major programs from at least one-half to at least one-fourth of the number of low-risk Type A programs
- Reduce the percentage of coverage from 50 percent (normal) and 25 percent (low-risk auditees) to 40 percent (normal) and 20 percent (low-risk auditees)
- Revise the criteria for determination of low-risk auditee status to more clearly include timely data collection form submission as a criteria and add a criteria that the auditor did not report a substantial doubt about the auditee's ability to continue as a going concern
- Reduce the number of compliance requirements to be tested from the current 14 types to six types
- Require increased detail be reported in auditor findings
- Increase the threshold for reporting questioned costs from $10,000 to $25,000
- Streamline 8 existing OMB Circulars into one document including OMB Circular A-133 and the various Cost Principles

You can access the proposed guidance on OMB's website at: http://www.whitehouse.gov/omb/grants_docs#proposed.

HOUSE WAYS AND MEANS HOLDS HEARING ON CHARITABLE DEDUCTION

By Laura Kalick, JD, LLM

ON FEB. 14, 2013, THE COMMITTEE ON WAYS AND MEANS HELD A HEARING TO EXAMINE THE ITEMIZED DEDUCTION FOR CHARITABLE CONTRIBUTIONS AS PART OF ITS WORK ON COMPREHENSIVE TAX REFORM.

There were six panels of witnesses from the private sector. The 40-plus witnesses included professionals who work with the charitable deduction, researchers, academics and representatives from charities and small business.

Other than a general reduction in the value of itemized deductions for individuals with adjusted gross income (AGI) above a certain level, the charitable deduction went untouched under the last tax bill. The purpose of the hearing was to have input from the charitable community before any legislation is proposed.

The charitable deduction is one of the 10 largest tax expenditures in the Internal Revenue Code. In past years various proposals have been introduced to modify the charitable deduction. Proposals to limit the deduction have included dollar caps, floors below which contributions may not be deducted, credits instead of deductions, etc. These various scenarios have been analyzed in the past in order to determine how much revenue could be raised by the proposals and what the impact would be on charities if a particular proposal were implemented. For example, a 2011 Congressional Budget Office study found that (based on 2006 Statistics of Income) if the current deduction available for just those who itemized deductions were replaced with a 15 percent nonrefundable credit for all taxpayers and a floor of 2 percent of AGI were imposed, charitable contributions would be reduced by $10 billion, (i.e., charities would lose this amount annually). The tax subsidy would be reduced by $11.9 billion, i.e., the federal government would gain this amount (states would gain also since most states "piggyback" their tax systems off the federal tax system). An example of the way this proposal would work: if an individual had AGI of $100,000 and gave a charity $2,000 there would be no tax benefit. On the other hand, if the individual gave $3,000, the individual would have a $150 credit against income taxes (15 percent of $1,000 ($3,000 minus the $2,000 floor).

Another issue that was raised at the hearing was whether gifts of property to charities should be revisited. Concerns in this area include valuation abuses and whether it is appropriate for a donor to be able to deduct the fair market value of a donated appreciated item since this is a double tax benefit, i.e., the donor avoids paying tax on the appreciation and receives a contribution deduction for the full fair value amount. For example, if a donor bought publicly traded stock in 2009 for $500 and the fair market value of the stock is now $5,000, the donor can give the stock to the charity, deduct $5,000 and not recognize any gain. The benefit of the non-recognition is even greater now than it was in 2012 since the tax rate on long-term capital gain was increased from 15 percent to 20 percent and there is an additional 3.8 percent tax on the gain for taxpayers who are at a certain income threshold.

The clear message from the charitable community was that charities depend on charitable giving and cannot do their jobs without the level of contributions they receive and that if they do not provide their needed services, the government will have to take on the burden or people and programs will suffer.

The charitable deduction is just one tax reform focus of Congress. In addition to changes to the charitable deduction it is possible that there could be changes to other aspects of tax laws affecting nonprofit organizations, for example, unrelated business income, and potential new requirements for exemption such as the ones now required for hospitals to qualify for 501(c)(3) status (i.e., new Internal Revenue Code section 501(r)). Also, Congress is looking at other tax benefits in order to determine whether the loss in revenue is justified in comparison to the benefits, whether tax incentives produce the

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OTHER ITEMS TO NOTE....

Draft OMB Compliance Supplement Released

OMB has provided the AICPA Governmental Audit Quality Center (GAQC) with a draft version of the *2013 OMB Circular A-133 Compliance Supplement* (the Supplement). The following is a summary of some of the more significant changes that appear in the draft Supplement.

Part 2, *Matrix of Compliance Requirements*
This has been modified for many programs to eliminate the applicability of certain compliance requirements. For many programs the compliance requirements related to "Equipment and Real Property," "Procurement and Suspension and Debarment," and "Program Income" were eliminated. These changes were made to ensure the auditor's attention is focused on the more significant compliance requirements.

Part 3, *Compliance Requirements*
The main proposed change in the draft for this section is the removal of the Federal Funding Accountability and Transparency Act (FFATA) testing requirements that were included in Compliance Requirement L, "Reporting." This deletion will also be seen in Part 4 from each specific program section.

Parts 4 and 5, *Agency Program Requirements* and *Clusters of Programs*
These have been modified to remove many of the American Recovery and Reinvestment Act of 2009 (ARRA) related programs since these have now been completed or there are limited amount of funds subject to audit.

Part 5, *Clusters of Programs*
The Student Financial Aid (SFA) cluster has been modified to remove the ARRA programs as well as to update various compliance requirements specific to SFA.

Appendix VII, *Other OMB Circular A-133 Advisories*
The list of ARRA programs not covered in Parts 4 or 5 of the Supplement, but potentially subject to an A-133 audit has been updated.

OMB has not provided a specific date or time frame for the issuance of the final 2013 Supplement. We will keep you posted and update you when they have released the final Supplement.

The IRS Current Exam Process

The IRS has added a webpage to its site that explains the current exam process for nonprofit organizations. Due to the government's resource limitations, the IRS will be making more contact via phone calls and reviews that are less than audits. These nonaudits are referred to as compliance checks. To view the new web page see http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Audit-Process.

The IRS Expands VCSP

The Voluntary Worker Classification Program (VCSP) is a voluntary program that provides an opportunity for taxpayers to reclassify their workers as employees for employment tax purposes for future tax periods with partial relief from federal employment taxes. The IRS is modifying several eligibility requirements of their VCSP, thus making it possible for more interested employers, especially larger ones, to apply for this program. Under the revamped program, employers under IRS audit, other than an employment tax audit, can qualify for the VCSP. Also, employers accepted into the program will no longer be subject to a special six-year statute of limitations, rather than the usual three years that normally applies to payroll taxes. For more information see Announcement 2012-45 at http://www.irs.gov/irb/2012-51_IRB/ar16.html.

Extension of Certain Tax Provisions

The American Taxpayer Relief Act of 2012 extended a modification of the tax treatment of payments to controlling exempt organizations to Jan. 1, 2014. It also extended provisions for the distribution to a charity by an Individual Retirement Account (IRA), and the contribution of conservation easements and food inventory.

Nonprofit Media Working Group

A group of tax and journalism experts supported by funding from the Knight Foundation have recently reported on issues facing nonprofit media organizations. The Council on Foundations and the Knight Foundation released the report in Washington, D.C., in conjunction with a panel discussion that featured journalism, legal and nonprofit leaders. Details of the report and panel discussion can be found at http://www.cof.org/templates/5.cfm?ItemNumber=18708.

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CHARITABLE DEDUCTION

intended results and whether new incentives are needed. Congress has established working groups that will receive input from stakeholders, advocacy groups and the public about current tax rules and how they should be reformed. The Joint Committee on Taxation will provide summarized comments along with the present state of the law as a resource for Congress. Comments can be submitted via email to tax.reform@mail.house.gov and will be posted on the Ways and Means website: www.waysandmeans.house.gov. Some of the other areas the working groups cover include Energy, International, Manufacturing, Pensions/Retirement and Real Estate and Small Business.

We will keep you informed as the debate continues.

The written testimony of the hearing is available at:

http://waysandmeans.house.gov/calendar/eventsingle.aspx?EventID=319000

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

BDO PROFESSIONALS IN THE NEWS

BDO professionals 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 professionals speaking. In addition to these external venues, BDO will be offering both live and local seminars, as well as webinars on such topics as nonprofit tax and accounting updates, international accounting and business issues, executive compensation and charitable solicitation registration. Currently there is a nonprofit tax update webinar planned for April 18 from 1 to 3 p.m. ET. There is also a webinar entitled "Performing an Executive Review of Your Form 990" planned for May 1 from 1 to 2 p.m. ET. Please check BDO's website at www.bdo.com for these events as well as other upcoming local events and webinars.

APRIL

David Trimner will be conducting a session entitled "Unrelated Business Income" at the Virginia Society of CPAs' Nonprofit Conference on Apr. 23 in Fairfax, Va.

Mike Sorrells will be presenting a course entitled "Non-Profit Tax Update – What the IRS Is Up To" at the Maryland Association of CPAs' Government and Not-for-Profit Conference on Apr. 26 in College Park, Md.

MAY

Adam Cole and **Mike Conover** will present "Effective Compensation in Not-for-Profits - Risky Business?" for the Financial Manager Association on May 1 in Cooperstown, N.Y.

Laura Kalick will be presenting a session entitled "IRS Initiatives – What's Going on in Washington?" at the Georgia Society of CPAs' 2013 Nonprofit Conference on May 17 in Atlanta, Ga.

David will be presenting two separate sessions at the Texas Society of CPAs' Non-Profit Organizations Conference being held in Dallas, Tx. He will present "Advertising and Sponsorships" on May 20 and "Advanced Topics in Unrelated Business Income" on May 21.

Mike will be presenting his session "Non-Profit Tax Update – What the IRS Is Up To" at the BDO San Antonio Nonprofit Conference in San Antonio, Texas, on May 21.

Dick Larkin will also be presenting a session entitled "Non-Profit Accounting and Auditing Update" at the BDO San Antonio Nonprofit Conference on May 21.

Tammy Ricciardella will be presenting a half-day seminar with Andrew Lang entitled "Financial Management for Association Executives and Board Members" on May 23, offered through the Greater Washington Society of CPAs Educational Foundation in Alexandria, Va.

JUNE

Dick will be presenting a session entitled "Advanced Audit & Accounting Issues for Not-for-Profit Organizations" for the Illinois Society of CPAs at its 2013 Not-for-Profit Complex and Emerging Accounting and A-133 Issues Conference in Springfield, Ill., on June 11, and in Chicago, Ill. on June 12.

A number of BDO professionals will be speaking at the 2013 American Institute of CPAs' Not-for-Profit Conference being held June 19 through June 21 in Washington, D.C. The following is a summary of the professionals speaking and the sessions they will be presenting:

- **David** is conducting a session entitled "Technical Writing."
- **Jeff Schragg** will be one of the panelists moderating the Ask the Experts Panel: Form 990.
- **Jeremy Migliara** will be conducting a session entitled "State and Local Tax Considerations for Nonprofit Organizations."
- **Laurie Arena Rocha** and **Rebekuh Eley** are conducting a session entitled "Board Governance – One Size Does Not Fit All."
- **Lee Klumpp**, (BDO professional currently serving a two-year Fellowship at the Financial Accounting Standards Board (FASB)), is one of the presenters for the session entitled "FASB NAC and Financial Reporting Projects."

Tammy will be one of the nonprofit speakers presenting with Andrew Lang at a two-day course entitled "Focus on Finance: Optimizing the Financial Team" offered through the American Society of Association Executives on June 27 and 28 in Washington, D.C.

INSTITUTE PERSONNEL CONTACTS:

WILLIAM EISIG
Director of Nonprofit & Education Practice/National Director, BDO Institute for Nonprofit Excellence℠
301-634-4923 / weisig@bdo.com

KAREN FITZSIMMONS
Assurance Partner, Greater Washington, D.C.
301-634-4969 / kfitzsimmons@bdo.com

DICK LARKIN
Director, BDO Institute for Nonprofit Excellence℠
301-634-4931 / dlarkin@bdo.com

LAURA KALICK
National Director, Nonprofit Tax Consulting/BDO Institute for Nonprofit Excellence℠
301-634-4950 / lkalick@bdo.com

TAMMY RICCIARDELLA
Director, BDO Institute for Nonprofit Excellence℠
301-634-0234 / tricciardella@bdo.com

MIKE SORRELLS
National Director of Nonprofit Tax Services/Tax Director, BDO Institute for Nonprofit Excellence℠
301-634-4997 / msorrells@bdo.com

JOYCE UNDERWOOD
Director, Nonprofit Tax Services/Tax Director, BDO Institute for Nonprofit Excellence℠
301-634-4916 / junderwood@bdo.com

REGIONAL CONTACTS:

HOWARD BLUMSTEIN
Assurance Partner, Chicago
312-616-4635 / hblumstein@bdo.com

ALFREDO CEPERO
Assurance Partner, Miami
305-420-8006 / acepero@bdo.com

ADAM COLE
Assurance Partner, New York
212-885-8327 / acole@bdo.com

CARLA FREEMAN
Assurance Partner, Los Angeles
310-557-8247 / cfreeman@bdo.com

EDWARD GUERRA
Assurance Partner, San Antonio
210-308-7905 / eguerra@bdo.com

LAURIE ARENA ROCHA
Assurance Partner, Greater Washington, D.C.
301-634-4976 / lrocha@bdo.com

BDO NONPROFIT & EDUCATION PRACTICE

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℠ (the Institute) has the skills and knowledge to provide high quality services and address 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.

ABOUT BDO USA

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