

THE NEWSLETTER OF THE BDO NONPROFIT &amp; EDUCATION PRACTICE

# NONPROFIT **STANDARD**



## THE OVERHEAD MYTH: A LONG-TERM CHALLENGE & OPPORTUNITY FOR NONPROFITS

By **Matt Cromwell, CPA** and **Sofia Blair, CPA**

In January we attended the BDO, UBS and Wells Fargo jointly sponsored event, "Summit to End the Overhead Myth," in New York City. Led by steering committee members Steve Barker (World Resources Institute), Tom Dente (InsideNGO), Sarah Gillman (Natural Resources Defense Council), Steve Howell (Nature Conservancy), Bob Mims (Ducks Unlimited), Arun Sardana (UBS), Tom McCauley (Wells Fargo) and our own Adam Cole, New York Assurance partner in the Nonprofit & Education and Healthcare groups, the event aimed to assess the way forward for organizations to measure impact by results, not administrative overhead. Key participants also included Ken Berger of Charity Navigator and Jacob Harold of Guidestar, two of the

charity rating organizations leading the charge to overhaul their rating systems.

The event's premise was not so much to solve the problem immediately; rather, it sought common ground across stakeholders, donors, non-governmental organizations, rating organizations and nonprofit staff alike on the scope of the challenges associated with moving charity effectiveness assessments away from the imperfect overhead metric. The general consensus was that the status quo of competing to have the lowest overhead ratio had become a death spiral for organizations, that it was not a sustainable system and that all interested parties needed to participate in making the change.

### CONTENTS

The Overhead Myth: A Long-Term Challenge & Opportunity for Nonprofits .....	1
Institute Professional Profile .....	2
BDO Supercircular Preparedness Series: Subrecipient Monitoring .....	3
IRS Provides Streamlined Procedures for Reinstatement of Tax-Exempt Status .....	4
Hot Topics in Higher Education .....	5
Draft Tax Reform Act of 2014 Proposed Profound Impact on Tax-Exempt Organizations .....	6
Small Nonprofit Employers May be Eligible for a Refundable Healthcare Tax Credit .....	7
Executive Pay in Nonprofits – No Longer "Exempt?" ..	8
BDO Professionals in the News .....	9
FASB Outlook – How Recent Decisions by the FASB Board to Reset its Agenda Might Impact Nonprofits ..	10
Challenges and Opportunities for Nonprofits in 2014 .....	11
New York Nonprofit Revitalization Act Signed into Law, with technical corrections expected .....	12
Exempt Organizations – Passive Activity Income (Loss) Reporting .....	13
Update to 2013-2014 IRS Priority Guidance Plan .....	14
Conflicts of Interest in Nonprofit Organizations .....	16
NONPROFIT FACTS: Did you know .....	18
BDO Launches BDOKNOWLEDGE Nonprofit & Education Seminar Series .....	18

### CONTACT:

**WILLIAM EISIG, CPA**  
 National Director of Nonprofit & Education Practice/National Director, BDO Institute for Nonprofit Excellence<sup>SM</sup>  
 Greater Washington, D.C.  
 301-634-4923 / [weisig@bdo.com](mailto:weisig@bdo.com)  
[www.bdo.com](http://www.bdo.com)  
<http://nonprofitblog.bdo.com>

►CONTINUED FROM PAGE 1

## THE OVERHEAD MYTH

Speaking panels and roundtable discussions addressed the major principles underlying a way forward, including what the 'Overhead Myth' actually means for organizations, how organizations can invest in outcomes, and what kind of data already exists for developing a new reporting system. Additional discussion topics revolved around how to educate donors about realistic overhead needs, how to persuade boards of directors about the importance of understanding robust administration, not as an excess cost, but as a necessary component for achieving results, and how to develop enhanced outcome metrics.

But the conversation is far from over. The steering committee is now compiling discussion points for future dissemination, and additional events to be held in Washington, D.C., and on the West Coast are currently in the planning stages.

The timeliness of this event and the enthusiastic engagement of attendees suggest that this issue is not going away anytime soon. The nonprofit sector is firmly invested in changing the way it portrays its impact to donors and other stakeholders, and it's ready to tackle the challenge of persuading the public to think differently about what constitutes organizational success.

*Article reprinted from the Nonprofit Standard blog.*

**For more information, contact Matt Cromwell, partner, at [mcromwell@bdo.com](mailto:mcromwell@bdo.com) or Sofia Blair, partner, at [sblair@bdo.com](mailto:sblair@bdo.com).**

## INSTITUTE PROFESSIONAL PROFILE

### R. MATTHEW CROMWELL



Matt is an Assurance partner in the Northeast Nonprofit and Education practice in the Bethesda office of BDO USA, LLP. He brings extensive knowledge and experience of the nonprofit industry to each engagement as a result of his 20 years of accounting and audit experience. Matt works with a wide range of nonprofit organizations and has extensive experience working with organizations with international operations. He has visited over 20 international locations throughout Central and South America, Asia and Africa for various clients.

Matt's experience also includes oversight of audits conducted in accordance with Office of Management and Budget (OMB) Circular A-133. He has experience with a wide range of federal agencies and has worked with many organizations with international funding and multisource reporting requirements. He also has experience with program specific compliance audits and agreed-upon procedures engagements.

Matt speaks regularly at internal and external seminars on topics including nonprofit audits, single audit and compliance audits, as well as governance best practices. He is currently a member of the American Institute of Certified Public Accountants, the Virginia Society of Certified Public Accountants and the Greater Washington Society of Certified Public Accountants. He also serves as a financial expert to the audit committee of a national charity. Matt received his B.S. in Accounting from George Mason University.

# BDO SUPERCIRCULAR PREPAREDNESS SERIES: SUBRECIPIENT MONITORING

By Eric Sobota

The federal government places many requirements on the entities that seek to receive government funding, whether through grants or by contract. On Dec. 26, 2013, the Office of Management and Budget (OMB) effectively consolidated and streamlined these administrative requirements for not-for-profit entities into what has been referred to as the "Supercircular" (See winter 2013 *Nonprofit Standard* for Mr. Sobota's article on the Supercircular and the [BDO Knows Government Contracting Alert](#) issued in January 2014 for more information on the Supercircular). One of the most significant changes and most widely commented upon during the rulemaking process was the more stringent requirements for subrecipient monitoring. These new requirements create a significant administrative burden for organizations to overcome. Given the timeframe for implementation, i.e., Dec. 24, 2014, organizations need to not only understand these new requirements, but develop and implement processes to achieve compliance while ensuring any additional costs are recoverable.

## ► DETERMINING SUBRECIPIENT VERSUS CONTRACTOR

As a starting point, it is necessary to understand the difference between a subrecipient and a contractor or what had historically been referred to as a vendor. The nuances between these terms are important and lead to stark differences in the way these services are procured and monitored. Pursuant to §200.330-332 of the Supercircular, a subrecipient "uses the federal funds to carry out a program for a public purpose specified in authorizing statute." Simply stated, the subrecipient will carry out a portion of the federal award. A contractor "provid[es] goods or services for the non-federal entity's [NFE] own use." These services are generally ancillary in nature and support the programs or organizations in a general manner, i.e., security services.



This determination can be ambiguous at times, and many not-for-profits have been in situations whereby this determination is challenged by an agency auditor, mostly for contractors which the federal agency believes are subrecipients. From a regulatory perspective, the financial risk associated with these two procurement methods is mitigated in very different ways. For subrecipients, the cost associated with performance is monitored post award by the NFE. For contractors, cost risk is mitigated through pre-award procurement methods including full and open competition.

A key concept for organizations dealing with these two procurement methods will be fully documenting this decision, especially if something is deemed a contractor rather than a subrecipient, within the procurement records.

## ► SUBRECIPIENT SELECTION AND PLANNING

As the financial and performance risks are mitigated throughout the life of the subaward, it is critical that processes exist to ensure these agreements are structured appropriately to allow for adequate monitoring during the performance period. During the negotiation process, NFEs must ensure that these agreements flow down all requirements imposed by the awarding agency to the

subrecipient. In addition, special terms and conditions should be incorporated into the agreement to allow the NFE the ability to monitor the activities of the subrecipient. These include the ability to accomplish the following monitoring functions:

- Adequate review of financial and programmatic reports
- Appropriate audit rights
- Onsite reviews of the program's operations
- Appropriate training of staff
- Timely action is taken to correct noted deficiencies

In addition, the NFE must negotiate an indirect cost rate for the subrecipient or allow for the de minimis rate of 10 percent. One additional twist to the new requirements is the ability to use fixed amount subawards. So long as the total award value does not exceed the Simplified Acquisition Threshold, i.e., \$150,000, and the NFE receives prior approval from the federal agency, then this may be one way to minimize the administrative burden of subrecipient monitoring.

## ► STRATEGIES FOR MONITORING SUBRECIPIENTS

For some organizations these new guidelines may require a significant increase in current monitoring requirements. Planning the right



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## SUBRECIPIENT MONITORING

strategy to accomplish these requirements is the key to success. Again, the monitoring activities broadly include onsite reviews of operations, review of financial and program reports, appropriate training of staff and a process to ensure timely resolution of deficiencies uncovered during audit. Organizations will need to choose one of two approaches. The first option is to accomplish these activities internally and refine existing processes to incorporate the additional requirements. Internal audit or program management would be options for these functions.

Organizations can also outsource these functions to external firms so long as these engagements are conducted in accordance with generally accepted government auditing standards (GAGAS), paid for by the NFE, and focused on determining whether the activities and costs are allowable or unallowable, and whether the entity is eligible for awards and maintains adequate reporting.

## ►COST RECOVERY STRATEGIES

Given the increase in requirements and the limited recovery afforded through an indirect rate using a Modified Total Direct Cost (MTDC) base (i.e., only the first \$25,000 of subrecipient costs receive an indirect cost allocation), the new guidance allows not only the outsourcing of these new subrecipient monitoring functions, but the recovery of these costs **directly** to awards. Organizations that may benefit from outsourcing this function should determine the mechanics and best way to allocate the cost to awards in the short-term to ensure such costs are included in their bids on upcoming proposals. Otherwise, these may not be part of the budget or allowed as direct costs going forward.

Properly planning now can ensure successful implementation of controls and/or processes to accomplish these broad monitoring requirements. BDO has counseled many clients on strategically preparing for these new requirements.

For more information, contact Eric Sobota, managing director with BDO's Government Contracting practice, at [esobota@bdo.com](mailto:esobota@bdo.com).

## IRS PROVIDES STREAMLINED PROCEDURES FOR REINSTATEMENT OF TAX-EXEMPT STATUS

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

**U**nder the Pension Protection Act of 2006 the tax-exempt status of an organization is automatically revoked if it fails to file the required annual return Form 990 (or Form 990-EZ or notice Form 990-N) for three consecutive years. Hundreds of thousands of organizations had their tax exemptions revoked as a result of this requirement. Many of these were smaller organizations (other than religious organizations not required to file Form 990 series) that were not aware of their new filing requirements.

On Jan. 2, 2014 the Internal Revenue Service (IRS) issued [Revenue Procedure 2014-11](#) which modifies and supersedes its earlier notices to provide procedures for retroactively reinstating the tax-exempt status of organizations that had their status automatically revoked for failure to file the annual returns or notices for three consecutive years.

This new guidance should provide welcome relief for smaller nonprofits as it clarifies and streamlines the process for an organization to have its tax-exempt status reinstated on a retroactive basis. With a retroactive reinstatement, there is no gap in the organization's tax-exempt status and there would be no need to file tax returns as a taxable organization for the period between revocation and reinstatement.

"Small" nonprofit organizations (those eligible to file Form 990-EZ or Notice 990-N) may apply for retroactive reinstatement by filing a new application for exemption (Form 1023 or Form 1024 for organizations other than those exempt under Internal Revenue Code Section 501(c)(3)), along with Forms 990-EZ for those past years in which it was required, but failed to file timely. The "Streamlined Retroactive Reinstatement Process" requires that the new application for exemption be submitted not more than 15 months after the organization's revocation of its exempt status.

If the nonprofit was eligible to file Form 990-N for any or all of the missed years, those

delinquent filings do not have to be made. In addition, reasonable cause for failing to file the delinquent tax returns will now be assumed, and does not need to be demonstrated. Also, late filing penalties for the prior year Form 990-EZs will be abated. These are significant changes that will benefit the "small" nonprofits.

Organizations not eligible for this streamlined process (because they were not eligible to file Form 990-EZ or Notice 990-N) may apply for retroactive reinstatement but are required to demonstrate reasonable cause for the earlier non-filing. If the application is submitted within 15 months of revocation, reasonable cause is required to be shown for at least one of the three consecutive years in which the organization failed to file. If the application is submitted more than 15 months after revocation, reasonable cause must be shown for all three consecutive years in which the failure occurred. Reasonable cause for late filing would require the organization to show that it exercised "ordinary business care and prudence" in determining, and attempting to comply with, its reporting requirements.

The [user fee must be included with the application](#) filed with the IRS. Applicants wishing to take advantage of this streamlined process should consult [Revenue Procedure 2014-11](#) which provides additional details including a special IRS mailing address and instructions to reference on top of the application (e.g., "Revenue Procedure 2014-11, Streamlined Retroactive Reinstatement").

Organizations that cannot qualify for retroactive reinstatement of exempt status under any of the procedures described above may apply for reinstatement of its tax-exempt status effective from the date on which the organization files its new application for exemption.

For more information, contact Paul Hammerschmidt, director, at [phammerschmidt@bdo.com](mailto:phammerschmidt@bdo.com).

# HOT TOPICS IN HIGHER EDUCATION

By Tom Gorman, CPA

**DURING THE AUDIT TEAM'S REGULAR MEETINGS WITH AUDIT COMMITTEES AND BOARDS OF TRUSTEES, A FEW COMMON QUESTIONS AND TOPICS FREQUENTLY ENTER THE CONVERSATION. I THOUGHT IT WOULD BE INSIGHTFUL TO SHARE A FEW OF THE MORE COMMON DISCUSSION POINTS THAT ARISE.**

## ►INTEGRITY OF NON-FINANCIAL REPORTS

Over the past several years, there has been increased scrutiny of the myriad of non-financial reports that colleges and universities are either required to or choose to submit to third parties. These reports may be mandated, such as the Clery Act reports which require schools to publish campus crime statistics, and others are voluntary. While the financial statement audit and the role of external auditors are well defined, the oversight of the preparation and submission of these other reports has been highly variable.

Recent headlines have included:

- schools failing to submit accurate campus crime statistics
- schools submitting false, incomplete or partial information to nationally recognized ranking agencies
- schools falsifying employment and job placement rates

All these undermine the credibility of the entire institution and damage one of their most important assets – their reputation. The recently proposed federal scorecard reporting requirements, which were highlighted in the fall 2013 *Nonprofit Standard*, would raise the bar on non-financial reporting.

Boards and audit committees have been asking about ways to implement controls over these processes. Parallels can be drawn to the same controls over financial reporting: proper segregation of duties; adequate review and approval of submissions; and testing the completeness of the information. In some instances, audit committees are asking auditors to perform agreed-upon procedures over these reports.

## ►ENROLLMENT TRENDS

Boards are increasingly keeping a watchful eye on enrollment trends. In the Northeast, we have seen this trend for the past several years. Anecdotally, it is starting to appear in other parts of the country as well. For top-tier institutions, demand is likely to continue to outpace supply and they will have the luxury of filling their classes according to their model of choice. But the vast majority of schools are vying for the same (shrinking) pool of students.

Boards are now asking more questions about student recruitment strategies. Too often the news hits them when the entering class misses the budgeted headcount. Or perhaps when the discount rate rises and the resultant net tuition does not keep pace with expenses. Either scenario is too late and results in knee-jerk reactions.

## ►SUFFICIENCY OF RESERVES

For most colleges and universities, endowments have recovered from the depths of the great recession. With most schools using a 12-quarter trailing average for their payout, the past three years' performance has resulted in endowment support returning to historical levels.

Now attention is turning to the sufficiency of reserves. There has been endless debate over the best yardstick to gauge sufficiency of reserves. Whether it is the ratio analysis approach, benchmarking to peers or divining the methods used by credit rating agencies, there seems to be an eternal struggle between constituents that want to spend all available resources and those that want to enhance the

intergenerational use of net assets for the next generation of students.

Reserves are sometimes referred to as "rainy day funds." In the governmental sector, some states have enacted laws to mandate the level of these rainy day funds. In this light, reserves are viewed as resources to soften the blow from unexpected events. I prefer to view reserves as resources that provide the institution with the ability to react and adapt to events that change the landscape. Adequate reserves allow schools the ability to transform themselves to meet new challenges or take advantage of emerging markets. Therefore, the answer to the question as to adequacy of reserves is: "it depends." The adequacy depends on the stage in the lifecycle of the school's programs, the school's competitive landscape, and the relationship of the reserves to the school's overall financial condition.

## ►TO BUILD OR NOT TO BUILD

Colleges and universities seem to be in an arms race to build the best dorms, student center or athletic facility in the quest to outshine the rest. This boom has been fueled by improving credit ratings, leading to greater borrowing capacity, and the wealth effect as donors fund legacy projects across the country.

Some boards are feeling pressure to upgrade facilities simply to maintain their competitive advantage. But building for the sake of building misses the mark. As noted in my article on strategic planning ([spring 2013 \*Nonprofit Standard\*](#)), aligning these decisions to strategic plans and mission may help institutions avoid costly mistakes. We have seen all too often new construction that goes underutilized or puts so much new debt and operating costs on the financial statements that schools lack the flexibility to respond to other challenges.

For more information, contact Tom Gorman, director, at [tgorman@bdo.com](mailto:tgorman@bdo.com).

# DRAFT TAX REFORM ACT OF 2014 PROPOSED PROFOUND IMPACT ON TAX-EXEMPT ORGANIZATIONS

By Laura Kalick, JD, LLM

On Feb. 26, 2014, the House Ways and Means Committee Chairman Dave Camp (R-Mich.) released draft legislation called the “[Tax Reform Act of 2014](#)” (Draft Legislation). Over the past three years Congress has held more than 30 hearings in the process of developing this proposal. Also, Chairman Camp and Ranking Member Sander Levin (D-Mich.) formed 11 separate bipartisan Tax Reform Working Groups to focus on specific issues that included tax-exempt organizations and charitable giving.

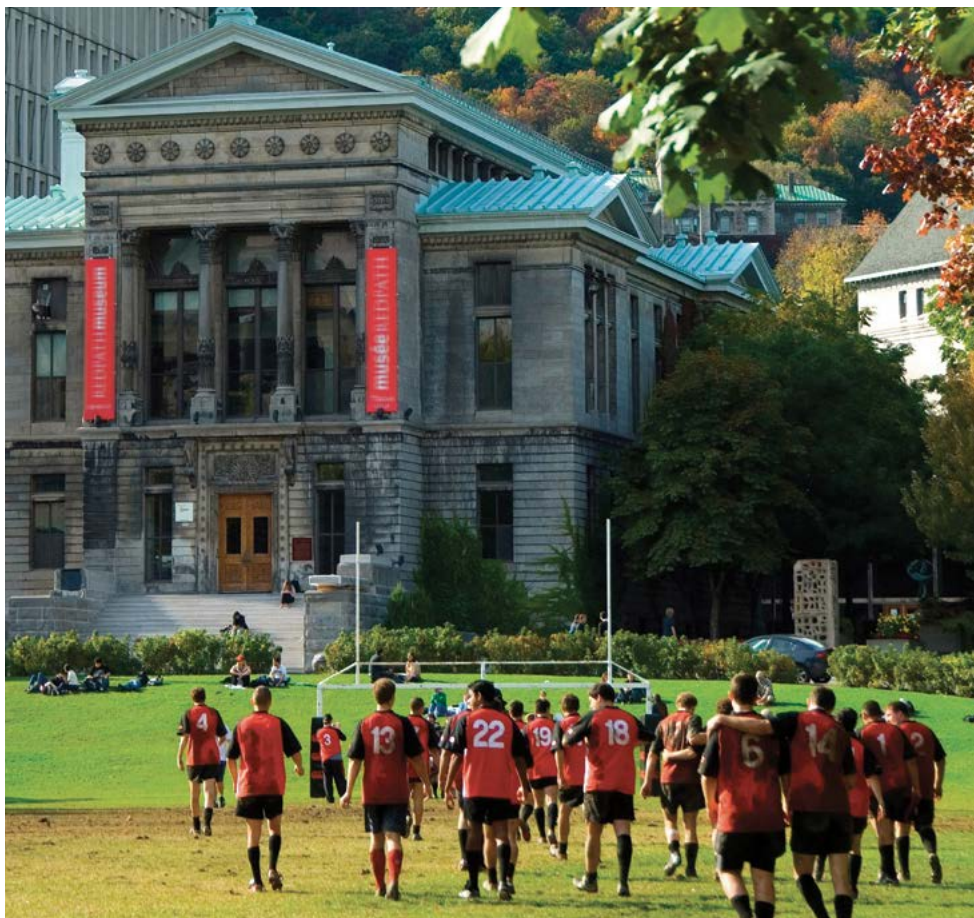
While the Draft Legislation's many provisions will be debated throughout the year ahead, and it's doubtful that it will even be voted on in 2014, it's crucial that tax-exempt organizations and charities stay on top of the process and understand the possible ramifications of the Draft Legislation's many provisions.

Some of the most significant highlights of the Draft Legislation include:

- Repealing the tax exemption for professional sports leagues
- Imposing a 2 percent Adjusted Gross Income (AGI) floor on deductible *charitable contributions*
- Imposing a 25 percent excise tax on *compensation* paid over \$1 million by exempt organizations to their five highest paid employees
- Expanding the reach of Intermediate Sanctions
- Tightening the rules on the unrelated trade or business income tax (UBIT)
- New and increased penalties related to return preparation
- Eliminating future tax-exempt private activity bonds

Some other provisions aimed specifically at *colleges and universities* are:

- Repealing *the rule that* provides a charitable deduction of 80 percent of the amount paid



for the right to *purchase tickets for college athletic events*.

- Imposing an excise tax based on investment income of private colleges and universities. This would be similar to a rule that taxes the investment income of private foundations. Under the provision, private colleges and universities would be subject to a 1 percent excise tax on net investment income. The provision would only apply to schools with investment assets valued at the close of the preceding tax year of at least \$100,000 per full-time student.
- Some of the proposed UBIT provisions appear to be aimed specifically at colleges and universities.

## ►UBIT PROVISIONS

Both Congress and the Internal Revenue Service (IRS) have been concerned about unrelated business income, especially after the “College and University Compliance Program Final Report” indicated that underreporting of Unrelated Business Taxable Income (UBTI) resulted in an increase in UBTI for the schools totaling approximately \$90 million in the aggregate and disallowance of more than \$170 million in losses and net operating losses (NOLs). The Draft Legislation proposes the following:

Unrelated business taxable income of each activity would be computed separately and the loss from one unrelated business activity could not be used to offset the income from



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## DRAFT TAX REFORM ACT

another unrelated trade or business activity. Any unused loss would be subject to the general rules for net operating losses – i.e., such losses may be carried back two years and carried forward 20 years. The provision would generally be effective for tax years beginning after 2014. However, NOLs generated prior to 2015 could be carried forward to offset income from any unrelated trade or business, but NOLs generated after 2014 could only be carried back to offset income with respect to the unrelated trade or business from which the net operating loss arose.

Other UBIT provisions in the Draft Legislation include:

- Royalty income for the use of names and logos would be impacted. Under this provision, any sale or licensing by a tax-exempt organization of its name or logo (including any related trademark or copyright) would be treated as a *per se* unrelated trade or business, and royalties paid with respect to such licenses would be subject to UBIT. Many institutions that have affinity credit cards or license their name for apparel could be impacted.
- A change in the rules for Qualified Sponsorship Payments whereby mention of a sponsor's product lines would turn a mere acknowledgement that is not taxed into advertising income that would be taxed.
- A limit of the exclusion for fundamental research unless results are freely available to the general public.
- Impose a penalty on organization managers such as officers, directors or responsible employees, for the substantial understatement of unrelated business income tax.

## ►INTERMEDIATE SANCTIONS

Under current law if a 501(c)(3) public charity or a 501(c)(4) organization pays excessive compensation (more than fair market value) to an individual who can substantially influence the organization, i.e., a Disqualified Person (DP), the DP is subject to a 25 percent excise tax. If the excess benefit is not corrected, a 200 percent tax is imposed on the individual. If the DP tax is imposed, a manager who

knowingly participated in the transaction is subject to a 10 percent excise tax. A manager may avoid the excise tax if the manager relies on advice provided by an appropriate professional. An organization can establish the rebuttable presumption of reasonableness that shifts the burden to the IRS to prove that the compensation is not reasonable.

The Draft Legislation proposes some significant changes to the Intermediate Sanctions rules:

- Intermediate Sanctions would also apply to Internal Revenue Code (IRC) 501(c)(5) unions and 501(c)(6) chambers of commerce and trade associations.
- A 10 percent tax would be imposed on the tax-exempt organization when the excess-benefit excise tax is imposed on a DP.
- Managers could not rely on the professional advice safe harbor.
- The rebuttable presumption would be eliminated.
- The provision would expand the definition of disqualified persons to include *athletic coaches and investment advisors*.

The Joint Committee on Taxation has "scored" the provisions indicating whether the provision would raise money (and how much) or lose money, or whether it is revenue neutral. There are various provisions that impose greater penalties for not properly reporting and disclosing returns, applications for exemption or transactions; for example, changes to private foundation rules, and the reduction of the excise tax on the net investment income of private foundations to a uniform 1 percent.

## ►CONCLUSION

It is very early in the process and we have no way to predict whether any of these provisions will become law. However it would be worthwhile for all tax-exempt organizations to take a look at the provisions to see what the impact could be.

For more information, contact Laura Kalick, national director, Nonprofit Tax Consulting, at [lkalick@bdo.com](mailto:lkalick@bdo.com).

## SMALL NONPROFIT EMPLOYERS MAY BE ELIGIBLE FOR A REFUNDABLE HEALTHCARE TAX CREDIT

By Laura Kalick, JD, LLM

If you offer health insurance to your employees and there are fewer than 25 full-time equivalents (FTEs), your organization may be eligible for a tax credit. Additional criteria include *average* wages of not greater than \$50,000. To figure average annual wages you divide total wages by the number of FTEs. The IRS Taxpayer Advocate has a page on its website that outlines the additional criteria for claiming the refundable credit, examples of the monetary benefits and a calculator so that you can estimate the benefit to your organization.

The credit is claimed by filing Form 990-T even if the organization does not usually file this form.

The credit was enacted into law in 2010. If an organization was eligible and missed the opportunity to claim the credit, an amended return can be filed to make the claim for a tax year that is open.

In general, the credit (that cannot be greater than payroll taxes paid) is equal to 25 percent of healthcare premiums paid. For tax years 2014 and beyond the credit is increased to 35 percent.

For more information and calculations as to how this can benefit your organization, click on this link:

<http://www.taxpayeradvocate.irs.gov/calculator/SBHCTC.htm>

For more information, contact Joan Vines, senior director, Specialized Tax Services – Global Employer Services, at [jvines@bdo.com](mailto:jvines@bdo.com).

# EXECUTIVE PAY IN NONPROFITS – NO LONGER “EXEMPT?”

By Mike Conover



I was wondering about a topic for this edition of the *Nonprofit Standard* – truthfully, in a bit of a panic for a good idea until I received a late Valentine's Day present and much-needed inspiration from a document released by the House Ways & Means Committee.

In late February, the Joint Committee on Taxation released a proposal for the “[Tax Reform Act of 2014](#).” The document, “A Discussion Draft of the Chairman of The House Committee on Ways and Means to Reform The Internal Revenue Code: Title V – Tax Exempt Entities,” details some significant changes impacting executive compensation for exempt organizations. (See Laura Kalick's article summarizing other proposed changes on page 6.) While many believe it highly unlikely that any significant tax reform will occur during the mid-term elections of 2014, I believe it is useful and instructive as a look into the future and quite possibly the shape of things to come.

Regular readers of our *Nonprofit Standard* are aware that problematic compensation practices among a few tax-exempt organizations provide a regular supply of great, bad examples that anger the public about executive pay. In addition, the Internal Revenue Service (IRS) has conducted several compliance studies among various types of tax-exempt organizations in recent years that always include an examination of compensation practices and invariably find

things that are not being done properly. Changes proposed in the “Tax Reform Act of 2014” are clearly targeted at these troublesome areas as well as a few that completely surprised me.

I believe the proposed changes are intended to send a strong signal to tax-exempt organizations that they are no longer going to be “exempt” from the public's outcry that something be done about high levels of executive pay. Several types of organizations, some positions and pay governance practices may undergo significant changes, if these proposals are adopted in the future.

Highlights of the proposed changes related to the issue of compensation include the following:

- Extends application of the section 4958 Intermediate Sanctions rules to tax-exempt organizations described in sections 501(c)(5) (labor and certain other organizations) and 501(c)(6) (business leagues and certain other organizations).

This change would bring the prospect of IRS enforcement for excess benefit transactions to groups of organizations heretofore outside the ‘charitable’ 501(c)(3)/(c)(4) entities now covered by Internal Revenue Code (IRC) 4958. These organizations which have a more “business”/non-charitable nature have long been believed by many

to not be as closely scrutinized or held to the same standards of propriety as their “charitable” counterparts. Clearly, this change would subject these organizations to the same/more rigorous standards of compensation conduct and, for some, undoubtedly create some completely new considerations for setting pay.

- Modifies the definition of a disqualified person for purposes of the Intermediate Sanctions rules:
  - Athletic coaches would become a disqualified person.
  - Investment advisors to donor advised funds would become disqualified persons in all organizations subject to the Intermediate Sanctions.

This change would bring two positions frequently cited for very high levels of compensation into the purview of the Intermediate Sanctions. Often treated as being paid “whatever the market required,” these positions would now need to be properly governed and administered from a compensation standpoint to avoid what could be substantial penalties for all concerned if excess benefits were determined to have been provided.

- Eliminates the rebuttable presumption of reasonableness in the Intermediate Sanctions regulations.

Surprisingly, this change would put all organizations covered by the Intermediate Sanctions on notice that they are no longer entitled to the ‘benefit of the doubt’ for adherence to IRS guidelines for managing the compensation of Disqualified Persons. Regardless of the steps taken, the data relied upon or the professionals involved (see below), an excess benefit is an excess benefit and will be pursued accordingly.

- Removes the relief offered from Intermediate Sanctions excise taxes offered to an organization manager's “not



## 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 listen to BDO professionals. In addition to these external venues, BDO offers both live and local seminars, as well as webinars, on such topics as nonprofit tax and accounting updates, international accounting and business issues, and charitable solicitation registration. Please check BDO's website at [www.bdo.com](http://www.bdo.com) for upcoming local events and webinars.

### APRIL

**Lee Klumpp** is presenting two sessions at the Virginia Society of CPA's 2014 Nonprofit Conference on April 22 in Fairfax, Va. One session is entitled "FASB Nonprofit Financial Statement Project" and the other session is entitled "FASB Update."

**Mike Sorrells** is presenting a session on April 25 entitled "Nonprofit Tax Red Flags" at the Maryland Society of CPA's 2014 Government and Not-For-Profit Conference in College Park, Md.

### MAY

**Tom Gorman** is presenting the topic "Employee Benefit Plan Fiduciary Update" at a BDO event being cohosted with Roper-Gray

and SageView Advisors in Boston, MA on May 13.

**Sandra Feinsmith** is speaking at the Georgia Society of CPA's Annual Nonprofit Conference on May 20 on the topic of advertising, sponsorship income and social media, and the potential impact on unrelated business income in Atlanta, Ga.

**Klumpp** will be presenting his session entitled "FASB Nonprofit Financial Statement Project" on May 20 and May 21 in Los Angeles, Calif., and San Francisco, Calif., respectively, for the California CPA Society.

**Sorrells, Laura Kalick** and **Feinsmith** are presenting the topic "Unrelated Business Income: IRS Focus on Expenses, NOL's, Advertising, Social Media and More" at the American Society of Association Executives' 2014 Finance, HR and Business Operations conference in Washington, D.C., on May 28.

**Joyce Underwood** will be speaking at BDO's San Antonio 2014 Mid-Year Nonprofit Accounting and Tax Update on May 28 in San Antonio, TX. **Klumpp** will also be speaking and will present a session entitled "FASB and Nonprofit Update."

### JUNE

**Klumpp** will be presenting two sessions at the Illinois Society of CPA's Not-for-Profit Advanced and Emerging Accounting and A-133 Issues full day seminar on June 3 in Chicago, Ill. He will be presenting a session entitled "FASB Nonprofit Financial Statement

Project" and a session entitled "Nonprofit Accounting and Auditing Update."

Several professionals are scheduled to speak at the 2014 AICPA Not-for-Profit Industry Conference being held June 11 – 13 in Washington, D.C. Here is a summary of the BDO speakers:

**Jeffrey Schragg** will be conducting a session entitled "Unrelated Business Income: Sponsorships, Publications, and Social Media" at the preconference on June 11.

**Schragg** and **Laurie Arena De Armond** will be conducting a session entitled "Interact with Your Industry: Large Not-for-Profits" on June 12.

**Patty Brickett** will be conducting a session entitled "Immigration and Tax: When Two Worlds Collide" on June 13 that discusses issues encountered with international staff moves.

**Schragg** and **Rebekuh Eley** will be presenting a session entitled "Auctions, Raffles and Gambling" on June 13 that addresses tax issues related to these events used in fundraising efforts.

**Schragg** will be the moderator for an "Ask the Experts Panel: Tax" on June 13.

**Klumpp** will be speaking at the BDO Annual Not-for-Profit Organization Conference in Fort Lauderdale, Fla., and Miami, Fla., on June 25 and June 26, respectively. He will present a session entitled "FASB Update" at each of these events.

## ►CONTINUED FROM PAGE 8

## EXECUTIVE PAY IN NONPROFITS

knowing" participation in an excess benefit transaction, specifically by excluding:

- Reliance on professional advice
- Conformity to requirements for presumption of reasonableness

As if to underscore the point made above, the proposed changes make it clear that organization managers cannot rely upon outside experts to relieve themselves of their responsibility for ensuring that compensation is reasonable.

The highly compensated have become a focal point for individuals and politicians claiming to be outraged and hostile to anything viewed as "excessive" executive compensation. Tax-exempt organizations are clearly not excluded from this acrimony. If anything, they are more intensely scrutinized and criticized because they are, after all, not-for-profit.

As I said at the outset, many believe it is very unlikely that significant tax reform will occur during this year. However, the proposals

contained in this document provide ample evidence of the intentions of some in Congress for increased scrutiny of compensation for executives among tax-exempt organizations. It would not be unrealistic, in my opinion, to expect that changes proposed will one day be enacted. Foretold is forewarned.

*For more information, contact Michael Conover, senior director, Specialized Tax Services – Global Employer Services, at [wconover@bdo.com](mailto:wconover@bdo.com).*

# FASB OUTLOOK – HOW RECENT DECISIONS BY THE FASB BOARD TO RESET ITS AGENDA MIGHT IMPACT NONPROFITS

By Laurie Arena De Armond, CPA

The Financial Accounting Standards Board (FASB) voted Wednesday, Jan. 29, to reorganize its future agenda in order to focus more closely on the issues most important to FASB stakeholders. This comes as the board anticipates completion of its remaining four convergence projects for harmonizing U.S. GAAP with International Financial Reporting Standards (IFRS).

The reorganization of the FASB agenda was guided by the results of a survey conducted by the FASB last year of more than 100 members of various FASB advisory groups and other interested parties on future priorities for standard-setting. The group surveyed consisted of a number of different stakeholders that included preparers, investors, auditors, academics, industry organizations, and other users and readers of financial statements.

How might the reorganization impact nonprofit organizations? There are several key areas to monitor over the coming months, including:

## ►THE GOVERNMENT ASSISTANCE PROJECT

The FASB board voted to add this project to its technical agenda as a way to develop guidance for disclosure requirements related to various types of government assistance. Presently, the FASB's *Accounting Standards Codification* lacks specific guidance on accounting for and disclosure of government assistance, which some believe results in significant shortcomings in these organizations' financial statements. There currently exists guidance promulgated by the International Accounting Standards Board under IFRS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, and since convergence with IFRS is a fundamental goal of the FASB, we can expect the board to investigate how those standards would impact any guidance issued in this regard.



## ►PROJECT REMOVAL

The FASB board also voted to remove the *Not-for-Profit Financial Reporting: Other Financial Communications* project from its research agenda. In this project, the FASB was considering whether adding a Management Discussion and Analysis section to nonprofit financials would be useful. While the board discussed a number of factors underlying the basis of its decision to remove this project, the key factors revolved around whether the final recommendations would be voluntary rather than mandatory. There was also a general cautiousness around tackling a project beyond the scope of traditional standard-setting activities, as it involves reporting outside of the basic financial statements.

## ►PRIVATE COMPANY COUNCIL

During the meeting, the board also decided that the Private Company Council (a group of stakeholders that works with the FASB to determine adjustments in accounting

standards for privately held companies) should consider doing pre-agenda work on phase two of the *Definition of a Nonpublic Entity* project. This may impact nonprofits that are required to include certain financial statement disclosures that are normally reserved for public companies by virtue of the fact that they hold public debt instruments, which make them, by definition, "public" entities.

As the FASB's agenda reorganization begins to take effect over the coming months, stay tuned to the *Nonprofit Standard* for the most up-to-date insights and analysis.

*Article reprinted from the Nonprofit Standard blog.*

For more information, contact Laurie Arena De Armond, partner, at [ldearmond@bdo.com](mailto:ldearmond@bdo.com).

# CHALLENGES AND OPPORTUNITIES FOR NONPROFITS IN 2014

By Sandra Feinsmith, CPA

The past year shook up the nonprofit sector—often in surprising ways. Notable policy changes, a government shutdown and a transforming donor landscape all made headlines in 2013. They also contributed to our readers' sentiments: according to the Nonprofit Standard blog December [reader survey](#), "financial management" and "reputational risks" were the two most-cited concerns for nonprofits in 2014. To help quell these anxieties, we've put together our list of the biggest challenges and opportunities for nonprofits in the year ahead:

## ►ATTRACTING AND RETAINING DONORS

Securing individual donors and winning their loyalty will remain one of the top priorities for nonprofits in 2014, particularly for small and midsize organizations, and especially at the beginning of the year, when money tends to be tight. A [recent study](#) from the Urban Institute and the Association of Fundraising Professionals found that while giving is rising overall, donor drop-off has become a considerable issue. To help understand and mitigate this attrition, organizations should focus more comprehensively on how they benchmark fundraising success. Net gains and losses are important, but boards and management need a wider lens if they want to know where and when to devote more resources. Understanding donor retention more acutely provides key insights into the ongoing effectiveness of an organization's messaging and community engagement. Keep in mind, encouraging a current donor tends to be more cost-effective than acquiring a new one, but both require nimble and targeted marketing efforts.

## ►SOCIAL MEDIA

Speaking of effective messaging, the year ahead should see more nonprofits carefully developing their social media strategies. Fundamentally, social media aims to create more human connection—a powerful tool for nonprofits that know how to use it well. For



relatively little investment, social networks offer the ability to 1) communicate and spread a nonprofit's mission, 2) identify and build lasting relationships with donors, and 3) demonstrate success through disseminating evidence of results. As donors often view their donations as investments, highlighting real results with your online community can be a highly effective way to materialize donors' "social dividends." With increasing competition for donations, nonprofits that actively leverage social media are better able to stay ahead of the pack. Of course, before jumping into it, what's most important is that your organization's social media strategy aligns with its overall mission.

## ►CHANGES TO FINANCIAL REPORTING STANDARDS

In late December 2013, the Financial Accounting Standards Board (FASB) continued its deliberations around improving expense reporting processes for all nonprofits. The debate centered on the fundamental question of whether organizations should be able to report expenses by nature, function or both. We [discussed](#) the Board's tentative decisions

in one of our January blog posts, but looking forward, all nonprofits should keep a careful eye to pending updates, as they may present both challenges and opportunities in terms of how organizations communicate their stories and objectives via their financial reporting.

## ►NEW REGULATIONS

As we [highlighted](#) in one of our [January blog posts](#), the federal government issued its omnibus OMB A-133 Circular—or Supercircular—that aims to consolidate regulations and offer a greater degree of consistent guidance and transparency for the recipients and issuers of federal grants. With the new changes, both parties should reflect on their grant practices under the scope of the new system in order to re-evaluate their alignment and determine where possible opportunities and trouble spots exist.

*Article reprinted from the Nonprofit Standard blog.*

For more information, contact Sandra Feinsmith, senior tax director, at [sfeinsmith@bdo.com](mailto:sfeinsmith@bdo.com).



# NEW YORK NONPROFIT REVITALIZATION ACT SIGNED INTO LAW, WITH TECHNICAL CORRECTIONS EXPECTED

By Christina K. Patten

The Nonprofit Revitalization Act (the Act), unanimously passed by New York's legislature on June 21, 2013, was signed into law by Governor Andrew M. Cuomo on Dec. 18, 2013. This Act, the first major revision to New York's nonprofit laws in over 40 years, will modernize the way not-for-profits conduct business and simplify a number of administrative procedures.

Most of the Act applies to nonprofits incorporated in New York, but one significant provision, relating to financial audits and reporting to New York State (NYS), applies to **all** nonprofits, regardless of state of incorporation, that are registered with New York for charitable solicitation. Some of these provisions will require many nonprofits to amend their governance documents, policies and procedures; and, in some cases, significantly rebuild their governance structure in order to comply with some of the detailed requirements of the Act. Most provisions are effective July 1, 2014, with a few provisions taking effect in 2015, 2017 and 2021.

Nonprofit organizations will now be able to operate, dissolve and merge more easily; communicate and hold meetings using modern technology; and enter into certain transactions without having to go to court. At the same time, the Act includes critical oversight and governance restructuring that is aimed at preventing fraud and improving public trust.

Some requirements of the Act include the following:

- **Adoption of a conflict of interest policy** – Many nonprofits have conflict of interest policies already in place but those policies will likely require revision to conform to the specific provisions mandated by the new law, including disclosure and documentation requirements.

- **Adoption of a whistleblower policy** – All nonprofits with 20 or more employees **and** annual revenue in the prior fiscal year in excess of \$1 million must adopt a whistleblower policy containing specific provisions mandated by the new law.
- **New requirements for "related-party transactions"** – The new law imposes requirements for reviewing and documenting transactions with "related parties," such as officers, directors, and key employees and any relative of theirs.
- **New audit requirements for New York and out-of-state nonprofits that will be required to file an independent certified public accountant's audit report with the New York State Attorney General** – These nonprofit boards or their designated audit committees will have oversight responsibilities for accounting, financial reporting and audit matters with additional responsibilities imposed on boards of nonprofits with gross revenues in excess of \$1 million. In addition, the new law requires that all audit committee members be independent directors.
- **Financial reporting requirements** – From July 1, 2014 to June 30, 2021, the new law outlines a sliding scale that incrementally increases the thresholds for heightened financial reporting and audit requirements for every nonprofit required to register under Article 7-A of the Executive Law. The three-step increase in revenue thresholds should relieve the burdens of filing audited financial statements or financial statements with review reports for some smaller nonprofits.
- **Board chair restriction** – Effective Jan. 1, 2015, no employee of a nonprofit may serve as the board chair or hold any other title with similar responsibilities. However, the prohibition on an employee serving as chair would presumably **not** apply to the

president in a nonprofit in which different individuals serve as chair and president.

The Act also removes some prior requirements:

- The requirement to provide residential addresses of board members will not be required.
- The requirement for private foundations to publish a newspaper notice about annual reports is no longer required.
- Elimination of the requirement to obtain consent of the New York Commissioner of Education (now notification) for some nonprofits with an educational purpose.

Although Governor Andrew M. Cuomo and New York's legislature have indicated that they plan to make changes to the new law prior to the July 1, 2014, effective date, the changes are expected to be technical corrections rather than major substantive changes. The technical corrections are expected to clear up any ambiguities within the Act.

For additional detail of the specific provisions of the Act please see my article published in the fall 2013 *Nonprofit Standard*, entitled "[New York Legislature Passed the NonProfit Revitalization Act providing comprehensive and significant changes to New York NonProfit Corporation Law.](#)"

For more information, contact Christina K. Patten, associate, at [cpatten@bdo.com](mailto:cpatten@bdo.com).

# EXEMPT ORGANIZATIONS – PASSIVE ACTIVITY INCOME (LOSS) REPORTING

By Rebekuh Eley, CPA, MST

For several years, exempt organizations have strained under the burden of reporting income from alternative investments. One area of controversy is the passive activity loss (PAL) rules in reporting unrelated partnership investment income. The [2013 Form 990-T instructions](#) include confirmation of the tax treatment for these investments when applying the complicated passive activity rules to income from alternative investment partnerships.

Certain exempt organizations are subject to the PAL rules under Internal Revenue Code (IRC) section 469 when reporting unrelated business income (UBI) from partnership activities. These organizations include exempt organizations organized as a trust, such as a trust described in IRC section 501(c), a trust described in IRC section 401(a) or an Individual Retirement Account (IRA). Also included are exempt corporations if at any time during the last half of its tax year, more than 50 percent in value of the outstanding stock of the corporation is owned, directly or indirectly, by five or fewer organizations that are private foundations under section 509(a) or are described in sections 401(a) or 501(c) (17). To clarify, if an exempt corporation is owned by one organization that is a 501(c) (3) but not a private foundation, the PAL rules would not apply. If that exempt corporation owner was a private foundation or a retirement trust, the PAL rules would apply to the exempt corporation.

Generally speaking, a passive activity is an activity which is a trade or business in which an organization does not materially participate, and rental activities regardless of participation. Typically exempt organizations do not materially participate in the business of the investment partnership which is producing the UBI. Organizations subject to the PAL rules must review any Schedule K-1s that they receive from all their investment partnerships to determine which passive activities are subject to the PAL rules.

The general rule when dealing with passive activities is that a taxpayer can only offset a



loss from one passive activity against other passive income. If the exempt organization does not generate passive income to utilize the passive loss, the passive loss is suspended and carried forward to future years to offset future passive income, or is released upon the disposition of the entire passive activity (e.g., the partnership is sold or dissolved). This suspended passive loss is tracked on Form 8582 and included with the Form 990-T.

When reporting income from partnerships on the Form 990-T, all of the income must be placed into two buckets: passive and non-passive (this includes portfolio income such as dividends and interest). Capital gain income or loss is put into a passive or non-passive bucket then broken out for separate reporting on the Form 990-T. The overall net loss in the passive bucket cannot be used to offset the net income or gain in the non-passive bucket. An organization could generate a substantial amount of losses from a partnership's passive business activities which cannot be used to offset the significant non-passive capital gain or interest and dividend income passed through from the same partnership.

The rules related to PALs have an extra layer of complexity when reporting the activities from

a publicly traded partnership (PTP). A publicly traded partnership is a partnership whose interest is traded on an established securities market or the interest is readily tradable on a secondary market (or the substantial equivalent thereof). Any PAL generated by a PTP cannot be used to offset income from other passive activities. The PAL can only be used to offset the income from that particular PTP. The income from a PTP allocated to the passive bucket must be further segregated and tracked by partnership to ensure compliance with these unique PTP rules.

Investments in alternative investment partnerships are a means to diversify and increase the rate of return on an investment portfolio. However, these investments come with the administrative burden of tracking and reporting passive activities. The compliance cost related to the complicated PAL rules, if applicable to the organization, should be factored into the overall return on these investments.

For more information, contact Rebekuh Eley, senior tax director, Central Region Nonprofit Tax Practice Leader, at [reley@bdo.com](mailto:reley@bdo.com).

# UPDATE TO 2013-2014 IRS PRIORITY GUIDANCE PLAN

By Joyce Underwood, CPA



**O**n Jan. 29, 2014, the Internal Revenue Service (IRS) released its second quarter update to the 2013-2014 IRS Priority Guidance Plan. The 2013-2014 IRS Priority Guidance Plan (the Plan) contains over 300 projects that the IRS has deemed appropriate to receive an allocation of their resources during the fiscal year that ends June 2014, but they commit to no target dates or deadlines. The Plan also includes in its appendix routine guidance published each year categorized by month. In situations where the IRS has issued guidance on items previous listed in the Plan, it now includes a reference to the citation and date of issuance. The IRS includes 11 additional projects in the current quarterly update that have developed during the year. Items of particular interest are as follows:

## ► EXEMPT ORGANIZATIONS

**Notice under §501(r), Additional Requirements for Certain Hospitals, containing a proposed revenue procedure that provides correction and disclosure procedures under which certain failures to meet the requirements of §501(r) will be excused for purposes of §501(r)(1) and 501(r)(2)(B). Published 1/13/14 in Internal Revenue Bulletin (IRB) 2014-3 as Notice 2014-2 (Released 12/31/13).**

**Summary:** Tax-exempt hospital organizations can rely on proposed regulations under Internal Revenue Code (Code) Sec. 501(r) contained in the Notice of Proposed Rulemaking (NPRM) REG-130266-11 and NPRM REG-106499-12, pending the publication of final regulations or other applicable guidance. In addition, organizations may rely on Reg. §1.501(r)-3 proposed regulations for any community health

needs assessment (CHNA) conducted or implementation strategy adopted on or before the date that is six months after final or temporary regulations are published.

**What it means:** Confirms that tax-exempt hospital organizations can rely on proposed regulations under section 501(r), pending the publication of final regulations or other applicable guidance.

**Notice under §501(r) confirming that tax-exempt hospital organizations can rely on proposed regulations under §501(r) published on June 26, 2012, and April 5, 2013, pending the publication of final regulations or other applicable guidance. Published 1/13/14 in IRB 2014-3 as Notice 2014-3 (Released 12/31/13).**

**Summary:** The IRS has issued a proposed revenue procedure that would provide

additional guidance to proposed regulations (NPRM REG-106499-12) regarding the requirements of Code Sec. 501(r)(3) and the consequences for failing to meet any of the Code Sec. 501(r) requirements. The proposed revenue procedure provides that the IRS will not treat a hospital organization's failure to meet a requirement of Code Sec. 501(r) as a failure for purposes of Code Sec. 501(r)(1) and Code Sec. 501(r)(2)(B) if the failure falls within the scope of section 4 of the proposed procedure, the hospital organization corrects the failure in accordance with section 5 of the proposed procedure and discloses the failure in accordance with section 6 of the proposed procedure. This procedure is proposed to be effective on and after the publication of the final revenue procedure in the Internal Revenue Bulletin.

**What it means:** Contains text of a proposed revenue procedure that provides correction



►CONTINUED FROM PAGE 14

## IRS PRIORITY GUIDANCE PLAN

and disclosure procedures under which certain failures to meet the requirements of section 501(r) will be excused. The IRS has requested comments concerning this proposed revenue procedure and comments had to be submitted by March 14, 2014.

### ►EMPLOYEE BENEFITS

**Notice on cumulative list of changes in the requirements for §401(a) plans. Published 12/23/13 in IRB 2013-52 as Notice 2013-84 (Released 12/11/13).**

**Summary:** The 2013 Cumulative List is to be used by plan sponsors and practitioners submitting determination letter applications for plans during the period beginning Feb. 1, 2014 and ending Jan. 31, 2015. Plans using this Cumulative List will primarily be single employer individually designed defined contribution plans and single employer individually designed defined benefit plans that are in Cycle D and multiemployer plans as described in Code Sec. 414(f). With certain exceptions, the IRS will not review plan language for guidance issued after Oct. 1, 2013, statutes enacted after Oct. 1, 2013, qualification requirements first effective in 2015 or later, or statutory provisions first effective in 2014, for which no guidance is identified in the 2013 Cumulative List.

**What it Means:** Notice 2013-84 and the 2013 Cumulative List will be used by those plan sponsors and others submitting determination letter applications for plans during the period beginning Feb. 1, 2014, and ending Jan. 31, 2015. Plans using the 2013 Cumulative List will primarily be single employer individually designed defined contribution plans and single employer individually designed defined benefit plans that are in Cycle D and multiemployer plans.

### ►EXECUTIVE COMPENSATION, HEALTH CARE AND OTHER BENEFITS, AND EMPLOYMENT TAXES

**Notice regarding modification of "Use-or-Lose" rule for health flexible spending arrangements (FSAs) and clarification regarding 2013-2014 non-calendar year salary reduction elections on §125 cafeteria**

**plans. Published 11/18/13 in IRB 2013-47 as Notice 2013-71 (Released 10/31/13).**

**Summary:** The Treasury Department and the IRS have issued guidance modifying the long-standing "use-or-lose" rule for health flexible spending arrangements (FSAs). The modifications permit Code Sec. 125 cafeteria plans to be amended to allow plan participants to carry over up to \$500 of their unused health FSA balances remaining at the end of a plan year. In addition, the existing option for plan sponsors to allow employees a grace period after the end of the plan year remains in place. However, a health FSA cannot have both a carryover and a grace period: it can have one or the other or neither. An employer may adopt the carryover provision authorized in the guidance for the current Code Sec. 125 cafeteria plan year (and/or subsequent Code Sec. 125 cafeteria plan years) by amending the Code Sec. 125 cafeteria plan document in the manner and within the time frames described. The guidance also clarifies the scope of the transitional rule applicable to noncalendar-year plans beginning in 2013 for participant changes in salary-reduction elections under health plans provided through Code Sec. 125 cafeteria plans.

**What it Means:** The Notice specifically modifies the "use-or-lose" rule for health flexible spending accounts (FSAs) and allows section 125 cafeteria plans to be amended to allow up to \$500 of unused amounts remaining at the end of a plan-year in a health FSA to be paid or reimbursed to plan participants for qualified medical expenses incurred during the following plan year, provided that the plan does not also incorporate the "grace period" rule.

### ►EXCISE TAX

**Notice providing guidance on procedural issues relating to the annual fee on health insurance providers under §9010 of the ACA. Published 12/16/13 in IRB 2013-51 as Notice 2013-76 (released 11/26/13).**

**Summary:** The IRS has provided guidance on the health insurance providers' fee. This fee is imposed by section 9010 of the Patient Protection and Affordable Care Act (P.L. 111-148), as amended by section 1406 of the

Health Care and Education Reconciliation Act of 2010, P.L. 111-152. The guidance provided relates to: (1) the time and manner for submitting Form 8963, Report of Health Insurance Provider Information; (2) the time and manner for notifying covered entities of their preliminary fee calculation; (3) the time and manner for submitting a corrected Form 8963 for the error correction process; and (4) the time for notifying covered entities of their final fee calculation.

**What it means:** Provides guidance on the timing and manner of notifications and submissions regarding the health insurance providers' fee.

### ►TAX-EXEMPT BONDS

**Notice providing relief for qualified residential rental projects financed with exempt facility bonds under §142 to provide emergency housing relief needed as a result of severe storms, flooding, landslides, and mudslides in Colorado. Published 10/28/13 in IRB 2013-44 as Notice 2013-63 (Released 9/30/13).**

**Summary:** The IRS will waive certain limitations for projects financed with exempt facility bonds so that owners and operators of these facilities anywhere in the nation can provide housing to victims of severe storms, flooding, landslides and mudslides in Colorado that began on Sept. 11, 2013. If an issuer of exempt facility bonds for a project wants to allow the use of the project to temporarily house displaced individuals, the issuer must approve that use and must determine an appropriate period for the temporary housing, not to extend beyond Sept. 30, 2014. The guidance is effective Sept. 14, 2013.

**What it means:** Allows low-income housing providers throughout the country to assist Colorado victims impacted by storms and flooding in the fall of 2013.

*For more information, contact Joyce Underwood, director, at [junderwood@bdo.com](mailto:junderwood@bdo.com).*

# CONFLICTS OF INTEREST IN NONPROFIT ORGANIZATIONS

By Richard Larkin, CPA

**W**hat is a conflict of interest? Simply put, it is a situation where someone in a position of authority in an entity – for-profit, nonprofit, or government – has the potential to act in a way that confers an inappropriate benefit to another person or organization, which action results in financial or reputational harm to the entity from which the benefit came. Managers and governors of organizations are held to a fiduciary standard that requires them to always act in the best interests of their own organization, even when such action may not be in their best personal interests or best interest of some other person or organization with which they are connected.

For example, suppose the manager of a nonprofit has a spouse who is the owner of a business. If it happens that the two organizations have business dealings with each other – for example, the business is the landlord of the nonprofit – each of the spouses must act in the best interests of his or her own organization without regard to how that action may affect their spouse or the other organization. The nonprofit manager cannot agree to pay inappropriately high rent to the spouse's business, which would benefit the spouse, but would harm the nonprofit. Also laws and regulations surrounding tax-exempt status may impose penalties in such cases, both on the organization and on the person who approved an inappropriate payment, or in some cases prohibit such transactions entirely.

Ethical standards to which nonprofits, especially, should be held require adherence to that fiduciary standard. To ensure such adherence, every organization should have a formal, written conflict of interest policy which should include several elements. First, there should be a statement that employees, volunteers, and members of governing boards and committees will always adhere to that fiduciary standard. Persons involved in decision making should disclose any potential conflicts of interest and recuse themselves from voting on or otherwise influencing decisions affecting parties that pose personal conflicts of interest. Organization managers



should be aware of potential organizational conflicts and act to avoid harming their own organization.

The written conflict of interest policy should be furnished to all persons upon becoming connected to the organization (new employees, volunteers and board members) and periodically to all continuing staff and board members. It may be desirable to have persons acknowledge in writing that they have read and understand the policy and will adhere to it. Then there should be a process for persons who become aware of a possible conflict of interest problem to report their concern (without fear of retaliation) to an appropriately high level individual in the organization. In serious cases this may be to the chair of the board, such as if the executive is the one with the conflict and he or she appears to be acting inappropriately.

Finally, there needs to be a process for identifying and documenting potential conflicts of interest. A best practice is to have each person in a decision-making position make a list of their personal and organizational relationships. Management should make a separate list of organizational relationships so that when decisions arise, it will be easy to

consult a master list to see if there is an actual problem, and to judge how visible the problem would likely be to others.

Such a list will probably be longer than one might at first think. Every person and organization has many relationships which might pose a conflict of interest. Following is a list of likely conflicts, with some comments about them. Also realize that the appearance of a conflict is just as serious an issue as an actual conflict, because outsiders who do not know the complete true situation often assume the worst.

Another aspect of this list is that there are degrees of 'conflictedness.' A person's relatives are an obvious potential conflict, but how far out do you take the genealogy? Parents, spouses, siblings and children are no-brainers, but how about a third cousin twice removed whom you haven't seen in years? Your estranged brother's wife's uncle in Poland? I have some first cousins I have not had contact with in over 40 years, but a number of seventh cousins I see regularly and with whom I am very close. Would it make a difference whether we share a last name? Judgment will often be required in making your own list.

►CONTINUED FROM PAGE 16

## CONFLICTS OF INTEREST

## Conflicts of Interest for Nonprofit Organizations

Persons inside an organization with the potential for conflicts:	Reason	Comment
Governance: Officers, directors, trustees, and the equivalent; non-board committee members	1	
Senior management: CEO, COO, CFO, counsel, directors of development, programs, HR, etc.	1	
Anyone with purchasing authority, including travel planners and meeting organizers	1	
Anyone with significant decision-making authority over use or disposal of organization resources	1	
Persons or organizations with which conflicts may exist:		
Family by blood, marriage or adoption, including 'significant others'	2	7
Friends, business associates	2	7
Affiliated organizations (for-profit or nonprofit), employee benefit plans	2	
Organizations with a common or overlapping board and/or management	2	
Agents, unions, employees, others with which the organization has business relationships	2	
Charitable beneficiaries	2	
Vendors, including fundraisers, investment managers, other professionals, landlords, etc.	2	8
Customers	2	8
Members	2	8
Donors, especially of large gifts and of gifts with significant restrictions and/or conditions	2	8, 9
Other organizations with which any of the above are connected as owners or managers	2	
Persons or organizations who are or should be concerned about conflicts of interest:		
Resource providers: Donors, including volunteers, governments, and other funders	3	
Members	3	
'Clients' (students, patients, concertgoers, etc.); other customers	3	
Taxpayers (whose taxes directly or indirectly subsidize nonprofits)	3	10
Regulators (IRS, state charity officials, accrediting bodies, etc.)	4	
Watchdogs (organization's governing board, BBB, Guidestar, Charity Navigator, ECFA, etc.)	4	
Media – acting to protect the interests of resource providers and beneficiaries	4	
Employees; charitable beneficiaries	5	
Other nonprofit organizations	6	

## REASONS:

1. Persons in an organization with decision-making authority may make decisions that unfairly benefit the person (directly or indirectly) or the person's associates to the detriment of the organization's reputation or financial health.
2. These are entities to which persons with conflicts may be motivated to provide improper benefits to the detriment of the organization. Improper benefits may also jeopardize the organization's tax-exempt status or cause the entity and persons involved to incur tax penalties.
3. Resource providers would not want their resources to be diverted from the mission of the organization, or feel that they were being charged unfairly higher prices for services.
4. Those who monitor the behavior of organizations on behalf of donors and the public seek assurance that organization resources are not being improperly used to benefit 'insiders' or those related to insiders.
5. If the financial health and/or reputation of the organization is damaged by improper financial dealings, employees' jobs and employee benefits, and benefits to charitable beneficiaries may be at risk.
6. Misbehavior (or the appearance of misbehavior) by one nonprofit organization 'taints' the reputation of the entire sector.

## COMMENTS:

7. The appearance of a conflict may be affected by similarity of names or apparent closeness of friendship.
8. If the organization is heavily dependent for its operations and/or financial health on one or very few persons or organizations in one of these categories, there is a greater possibility of improper influence occurring or appearing to occur.
9. A prospective donor of a large gift may demand concessions that could damage the organization's finances or reputation.
10. Taxpayer subsidies occur in three ways: (1) direct government payments to nonprofits such as contributions or exchange transactions; and additional taxes paid to make up lost government revenue resulting from (2) the charitable donation income tax deduction, and (3) the tax-exempt status of most income, and some property of and sales by and to nonprofits.

For more information, contact Dick Larkin, director, BDO Institute for Nonprofit Excellence<sup>SM</sup>, at [dlarkin@bdo.com](mailto:dlarkin@bdo.com).



## NONPROFIT FACTS: *Did you know...*

- As a result of the overhaul of federal OMB rules surrounding grants and contracts, there is a new stipulation that raises the threshold for a single audit (A-133) requirement from \$500,000 to \$750,000, thereby reducing costs for smaller contracts and grants.
- When U.S. student debt surpassed credit card debt in 2010, exceeding the \$1 trillion mark, higher education officials began focusing on how much college graduates owed after commencement — \$26,600 on average, according to the latest statistics.
- Charitable giving grew 2.3 percent for the three months ending October 2013 and online giving grew almost 10 percent, compared with the same period in 2012.
- Individual giving to charities would drop by more than 4 percent overall if the charitable deduction were capped at 28 percent for the nation's highest earners, and secular giving would drop by more than 7 percent as a result, according to research from the American Enterprise Institute.
- Fundraising in response to Typhoon Haiyan in the Philippines surpassed \$100 million within two weeks of the disaster and was approaching the \$200-million mark after the first 30 days.
- The implementation of the Affordable Care Act and increasing support for education at all levels help explain the nonprofit sector's large, recent growth. Healthcare is by far the largest employer of nonprofit workers, representing 57 percent, with education second at 15 percent.
- Philanthropy made a comeback in large donations in 2013, with the nation's wealthiest donors giving more than \$3.4 billion to charity, according to a new tally of the top 10 gifts of 2013 by the Chronicle of Philanthropy.
- Eighty-four percent of nonprofits, including many of the nation's largest

## BDO Launches BDOKNOWLEDGE Nonprofit & Education Seminar Series

The BDO Institute for Nonprofit Excellence has just announced an all-new BDOKNOWLEDGE Nonprofit & Education seminar series. This complimentary educational series has been designed specifically for busy professionals in nonprofit and education organizations, with convenient options for live or online participation.

We invite you to take part in this program with members of your organization, including board members, whether they are centrally positioned in the nation's capital or spread across the United States. All webinars are conveniently scheduled from 12:30 to 2:00 p.m. Eastern Time, and participants can join either in-person at the City Club of Washington in Washington, D.C., at select local BDO offices nationwide or via individual webinar access from their own desks.

Stay tuned to the *Nonprofit Standard* blog for further details and registration information for both in-person and online participation. In the meantime, check out the calendar of events below.

4/17/2014	<b>2014 Nonprofit Tax Update: Navigating Through Changing Waters</b>
5/16/2014	<b>The Latest Nonprofit Accounting and Financial Reporting Developments</b>
7/23/2014	<b>Good Governance and Strategic Planning</b>
9/18/2014	<b>The Impact of Healthcare Reform on Organizations</b>
10/9/2014	<b>International NGO Hot Topics</b>
11/2014	<b>Are You Ready for the Supercircular?</b>

charities, haven't made their donation websites easy to read on mobile devices, one of several flaws that can cost them significant contributions, according to experts who studied 150 charities and other organizations.

- Despite a downturn in giving by private donors and dramatic cuts in government spending, the rate of mergers in the nonprofit sector remained flat. Meanwhile, the number of U.S. nonprofits actually grew 7 percent between 2007 and 2011 to 1.58 million, an average of nearly 40 nonprofits per U.S. zip code.
- In a new survey by Gallup measuring how business leaders and the American

public view the state and value of higher education, just 14 percent of Americans—and only 11 percent of business leaders—strongly agreed that graduates have the necessary skills and competencies to succeed in the workplace.

- According to the Bureau of Labor Statistics, the U.S. volunteer rate declined by 1.1 percent to 25.4 percent of the population for the year ending in September 2013. Approximately 62.6 million people volunteered through or for an organization at least once between September 2012 and September 2013.

## INSTITUTE PERSONNEL CONTACTS:

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### WILLIAM EISIG

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

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### KAREN FITZSIMMONS

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

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### DICK LARKIN

Director, BDO Institute for Nonprofit Excellence<sup>SM</sup>  
301-634-4931 / dlarkin@bdo.com

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### LAURA KALICK

National Director, Nonprofit Tax Consulting/BDO Institute for  
Nonprofit Excellence<sup>SM</sup>  
301-634-4950 / lkalic@bdo.com

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### TAMMY RICCIARDELLA

Director, BDO Institute for Nonprofit Excellence<sup>SM</sup>  
301-634-0234 / tricciardella@bdo.com

---

### MIKE SORRELLS

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

---

### JOYCE UNDERWOOD

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

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## REGIONAL CONTACTS:

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### 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 DE ARMOND

Assurance Partner, Greater Washington, D.C.  
301-634-4976 / ldearmond@bdo.com

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## 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<sup>SM</sup> (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](http://www.bdo.com) for upcoming local events and webinars.

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Material discussed is meant to provide general information and should not be acted on without professional advice tailored to your firm's individual needs.

**People who know Nonprofits, know BDO.**