FALL 2015
www.bdo.com

THE NEWSLETTER OF THE BDO NONPROFIT & EDUCATION PRACTICE

NONPROFIT STANDARD

CONTENTS

TAX-EXEMPT BOND COMPLIANCE

By Marc Berger, CPA, JD, LLM

One of the benefits of tax exemption under Internal Revenue Code (IRC) Section 501(c)(3) is the ability to use tax-exempt financing.

Tax-exempt bonds generally carry a lower interest rate than taxable bonds and the interest received by the bondholders is excludable from income for federal income tax purposes.

Because of these advantages, tax-exempt bonds are subject to strict federal tax requirements both at the time of issue and for as long as the bonds remain outstanding. The Internal Revenue Service (IRS) recognizes that all requirements are closely monitored and complied with at the time bonds are issued. Bond counsels for the organization, the issuing authority and the underwriter are all keenly focused on closing a clean transaction. However, problems can arise after closing, when all of the outside professionals have moved on to the next transaction.

In order to keep their tax-exempt bonds in compliance, organizations must actively monitor the use of proceeds and bond-financed property throughout the entire period that bonds remain outstanding. The IRS encourages organizations to adopt written procedures which go beyond reliance on the tax certificates included in bond documents. Written procedures should contain certain key characteristics, including:

- Due diligence review at regular intervals;
- Identifying the official or employee responsible for review;
- Training of the responsible official/employee;
- Retention of adequate records to substantiate compliance (e.g., records relating to expenditure of proceeds and use of facilities);

Read more

CONTINUED FROM PAGE 1

BOND COMPLIANCE

- Procedures reasonably expected to identify noncompliance in a timely manner; and
- Procedures ensuring that the issuer will take steps to correct noncompliance in a timely manner.

The goal of establishing and following written procedures is to identify and resolve noncompliance on a timely basis in order to preserve the preferential status of the bonds.

OWNERSHIP AND USE OF PROPERTY

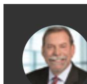
All property financed with 501(c)(3) bonds must be owned by a 501(c)(3) organization or a governmental entity. For this purpose, a "governmental entity" includes a state or local governmental entity, but not a federal entity. In addition, use of bond-financed property in an unrelated trade or business or use by parties other than 501(c)(3) organizations is limited. This type of nonqualified use is known as private business use, or private use. In order to maintain its tax-exempt status, a 501(c)(3) bond issue may not have more than 5 percent private use over its lifetime. The 5 percent limit applies to a bond issue as a whole as opposed to each underlying project being financed. Additionally, the costs associated with a bond issue (e.g., counsel fees, underwriters' discounts, financial advisory fees, accounting fees, rating agency fees) count toward the 5 percent private use limit. Depending on the size of a bond issue, costs of issuance may range from .5 to 2 percent of the bond issue. As a result, tracking private use becomes very important. The situations that can generate private use fall into the following categories:

- Property sold or leased;
- Property subject to management and service contracts;
- Property involved in research activities; and
- Property used in unrelated business activities.

While each of these situations results in private use, there is some potential relief from private use treatment. Bond-financed property that is sold to a non-501(c)(3) organization or governmental entity can be "remediated." For example, if an organization's sales proceeds are used to make qualifying capital expenditures, private use treatment can be avoided. In addition, there are safe harbors for certain management and services contracts as well as for certain research activities. If these safe harbors are met, then no private use will result. Proper planning in each of these situations can avoid exceeding the private use limit.

Section 501(c)(3) organizations with tax-exempt bonds should be tracking private use at regular intervals. This may involve working with an organization's legal, facilities, contracting, real estate and finance departments. Schedule K of the Form 990, which must be completed by organizations with outstanding tax-exempt bonds, asks whether the organization has established written procedures to track compliance with all of the tax requirements - a question to which all organizations should be answering "yes." The ability to issue tax-exempt bonds is a benefit that should not be taken for granted, and consistent post-issuance compliance will allow an organization to realize this benefit over many years.

Article reprinted from BDO Nonprofit Standard blog.



For more information, contact Marc Berger, director, Nonprofit Tax Services, at mberger@bdo.com.

AUTHOR PROFILE

MARC BERGER

Marc is a director of Nonprofit Tax Services in the Atlantic Nonprofit & Education practice in the BDO Greater Washington, D.C. office in McLean, Va. Marc has more than 25 years of experience in both public and private tax practice, including positions at large accounting firms, complex healthcare organizations and the U.S. Tax Court. He has also practiced law. Marc has advised a diverse group of organizations, including hospitals and healthcare organizations, colleges and universities, charities and foundations, and other tax-exempt institutions.

Marc's expertise in the nonprofit tax space includes applications for exemption, protection of tax-exempt status, private inurement and excess benefit transactions, unrelated business income and allocation of expenses, joint ventures with for-profit entities, mergers and acquisitions, tax-exempt bond compliance, compensation arrangements, IRS and state audits, state and local tax exemptions, and Forms 990 and 990-T compliance.

Marc is a member of the AICPA and the Maryland Association of CPAs. He is also a member of the District of Columbia and Florida Bar Associations as well the American Health Lawyers Association.

Marc received a B.S. in Accounting from the University of South Florida, a J.D. from the Nova Southeastern University and an LL.M. in Taxation from the University of Florida.

▶Read more

LIQUIDITY – WHAT'S ALL THE FUSS ABOUT?

By Lee Klumpp, CPA, CGMA and Adam Cole, CPA

Liquidity is crucial for not-for-profit (NFP) and for-profit entities alike to have the right amount of liquid and non-liquid resources available when needed to accomplish an organization's mission.

While there is a cost associated with not having enough liquidity, there is a foregone opportunity cost for having too much liquidity. Therefore, an NFP's liquidity is an important story to convey to the users of its financial statements.

DEFINING LIQUIDITY

Liquidity is a multifaceted concept that encompasses many different meanings, so in order to determine how liquidity should be communicated by an NFP in its financial statements, let's first consider how it is defined. Often, when users of NFP financial statements use the term "liquidity" they are referring to liquidity risk or financial flexibility. For the purposes of our discussion, the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) defines liquidity and the related concepts of financial flexibility as follows:

Liquidity is defined in the ASC Master Glossary as an asset's or liability's nearness to cash. Donor-imposed restrictions may influence the liquidity or cash flow patterns of certain assets.

Financial Flexibility is defined in the ASC Master Glossary as an entity's ability to take effective actions to alter amounts and timing of cash flows so it can respond to unexpected needs and opportunities.

Liquidity Risk is not defined in the ASC Master Glossary, but it was discussed in a recent research project by the FASB on disclosures about liquidity risk and interest rate risk. This project utilized the term "liquidity risk" to mean the risks and uncertainties that an entity might encounter in meeting its financial obligations.

Liquidity is typically defined as how much cash and/or assets (such as short-term investments) that an NFP holds that can easily be converted to cash for use in the immediate or near future. An entity is thought to be liquid if it has ready access to cash to meet its needs. An entity may be described as liquid because it holds cash directly or because it holds other liquid assets such as money market accounts, certificates of deposit or other short-term investments that can readily be converted to cash. Some might describe an NFP as liquid if it has access to cash (borrowing power, lines of credit, etc.). Access to cash through borrowing may create liquidity, but it is more akin to financial flexibility and clearly is not a liquid asset that can be communicated in the statement of financial position at the measurement date.

CURRENT ACCOUNTING REQUIREMENTS

The guidance for NFPs (ASC Topic 958) requires that an NFP report assets and liabilities in reasonably homogeneous groups and sequence or classify them in ways that provide relevant information about their interrelationships, liquidity and financial flexibility. Some might interpret this requirement to mean that an entity might only need to sequence its assets according to their nearness to cash and its liabilities based on the timing of their maturities. This could be correct for some small, less-complex NFPs. However, for more complex NFPs with endowments and sinking funds, for example, it could be misleading to classify the endowment with the NFP's unrestricted investments and to combine the sinking fund cash with the NFP's unrestricted cash and cash equivalents. If items were grouped together solely by the nature of the asset (cash, investment, etc.) or liability, the users would get a different picture of the NFP's liquidity than reality, even if further details are provided in the notes. In order for the users of an NFP's financial statements to understand the NFP's liquidity, they must be able to understand the restrictions, whether donor, contractual or legal, on the NFP's use of particular assets.

The industry guidance for NFP business-like health care entities (ASC Topic 954) is more prescriptive, requiring the use of a classified balance sheet and the segregation of assets limited to use on the face of the balance sheet.

▶Read more

CONTINUED FROM PAGE 3

LIQUIDITY

It has been our experience in speaking with creditors, credit rating agencies, grantors and donors of NFPs that they would like to know how much cash and/or liquid assets (such as short-term investments) an NFP holds that can be easily converted to cash for immediate or near-term use. That is because they would like to know what liquid assets are available to pay for current or future programmatic activity, debt service and other activities.

Some have argued that you can get to liquidity through analyzing an NFP's net assets, but net assets is solely a residual of assets less liabilities and does not convey liquidity. For net assets themselves to be able to convey liquidity, they would have to be able to be converted to cash or used to settle an obligation based on the definition of liquidity. Therefore, it would be difficult to use the components of net assets to communicate what net assets are available, for what purpose the net assets can be used and whether the net assets are with or without donor-imposed restrictions.

NFPs currently have flexibility under generally accepted accounting principles (GAAP) in telling their story regarding liquidity to the users of their financial statements. The various ways NFPs currently can discuss their liquidity are:

a. Sequencing assets according to their nearness of conversion to cash and sequencing liabilities according to the nearness of their maturity and resulting use of cash

b. Classifying assets and liabilities as current and noncurrent

c. Disclosing in notes to financial statements relevant information about the liquidity or maturity of assets and liabilities, including restrictions on the use of particular assets

Even with these options, it can still be difficult to understand an NFP's liquidity. Additionally, there are even difficulties in comparing liquidity within particular industries of the NFP sector. Reasons for that include the following:

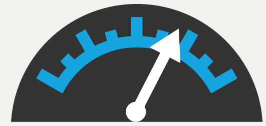
a. Complexity of restricted contributions and designations by the board of directors

b. Lack of information presented in the notes to the financial statements related to the board of director's policy on investments specifically around pooled investments that include both restricted and unrestricted amounts

c. Lack of disclosures about how the organization will meet its short-term liquidity needs

The most significant issue for an NFP around liquidity is the aggregation by type (nature) of assets in the statement of financial position versus the presentation of the components of assets based on their nearness to cash or how the assets are expected to be used. It is believed that a liquidity measure would benefit the users of NFP statements and address this issue.

How Can I Measure My Organization's Liquidity?



Financial performance measurement is a strategy a not-for-profit (NFP) can use for evaluating operations, programs, services and financial stability. One of the key measurement tools is financial ratio analysis. It involves taking data from your NFP's financial statements, using it to calculate ratios appropriate for your NFP, and then benchmarking those ratios against past performance, management objectives or other organizations.

Utilizing financial ratio analysis can help you assess your NFP's overall financial condition and liquidity and flag patterns that might not be conducive to your NFP's success.

If we look closer at liquidity, there are certain measures that can be used to ensure your NFP has a sufficient level of cash flow for continued programmatic operations and growth. There are three main financial ratios you may want to consider to measure your NFP's liquidity:

1. **Current ratio** equals current assets divided by current liabilities. A 2-3 ratio generally indicates that the NFP has adequate liquid funds to pay its current obligations.
2. **Quick ratio** equals current assets (less any inventory amounts) divided by current liabilities. A ratio of 1 - 2 generally indicates an NFP has adequate liquid funds to pay its current obligations without selling inventory.
3. **Organizational liquidity funds indicator** equals expendable net assets divided by average monthly total expenses. Expendable net assets are calculated as net assets less restricted endowments, fixed assets and prepaid expenses. This indicator measures how many months the NFP has before it will consume its liquid assets, assuming that no additional revenue flows into the NFP. The higher the ratio, the better the liquidity.

These ratios are fairly easy to calculate for any NFP and you can then benchmark your organization by comparing it to other similar NFPs. Comparing your organization's performance to benchmarks allows you to zero in on areas with the greatest potential for improvement. Using this information, you may be able to improve performance without making significant changes in your operations. Further, when comparing against similar NFPs, you might improve performance by simply adopting best practices used by your peers. You can obtain information on other nonprofits' metrics from websites such as GuideStar and Charity Navigator.

Using monthly, quarterly or even yearly financial ratio analysis can help you understand your NFP's liquidity and provide you with valuable insight into your organization's financial future. You will be able to identify the strengths and weaknesses of your NFP and take appropriate actions to improve liquidity.

▶Read more

CONTINUED FROM PAGE 4

LIQUIDITY

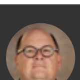
WHAT DOES THE FUTURE HOLD FOR NFP LIQUIDITY?

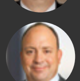
In April 2015, FASB issued an exposure draft of the Proposed Accounting Standards Update (ASU), *Not-for-Profit Entities (Topic 958) and Health Care Entities (Topic 954): Presentation of Financial Statements of Not-for-Profit Entities*. This proposed ASU addresses the issue of how an NFP should disclose information regarding liquidity.

Specifically, the ASU proposes that an NFP disclose both quantitative and qualitative information about the liquidity of assets and near-term demands for cash as of the reporting date, including (1) the amount of financial assets at the end of the period; (2) the amount that, because of restrictions or other limitations on their use, is not available to meet cash needs in the near term; (3) the amount of financial liabilities that require cash in the near term; and (4) information regarding how an organization manages its liquidity, including the time horizon it uses in the management of liquidity as well as any other sources of cash (such as lines of credit) during that time horizon. It's believed that this information will significantly improve users' ability to assess NFPs' liquidity risk. The comment period on the proposed ASU ended on Aug. 20, 2015, so stay tuned to see what the FASB Board's ultimate decision is regarding the liquidity component of the ASU as all comments are considered.

The FASB is not the only entity looking at this issue. Liquidity has also become a critical metric used by boards and stakeholders to measure the potential sustainability of an organization. Currently, the state of New York is working on a Medicaid transformation project that will result in enhanced reimbursements to those organizations that qualify. In order to qualify, one criterion will be that an entity has adequate liquidity.

These events highlight the need for entities to be able to measure, and more importantly, communicate liquidity.


For more information contact Lee Klumpp, director, at lklumpp@bdo.com. or


Adam Cole, partner, at acole@bdo.com

EXECUTIVE COMPENSATION AT TRADE ASSOCIATIONS – WHO CARES?

By Mike Conover

There are tens of thousands of tax-exempt 501(c)(6) organizations that represent the interests of virtually every type of business in the United States.

They are as diverse in their size and scope of activities as the businesses they represent. And the compensation paid to the executives that manage these organizations can range from less than $100,000 to multi-million dollar packages for the most highly paid executives. Somehow, despite their non-profit status, these organizations are not often the subject of much controversy concerning their pay practices, even when pay reaches levels that sound alarms in for-profit organizations. Does no one care?

Unlike charitable, educational or social welfare organizations (i.e., 501(c)(3) and (c)(4) organizations) whose executive compensation practices are subject to the Internal Revenue Service (IRS) Intermediate Sanctions (Internal Revenue Code (IRC) section 4958) penalties and remedies for excess benefit transactions, the 501(c)(6) ("trade associations") are subject to the broadly defined private inurement prohibition, which is a fundamental requirement for securing tax-exempt status. Quite simply, revenue or assets of a tax-exempt organization are not allowed to benefit an individual associated with the organization without being directly related to the organization's exempt purpose.

Of course, trade associations are not expected to be run by executives who volunteer their services, so compensation for staff members is a necessary and allowable expenditure that allows the organization to pursue its purpose. However, at what point does compensation reach a level that it becomes unreasonable and possibly creates a case of private inurement? If that does occur, what happens next?

Quite simply, the organization's tax-exemption would be at stake. Fundamentally, its ability to continue to exist could hang in the balance if an instance of private inurement were confirmed. For this reason, a strong case can be made for ensuring that a trade association has its executive compensation practices well in hand.

Almost as troubling are the embarrassing disclosures of executive compensation practices that appear to be problematic to outsiders and can have lasting negative consequences for the organization, its executives and governing board. This is particularly true in light of the public's skeptical or even hostile view of all things associated with executive pay, fueled by sensational media attention and online access to compensation information.

THE OVERSIGHT KNOWLEDGE AND EXPERIENCE GAP

Clearly, *someone* in every trade association should care about the organization's executive compensation and ensure that all necessary steps are taken to avoid any problems that might threaten the organization or interfere with its mission.

Let's explore some of the issues facing trade associations and the steps that can be taken to address them.

Overall, responsibility for the oversight and governance of executive compensation rests squarely upon its outside or independent directors. Often, there is an executive committee or compensation committee specifically charged with this responsibility. In most cases, these outside directors (non-staff members) come from the organization's membership or closely-related fields and are highly regarded for their expertise related to the trade association they serve. But they often have little to no knowledge or expertise in the area of executive compensation, particularly for a tax-exempt trade association. This can, and has, created some challenging

▶Read more

CONTINUED FROM PAGE 5

EXECUTIVE COMPENSATION

issues, as boards address their executive compensation responsibilities.

For example:

- Board members drawn from a for-profit sector known for its high-pay or exotic compensation practices might well have a different frame of reference on what constitutes competitive or excessive compensation than those board members from a much more conservative sector. In both cases, comparisons of what the trade association's executives are making versus what board members make are bound to occur. The comparisons are understandable, but may not have any bearing on the determination of the reasonableness of the trade association's compensation.
- Board members from for-profit organizations may be accustomed to types of incentives, benefits and perquisite arrangements that are common in their own organizations but not allowed in a tax-exempt organization.
- Even those individuals familiar with executive compensation, may not realize that simply looking at the size (i.e., revenue, budget, membership, etc.) of a trade association alone to establish pay levels may not accurately or adequately provide the proper basis for determining what constitutes reasonable or excessive compensation. Trade associations vary greatly in their missions and the expertise required to carry them out (i.e., an organization simply promoting the industry vs. an industry's self-regulating organization).
- Similarly, some trade association executives may have or require specialized experience and/or expertise that have a far more significant bearing on the competitive compensation than the type or size of the organization.

COMPLYING WITH REGULATIONS AND BEST PRACTICES

Given the potential consequences of an executive compensation problem and the challenges that face the board members responsible for avoiding those consequences, what can be done to minimize the likelihood of problematic executive pay?

Rather than assuming no one cares, or that their own organization is somehow different, trade associations would be well advised to take all steps necessary to ensure that their executive pay practices are governed and administered in accordance with applicable IRS regulations and best practices that are widely recognized among tax-exempt and for-profit organizations alike.

Specific steps would include the following:

- If a specific group of outside or independent directors has not been charged with responsibility for executive compensation, one should be established. The group (compensation committee) of individuals would be well-advised to formally define the responsibilities and authorities assigned and their accountabilities to the overall board.
- A formal process should be established for the regular and ongoing oversight of the organization's executive compensation. This would include the identification of the specific positions overseen by the compensation committee as well as the adoption of policies and processes that will be used to understand the role of each position, obtain valid information about competitive pay practices from other organizations that compete for similar executive resources and maintain such documentation, and make informed decisions about pay to ensure the organization's business needs are met.
- Finally, the compensation committee should keep timely minutes of all its meetings detailing the topics, deliberations and decisions made about executive compensation or related matters (i.e., employment agreements, compensation surveys, consultant reports, etc.) associated with the committee's work.

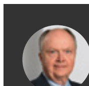
Readers who are familiar with IRS Intermediate Sanctions will recognize that these are the steps required for the "Rebuttable Presumption of Reasonableness." Complying with these steps effectively shifts the burden of proof to the IRS to refute the value of the comparability data used and decisions made relying upon it. They are also quite consistent with generally recognized best practices for oversight of executive compensation used by all types of organizations, both non-profit and for-profit.

FURTHER ENHANCING OVERSIGHT

In addition to the steps above, the following should be considered as ways to further enhance the oversight of the trade association's executive compensation program:

- Part III of Schedule J and Schedule O of IRS Form 990 provide opportunities for organizations to provide additional details about reported compensation amounts as well as the plans and policies associated with them. Many organizations ignore or underutilize the opportunity to proactively explain what might at first appear to be an alarming amount of compensation.
- Occasionally, a trade association might consider an independent review of its compensation governance process. An independent third party (attorney, consultant, etc.) who is knowledgeable of the compensation issues applicable to a 501(c)(6) organization should be retained to assess the overall quality of the governance process. These reviews not only provide assurance of sound practices but may also identify areas for improvement.
- Finally, all members of the trade association's governing body should be provided with an annual briefing on the organization's executive compensation program and governance process. The facts and circumstances of every organization will dictate the most appropriate manner for sharing information as well as the level of detail provided. However, every member of the organization's governing body should be provided sufficient information to address questions that may arise from members or the public. After all, the pay information is only a few clicks away on the Internet.

Who cares about executive compensation at trade associations? The IRS, association members and the public at large, especially if there is ever a question or unusual compensation disclosure that may appear as if executive pay is excessive.



For more information, contact Mike Conover, senior director, Specialized Tax Services – Global Employer Services at wconover@bdo.com.

▶Read more

TAX ISSUES WITH COMPLEX NONPROFIT ORGANIZATION STRUCTURES

By Mike Sorrells, CPA and Joyce Underwood, CPA

As nonprofits grow larger and their missions expand, many organizations structure their activities through a variety of related organizations, often because a particular structure may not work at all if the activity were carried out in the main nonprofit organization.

We commonly see structures involving 501(c)(3), 501(c)(4) or (6), Political Action Committees (PACs), for-profit corporations, and single member Limited Liability Companies (LLCs), as well as partnerships or LLCs with both nonprofit and for-profit partners—either domestic or foreign. Within these complex structures, there are a number of tax issues that can arise, including those related to tax-exempt status and unrelated business income. Here are eight of the most common issues nonprofits encounter, as well as some best practices regarding tax issues for complex nonprofit organization structures.

1 SEPARATION OF ENTITIES

One of the most important starting points for tax considerations for related organizations is legal and operational separation. If proper separation is not maintained among related entities, the Internal Revenue Service (IRS) may attribute the activity of the related entity to the parent nonprofit, sometimes with dire results. Related organizations should be separate legal entities (usually corporations) with separate bank accounts and books, and the corporate status must be maintained by filing annual registrations with the state. It's acceptable for the books of related organizations to be kept on one general ledger system as long as it is possible to easily separate the records of one entity from another. Corporate formality must be maintained with separate board meetings and minutes, although having overlapping boards is generally permitted. For a number of reasons, it is highly recommended that there be written contracts between related organizations as well as between organizations and third parties (i.e., the contract should be with the entity receiving services and not with the main organization). Expense reimbursement arrangements between related organizations should be documented in writing.

2 PROVISION OF SERVICES

It is common and often efficient to share employees and administrative resources among related organizations as this practice can avoid duplicate staff and unnecessary administrative costs. A proper method of allocating costs should be developed and applied consistently using timesheets and other such cost allocation documents. It is important to determine if an employee sharing arrangement is classified as a common paymaster or leased employee arrangement, since the type of agreement can impact employee benefits, tax information reporting and disclosure on IRS Form 990. Beware that providing services for affiliated organizations, whether they are administrative or program related, can result in unrelated business income tax (UBIT). Additionally, the terms of the agreement cannot put the nonprofit in a disadvantageous position. This is particularly important when the nonprofit is a public charity, as the IRS does not allow charitable assets to be released for less than fair market value. It is equally true when the arrangement involves a for-profit affiliate, particularly one that is not wholly-owned. It is also important that "due to" and "due from" accounts be settled frequently so large balances don't build up that cannot be repaid.

3 501(c)(3) CHARITY RELATIONSHIPS WITH OTHER NONPROFITS

When structuring complex organizations, it is important to remember that 501(c)(3) organizations cannot be involved in political campaign activities and must be isolated from such activities by their affiliates. They also cannot have a PAC (political action committee) directly associated with them. The 501(c)(3) organizations must avoid links on their website to affiliated organizations' content regarding political activities as well as to other organizations with political or lobbying content.

A 501(c)(3) may make grants to a 501(c)(4) or 501(c)(6) organization (affiliated or unaffiliated) in support of their programs, but the funds must be used exclusively for educational or other purposes appropriate for a 501(c)(3), and the 501(c)(3) should require reports (expenditure responsibility) showing that this requirement has been honored. Although they can support certain affiliate activities, the programs of the entities should remain separate to avoid any potential confusion as to which organization is conducting which activities. The 501(c)(3) cannot, under any circumstances, provide grant funds to a 501(c)(4) or 501(c)(6) for use to support partisan political activities.

4 POLITICAL ACTION COMMITTEES (PACs)

A political organization (organized under Internal Revenue Code (IRC) Section 527) is used primarily to fund activities designed to influence the nomination or election of candidates for public office. These organizations are frequently associated with 501(c)(4)s and 501(c)(6)s using a PAC in the form of a separate segregated fund (SSF). SSFs have tax-exempt status and are treated as an entity separate from the connected 501(c)(4) and/or 501(c)(6). They must obtain a separate employer identification number (EIN) and maintain a separate bank account. The PAC typically must report periodic receipts and disbursements to the Federal Election Commission (FEC) or state equivalent, instead of filing a Form 990. A sponsor cannot donate directly to a PAC, but employees or members can contribute funds. A PAC cannot loan money to its sponsor, although the sponsor may pay the administrative expenses of a PAC, as such administrative expenses are not considered political expenditures of

▶Read more

CONTINUED FROM PAGE 7

TAX ISSUES

the sponsor. Often, a PAC will be included in consolidated financials, but it cannot be included in the sponsor's Form 990 financial information.

5 SINGLE MEMBER LIMITED LIABILITY COMPANIES (LLCs)

In the past several years, the nonprofit arena has seen a proliferation of the use of single member LLCs. This kind of entity provides the owner or single member significant protection from various liability issues while not requiring separate tax reporting. Single member LLCs are so-called disregarded entities under tax law, meaning that unless they elect otherwise, their activities are considered to be those of the single member and are reported on the member's tax return as such (in the case of a nonprofit, on its Form 990). LLCs may elect to be treated as a corporation for tax purposes and thus, are taxed and file tax returns under C-corporation rules. If a 501(c)(3) has a single member LLC, then contributions to the LLC will be considered as being made to the parent charity, so it is not necessary for an LLC conducting charitable activities to obtain separate exempt status. However, states may treat single member and other LLCs differently with regard to sales, property, payroll and sometimes, income tax. Therefore, it is advisable to research applicable state laws when setting up such an entity.

6 CONTROLLED C-CORPORATIONS

Many nonprofit organizations own controlled C-corporations (requiring greater than 50 percent ownership) for a variety of reasons, including having enough unrelated activity that it might endanger the nonprofit's exempt status. The IRS ruled many years ago that a controlled C-corporation, if the corporate formalities are observed, will not have its activities attributed to the parent organization and thus, will not endanger the exempt status of the parent. However, the IRS has a special rule that can catch the unwary nonprofit organization: Under IRC Section 512(b)(13), passive income such as rents, royalties and interest (which are normally excluded from taxable UBIT) generally become taxable to a greater than 50 percent nonprofit owner of a C-corporation if that corporation takes a deduction for the related expense. There are exceptions and complexities with this provision, so organizations with controlled C-corporation subsidiaries should carefully examine these issues prior to engaging in intercompany transactions.

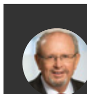
7 EXPLOITATION OF NONPROFIT ASSETS

It is important to avoid the exploitation of nonprofit assets when structuring an arrangement between affiliates. There must be fair compensation to the nonprofit, especially when the transaction is with a controlled C-corporation. Royalty and service agreements must be in writing with all terms concisely outlined. The dual-use of property (i.e., property used partly for an exempt activity and partly for an unrelated activity) requires proper allocation and substantiation. It is important to note that there may be exemption issues when partnering with a for-profit entity, especially in the healthcare industry. The nonprofit must have control, at least with regard to any activity endangering exempt status of the nonprofit.

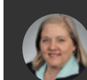
8 FORM 990 REPORTING

Of course, complex structures require special reporting on Form 990. First of all, with the exception of single member LLCs, all activities and balance sheet amounts for related organizations are not included on the parent organization's Form 990. These other entities will generally have to file their own tax returns. All related organizations, including single member LLCs, have to be listed on Schedule R along with certain financial and other information. "Related," for purposes of the Form 990, generally means an organization that controls another organization or is controlled by one; or are brother/sister organizations under common control. However, a careful reading of the Form 990 instructions is required to understand the nuances of this definition. Transactions between the reporting organization and related organizations are generally required to be detailed on Schedule R if transactions exceed certain thresholds. Related organizations controlled by insiders may also need to be reported on Schedule L for certain transactions. If related organizations are foreign entities, then expenditures to them, including grants, will generally need to be reported on Schedule F.

In addition to the most common issues regarding related organizations described above, there can be many additional situations and fact patterns that should be considered in establishing such complex structures. Before setting up related entities, it is prudent to consult with an experienced advisor who can provide the specific facts and circumstances of the new entity structure and the activities of the new entity that are being contemplated.



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



Joyce Underwood, director, at junderwood@bdo.com.

▶Read more

IT'S BUSY SEASON FOR THE HIGHER EDUCATION INDUSTRY

By Terri Albertson CPA and Tom Gorman, CPA

In the time since our team attended the 2015 NACUBO Annual Meeting, we've been continuing to mull over many of the presentations we attended and conversations we had, particularly around the breakneck pace of change in the higher education industry.

Each busy back-to-school season, as colleges and universities welcome new students, they also establish new value propositions and invest in innovations and updates across their campuses and programs.

With that in mind, here are a few key stories and issues capturing our attention as colleges and universities gear up for another academic year:

VALUE METRICS

We've previously discussed the use of metrics to evaluate the value of college education, and it should come as no surprise that the discourse around metrics has escalated with recent funding proposals from the Obama administration, as well as private foundations focused on improving higher education.

A new model for educational affordability released by the Lumina Foundation focuses on charging what students and families have the capacity to pay. It proposes that families should contribute to a child's college education the amount they can reasonably save over 10 years by setting aside 10 percent of their disposable income. Meanwhile, students should contribute their earnings from working 10 hours per week.

A report was released in August 2015 from researchers at Georgetown University, marking a big first step toward upending the conventional wisdom of the under-employment or unemployment of the nation's graduates. The study finds that of the 6 million jobs added to the U.S. economy last year, 2.9 million were "good" jobs, generally defined as paying at least $53,000 and offering benefits like health and retirement plans. Of those 2.9 million "good" jobs, 2.8 million went to college graduates, the report finds. The findings show most of these jobs were in managerial, STEM or healthcare professions. It is worth noting, however, that this report doesn't specify when degrees were earned, so the question of how recent graduates are faring in the job market is still up in the air.

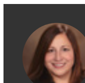
ONLINE LEARNING AND RETENTION

A new white paper released in August 2015 by researchers at the University of Ohio argues that the appeal behind the popular mobile game app Candy Crush could be used to improve higher education online course models through gamification. The authors recommend creating a game-like "flow" with clear goals, enticing challenges and immediate feedback to stimulate students' engagement in learning and, as a result, their retention. At a time when retention rates are flagging, harnessing new approaches and technologies to generate competitive spirit could positively impact student success in massive open online courses and other online coursework.

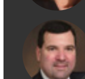
TIDAL CHANGES IN STUDENT POLICY

The U.S. Department of Education issued a clarification in August on federal privacy laws concerning student medical records. The draft guidance proposed that institutions, which have limited authority to review records from an on-campus provider under the Family Educational Rights and Privacy Act, should avoid reviewing students' medical records in litigation cases unless the case directly relates to the medical treatment itself or the payment for that treatment. The department is seeking input until Oct. 2. Looking forward, organizations should be prepared to adjust budgets as needed and prepare financially to mitigate risk and cover the costs of compliance with these and other emerging student policies and procedures.

Article reprinted from the Nonprofit Standard blog.



For more information, contact Terri Albertson, partner, at talbertson@bdo.com or



Tom Gorman, director, at tgorman@bdo.com.

Read more

IRS AUDITS: WHAT COULD THEY MEAN FOR UNRELATED BUSINESS INCOME?

By Laura Kalick, JD, LLM in Tax

Most exempt organizations are well aware that the IRS conducts random audits.

But in light of its limited resources, particularly for the Exempt Organizations Division, the agency is increasingly focusing its examinations on areas it believes will yield a high return for its efforts.

When it comes to exempt organizations, the area that comes to mind is unrelated business income (UBI). For a recent example, look no further than the IRS College and University Compliance Project, in which the agency examined approximately 40 colleges and universities and disallowed more than $170 million in losses and net operating losses (NOLs) due to errors in computation or substantiation of NOLs, lack of profit motive, improper expense allocations and unrelated activities that were classified as exempt or excluded. Nonprofits engaging in unrelated activities face the risk of IRS audit and having past NOLs disallowed, which can result in a substantial retroactive tax burden.

With that in mind, in order to mitigate their risks, nonprofits should consider the following precautions when allocating expenses and using NOLs from unrelated business activity.

DEFINING UNRELATED BUSINESS INCOME

The IRS has established certain analytic metrics to identify where there may be issues. The first page of the Form 990 reveals how much gross unrelated business income an organization has and the net amount of unrelated business taxable income reported on Form 990-T. To note, when organizations have had substantial gross UBI but no taxable income for three years, they may have a greater chance of being selected for an IRS examination. The biggest concerns are whether expenses being used to offset unrelated business income are properly allocated to that income, and whether the activity generating the expenses even fits the definition of a trade or business, which depends on whether there was a profit motive when conducting the activity.

With regard to the allocation of expenses, page 9 of Form 990 provides a road map for the allocation of expenses, helping organizations characterize revenue as related, unrelated or excluded. To claim unrelated trade or business income, the activity generating the income must pass a three-part test:

1. The activity must not be substantially related to the exempt purpose of the organization;
2. The activity must be a trade or business; and
3. The activity must be carried on regularly.

If a single activity is listed in both the related and unrelated columns, the IRS assesses whether the corresponding expenses are being allocated on a reasonable basis. Expenses related to an organization's mission cannot be used to offset unrelated business income. If personnel or facilities are used for both related and unrelated activities, a reasonable allocation must be made. Historically, this case-by-case assessment process has proved troublesome, and the IRS has begun work to smooth out issues and promote consistency. In fact, in the 2015-2016 Priority Guidance Plan, the IRS indicates it plans to work on methods of allocating expenses relating to dual use facilities.

WHERE'S THE PROFIT MOTIVE?

Profit motive is a key piece in defining an unrelated activity as a trade or business and whether net expenses from that activity are available to offset income from another unrelated trade or business. When considering an activity that generates losses year after year with no net income, the IRS and the courts have historically asserted that such activity is being conducted without motive to generate profit, and therefore can't be considered a trade or business. Consequently, an organization can't use the losses from such activities to offset the income from a profitable unrelated trade or business.

If such activities are determined to be without a profit motive, the IRS can disallow, or "throw out" the losses, requiring an organization to pay up. In fact, it is a typical tactic for the agency to disallow expense deductions from an unprofitable activity, even though the net operating losses may have been generated

Read more

CONTINUED FROM PAGE 10

IRS AUDITS

years ago. Such a verdict could pose significant unanticipated tax costs to an organization, and nonprofits should take steps to minimize the possibility of disallowed expense deductions. Note that the rule for NOLs is that they can be carried back to the two prior tax years to offset income from those years. Or, they can be carried forward for 20 years.

DOCUMENT, DOCUMENT, DOCUMENT!

When undergoing an audit, an organization must provide sufficient documentation proving the profit motive of the activity in question. While the IRS' general rule is to assess only the open tax years, when assessing whether an NOL is legitimate, the agency can review taxes back to the year the loss was generated, even if this means going back 20 years. In order to prepare for the possibility of an IRS audit, organizations should carefully track and document losses and expenses from all UBI activities. Specifically, nonprofits should keep and file old tax returns and all related calculations, as well as allocations, memos and agreements.

Recently, Congress has weighed in on the issue of using net operating losses from one activity to offset income from another activity. In fact, a provision of the Draft Tax Reform Act of 2014 would not allow losses from one UBI activity to offset the gains of another UBI activity.

Does your nonprofit conduct any unrelated business activity? If so, what practices have you implemented to prepare for a potential IRS audit?

Article adapted from the Nonprofit Standard blog.

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

ISSUES FOR EMPLOYERS IMPLEMENTING THE NEW PENSION STANDARDS (GASB 68)

By Patricia Duperron, CPA

Effective June 30, 2015, governmental employers are required to report their net pension liability (NPL) in the full accrual financial statements.

Cost sharing employers will also report their share of the collective net pension liability. The footnotes will disclose basic information about the pension plan, the long-term expected rate of return, the discount rate, the deferred inflows of resources and deferred outflows of resources, and a sensitivity analysis.

There are several issues that must be addressed to ensure that auditors can give an unmodified opinion on the governmental employer financial statements. The American Institute of Certified Public Accountants (AICPA) AU-C Section 9500 states that audited plan financial statements do not provide sufficient evidence to support the relevant assertions in the employer's financial statements with regard to the NPL. Without obtaining additional information, the employer auditor would likely not be able to accumulate sufficient appropriate audit evidence to support the pension amounts, and would likely have to modify the audit opinion.

It is important to note that the group audit standards (AICPA AU-C Section 600) do not apply to reporting the pension amounts. The AICPA issued AU-C Section 9600 to clarify this.

The Governmental Accounting Standards Board (GASB) Statement No. 68 (GASB 68) specifies that a primary government and its component units should be considered to be one employer for purposes of classifying a defined benefit plan as single-employer or multiple-employer. Therefore, the NPL must be allocated to component units that are part of the plan. Although GASB 68 does not establish specific requirements for allocation

Read more

CONTINUED FROM PAGE 11

GASB 68

of the NPL to individual funds, question 36 of the GASB 68 Implementation Guide indicates that the National Council on Governmental Accounting (NCGA) Statement No. 1 would require allocation of the NPL to proprietary and fiduciary funds.

GASB 67 and 68 changed the definition of covered payroll, which is included in the Required Supplementary Information (RSI). GASB 25 and 27 defined covered payroll as "all elements included in compensation paid to active employees on which contributions to a pension plan are based." This was often referred to as "pensionable wages." GASB 67 and 68 define covered payroll as "the payroll of employees that are provided with pensions through the pension plan." Question 210 of the GASB 68 Implementation Guide indicates that the total payroll of covered employees on the accrual basis should be presented in the RSI schedules.

An employer will likely select a measurement date that coincides with the year-end of the plan. For example, an employer implementing GASB 68 for its June 30, 2015 financial statements would likely use a measurement date of June 30, 2014. The NPL to be reported at June 30, 2015, would have a measurement period of July 1, 2013, to June 30, 2014. The prior period adjustment to be recorded as of July 1, 2014, would include the effects of the deferred outflows of resources for employer contributions since the beginning of the measurement period (July 1, 2013 to June 30, 2014). The effect on the beginning net position (July 1, 2014) would be the beginning NPL less the deferred outflows of resources. Question 267 of the GASB 68 Implementation Guide discusses this. Also, the prior period adjustment should remove the net pension obligation (asset), if any, that was determined in accordance with GASB 27.

There are several issues related to multiple-employer cost-sharing plans and agent plans. The AICPA issued two whitepapers to address these issues and provide best practices. The whitepapers are included in Appendix A and B of Chapter 13 of the AICPA *Audit Guide for State and Local Governments* as of March 1, 2015 (the Guide).

Each employer participating in a multiple-employer cost-sharing or agent plan needs to obtain the necessary information to support its specific pension amounts, including net pension liability, deferred outflows of resources, deferred inflows of resources and pension expense.

COST-SHARING PLANS

Employers should obtain the audited schedule of employer allocations and the schedule of pension amounts by employer as described in the AICPA whitepaper, *Governmental Employer Participation in Cost-Sharing Multiple-Employer Plans* (Appendix B of the Guide) and determine whether the schedules are adequate and appropriate for the employer auditor's purposes. The employer auditor will need to evaluate whether the plan auditor has the necessary competence and independence and also verify and recalculate certain amounts specific to the employer. Audited amounts should also be obtained for the beginning NPL and allocation percentages. Sample reports under AU-C Section 805 are included in Appendix B of the Guide.

Employer auditors will need to perform procedures to test the census data submitted by the employer to the plan. These procedures would ordinarily cover the census data reported to the plan during the year immediately preceding the actuarial valuation. Examples of procedures are included in Chapter 13 of the Guide.

AGENT PLANS

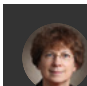
Employers' pension amounts depend on certain accounting records that are maintained by the plan, the controls and processes of the plan, as well as the calculations by the plan's actuary.

Appendix A of Chapter 13 of the Guide provides a two-part approach for employers to obtain sufficient appropriate audit evidence to support their pension amounts. The first part addresses the total pension liability, deferred inflows and outflows of resources, and pension expense. The plan should issue a separate actuarial valuation report specific to each employer and the plan engages its auditor to issue (1) a SOC 1 Type 2 report on controls over the census data maintained by the plan or (2) an examination engagement over selected management assertions related to census data maintained by the plan.

The second part addresses the employer's specific interest in the plan's fiduciary net position and calls for the plan to prepare a schedule of changes in fiduciary net position by employer and engage its auditor to opine on the schedule either through (1) an opinion on the schedule as a whole combined with a SOC 1 Type 2 report on the controls or (2) an opinion on each employer column in the schedule. Appendix A of the Guide includes sample reports under AU-C Section 805.

SUMMARY

Keep in mind that no matter what type of plan the employer participates in, it is not sufficient to simply obtain audited plan financial statements. Employers will need to obtain the audited schedules of pension amounts and the employer's auditor will need to perform additional procedures on the pension amounts and census data. Chapter 13 of the Guide provides audit considerations and suggested audit procedures for all three types of plans.



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

Read more

GASB 72 – FAIR VALUE MEASUREMENT

By Kurt Miller, CPA

For colleges and universities that follow governmental accounting standards (GAS) the definition of fair value has changed.

In February 2015, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 72 (GASB 72), *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurement. The standard provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

GASB's objective is to improve the financial reporting by clarifying the definition of fair value. The new standard aligns the GASB's fair value definition and principles with those of the Financial Accounting Standards Board (FASB). However, some differences remain.

GASB defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." When measuring fair value, the assumption is that the transaction would occur in the principal (or most advantageous) market.

Generally, all investments will be measured at fair value. However, GASB 72 maintains existing GASB standards with a number of exceptions for some investments that should be valued differently, including money market investments, 2a-7-like external investment pools, unallocated insurance contracts, non-participating interest-earning investment contracts and synthetic guaranteed investment contracts.

VALUATION TECHNIQUES

Fair value is determined using one of three valuation techniques:

a. **Market Approach** – uses prices generated by market transactions involving identical or comparable assets or liabilities;
b. **Cost Approach** – uses the amount that would be required to replace the present asset; or
c. **Income Approach** – discounts the cash flows or income and expenses to the present value at the measurement date.

All these techniques should maximize relevant observable input and be consistently applied.

DISCLOSURES

For most colleges and universities, GASB 72 will have the most significant impact on the footnote disclosures. Fair value measurements will be organized into a hierarchy, using the same three levels typically seen in financial statements that follow FASB standards, based on the reliability of the inputs. The levels are:

- **Level 1** – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.
- **Level 2** – Based on other observable inputs (not quoted in the market)
- **Level 3** – Based on unobservable inputs

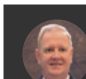
In addition to disclosing investments by level as described above, disclosures required by GASB 72 should be organized by type of asset or liability and include consideration of:

a. **Nature, characteristics and risks.** Assets or liabilities that share the same nature, characteristics or risks may be aggregated.
b. **Level of asset or liability in the fair value hierarchy.** Level 3 fair value measurements may need greater disaggregation.
c. **Whether generally accepted accounting principles (GAAP) require disaggregation.** Disclosures about derivative instruments should distinguish between hedging derivative instruments and investment derivative instruments.
d. **The relative significance of the assets and liabilities** measured at fair value to total assets and liabilities.
e. **Line items presented in the statement of net position.** A type of asset or liability will often require greater disaggregation than the line item presented in the statement of net position.

Additional disclosures are required for alternative investments that are measured using the Net Asset Value (NAV) per share. The disclosures for alternative investments should include the fair value, the investee's significant investment strategies and other factors that affect liquidity.

EFFECTIVE DATE

The requirements of GASB 72 are effective for financial statement reporting periods beginning after June 15, 2015. Earlier application is encouraged. The implementation of this standard will require restatement of the prior periods presented.



For more information, contact Kurt Miller, director, at kmiller1@bdo.com.

Read more

NONPROFIT FRAUD: IT'S A PEOPLE PROBLEM, SO COMBAT IT WITH GOVERNANCE

By Laurie De Armond, CPA and Gerry Zack, CPA

Skimming cash, purchasing schemes and financial statement fraud are three very different types of fraud that nonprofits must prevent, detect and insure against.

Still, behind each of them—and every variety of deliberate, deceptive act against nonprofits—there's a fundamental and shared dynamic at play.

Fraud isn't just an operational or financial risk. It's inherently a human risk, meaning it often crosscuts numerous functions and departments within a nonprofit organization. Not only that, but the people behind these acts are complex. They are pressured by varying circumstances, motivated by different opportunities and self-assured by their own unique rationale. Making matters more complicated, fraud is not always a solo act. In fact, a 2014 ACFE report found that 46 percent of fraud cases involve multiple perpetrators, meaning that when fraud does occur, the web of nefarious activity often extends to surprising depths within an organization.

To combat this threat, nonprofits face a critical need to address fraud from the top—starting with more guidance and engagement from leaders and boards to create an anti-fraud environment and oversee a fraud risk management function. Realistically, though, due to their mission-driven focus and more limited operating budgets, nonprofit leaders are often left with less time and fewer resources at their disposal to proactively develop anti-fraud governance measures. One of the most important deterrents of fraud is knowing that the organization has no tolerance for it and will act accordingly to detect it and take appropriate action if identified.

Given these challenges, how can nonprofits' leaders and boards establish and enforce governance? To start they can focus on these four key areas:

CATALYST REQUIRED:

Nonprofits need a high-ranking sponsor to get fraud risk management off the ground. This leader and his/her team's first order of business should be deciding whether their organization's fraud risk management will be integrated into the existing risk management function (which typically focuses on strategic, operational, reporting and compliance risks)—or whether it will be separate. Either way, the goal is the same: embed a risk management element into the daily activities of all your personnel.

RESPONSIBILITIES AND STRUCTURES:

With your management process in place, establish a governance structure for it, including designated oversight responsibilities at the board level, such as an audit committee. Keep in mind, this framework and the tools your organization uses should be scaled to fit both your size and your available resources. It's impossible to completely "fraud-proof" any organization, so understand the weak points in your infrastructure and organization, and then work backwards to execute. Also, while fraud prevention is ideal, many nonprofits have to weigh the costs and practicality of preventive processes versus detective measures.

ENGAGE AND EDUCATE:

Especially when faced with resource constraints, nonprofits should utilize all their personnel in an ongoing system of fraud deterrence. Above all, engage with your employees through workshops and trainings in which you educate them on why people perpetrate fraud, which red flags to watch for and what resources are available to them, such as whistleblower policies, reporting systems and hotlines. Awareness throughout your organization can be the single most effective fraud deterrent and vehicle for detection, but it has to start from the top.

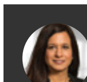
DYNAMIC RISK ASSESSMENTS:

People are dynamic, so your risk assessments must keep pace. With roles and responsibilities identified, use your team to pinpoint which inherent risks exist, and then prioritize them based on their impact, likelihood and speed at which they occur. Finally, use those priority rankings to map the risks to the best preventive and detective controls.

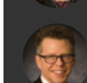
How does your nonprofit organization approach its fraud risk management?

See the related anti-fraud governance checklist and tips to help establish segregation of duties to decrease fraud risk on the next page.

Article adapted from the Nonprofit Standard blog.



For more information contact , Laurie De Armond, partner, at ldarmond@bdo.com or



Gerry Zack, litigation managing director in BDO's Global Forensics practice, at gzack@bdo.com.

▶Read more

Anti-Fraud Governance Checklist

By Laurie De Armond and Gerry Zack

To assess your organization's anti-fraud governance practices, ask the following questions:

- Does the organization have a clearly stated code of conduct that explicitly prohibits fraud and other unethical behavior?
- Does senior management openly discuss the importance of ethics and reporting suspected acts of fraud and other ethical breaches with the staff?
- Does senior management recognize the importance of setting an example for all staff by consistently abiding by the organization's code of conduct?
- Does the organization have a robust and readily available hotline/reporting system for employees to communicate suspected fraud?
- Does the organization have and consistently follow formal procedures for following up on and investigating allegations of fraud, noncompliance and other ethics breaches?
- Does the organization provide fraud awareness training (online or live) that all employees are required to participate in periodically (preferably annually)?
- Are management and the board aware of pressures associated with the achievement of the organization's objectives in the assignment of responsibilities and evaluation of performance?
- Are employees provided with a confidential means of discussing issues they are facing, such as work-related or personal pressures (for example, an Employee Assistance Program (EAP))?
- Does the organization perform periodic fraud and compliance risk assessments?
- Is the board of directors, or a committee of the board, formally charged with oversight of management's fraud risk management activities?
- Does the board (or audit committee) receive periodic updates regarding the nature of communications received by the hotline/reporting system and how these communications were resolved/investigated?
- Does the board (or audit committee) have formal authority to investigate allegations of fraud, including the ability to bring in outside investigators if deemed necessary?
- Does the board (or audit committee) hold discussions with the external auditors regarding the potential for management to override internal controls, and what the auditors do in response to this risk?
- When violations of the code of conduct are identified, is disciplinary action consistently enforced?
- Are fraud and compliance risks included as part of the board's discussions of new programs or other significant strategic changes under consideration?

TO PROPERLY SEPARATE DUTIES, THINK LIKE A THIEF

"We don't have enough people to properly segregate duties" is something we hear from many smaller organizations, and even some large ones. Proper separation of duties can certainly be a challenge. One way to simplify this challenge is by thinking like a thief. By that, we mean that organizations should consider that in order for crooks to perpetrate fraud, they need to be able to commit and conceal their crimes. If organizations can segregate the duties necessary to conceal the fraud from the duties necessary to commit the fraud, odds are that the person will not even attempt the scheme.

Sometimes, this means simply segregating a single step from the others. For example, many disbursement schemes in which perpetrators write checks to themselves or to personal vendors would easily be detected by having a separate person (e.g., a board member in the case of a small organization) reviewing the cancelled checks. Arranging for access to view cleared checks on the bank's website or receiving the bank statement directly from the bank creates a significant obstacle for a potential fraudster to overcome, and all that has been done is to segregate the critical concealment step necessary for the successful perpetration of the fraud.

Continue this process by thinking through each of the significant fraud schemes that your organization is exposed to and analyzing the most important duties necessary to conceal each scheme. Separate those duties so that a different person executes those steps.

Finally, if possible, separate the duties necessary to perpetrate the scheme. This often requires additional staff or volunteers, but it provides even stronger internal controls.

▶Read more

BDO PROFESSIONALS IN THE NEWS

BDO professionals are regularly asked to speak at various conferences due to their recognized experience in the industry. You can hear BDO professionals speak at these upcoming events:

OCTOBER

Rebekuh Eley will be presenting a webinar entitled "Non-Profit Supporting Organizations: Exempt Rules of IRC 509(a)(3)" for Strafford Continuing Education on Oct. 20 from 1 to 2:50 pm ET.

NOVEMBER

Andrea Wilson will be presenting a session on Nov. 12 entitled "The Wisdom of Bridges Comes from Knowing Both Sides: Federal Grant Law and Government Contracting" at the ABA Public Contract Law Fall Program scheduled for Nov. 12 – 14 in Charleston, S.C.

Andrea also will be presenting a session on Nov. 13 entitled "Tax Exempt Organizations: An Advanced Course" at the American Law Institute Conference scheduled for Nov. 12 – 13 in Washington, D.C.

Lee Klumpp will be presenting an "Accounting and Auditing Update" on Nov. 19 at the Illinois CPA Society's Not-for-Profit Conference in Rosemont, Ill.

DECEMBER

Lee Klumpp and **Dick Larkin** will be presenting an "Accounting and Auditing Update" on Dec. 4 at the Greater Washington Society of CPAs' (GWSCPA) 27th Annual Nonprofit Finance & Accounting Symposium scheduled for Dec. 2 – 4 in Washington, D.C.

Mike Sorrells will be presenting a session on Dec. 4 entitled "State and Local Tax Credits" also at the GWSCPA conference.

OTHER ITEMS **TO NOTE**

2015 OMB Compliance Supplement

The Office of Management and Budget (OMB) has issued the final 2015 2 CFR 200, *Compliance Supplement* (the Supplement). The 2015 Supplement is effective for all audits of fiscal years beginning after June 30, 2014, and supersedes the 2014 Supplement. The 2015 Supplement contains new and critical information for testing expenditures that are subject to OMB's *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards at 2 CFR 200* (Uniform Guidance). It is significant to note that there are two Part 3s in the new Supplement. Part 3.1 should be used to determine the applicable compliance requirements to test federal awards made prior to Dec. 26, 2014, and Part 3.2 should be used to determine the applicable compliance requirements to test federal awards subject to the Uniform Guidance (i.e., new awards made on or after Dec. 26, 2014, or funding increments made on or after that date). Recipients of federal money should familiarize themselves with the new provisions contained in the Supplement.

FAC Security Incident

The Federal Audit Clearinghouse (FAC), which is run by the U.S. Census Bureau, experienced an effective cyber-attack on one of its databases that is used to access the site. The FAC has been offline since July and will remain offline until the U.S. Census Bureau completes its investigation and takes steps to ensure the system's integrity.

As a result of this incident, the FAC has issued a formal extension for data collection forms (DCF) that have due dates between July 22, 2015 and Sept. 30, 2015, that extends their due dates until Oct. 31, 2015. You can access the formal extension notification at http://harvester.census.gov/sac.

Once the FAC system is back online, all users will be required to reset their passwords.

In addition, due to this shutdown the U.S. Department of Housing and Urban Development (HUD) is extending the due date for financial statements with fiscal years ending June 30, 2015 to Oct. 31, 2015. This is due to the fact that HUD agreed-upon procedures engagements performed on Financial Assessment Subsystem (FASS) submissions include procedures that compare information to the DCF.

ASU 2014-09 *Revenue from Contracts with Customers* Implementation Delayed

As discussed in the Spring 2015 Special Edition of the *Nonprofit Standard* there was a proposal to delay the effective date of the provisions of ASU 2014-09. The FASB has issued ASU 2015-14 to defer the effective date of ASU 2014-09 by one year. For many nonprofit entities, the effective date of ASU 2014-09 will be for fiscal years beginning after Dec. 15, 2018. For those nonprofit entities with public debt the effective date of ASU 2014-09 will be for fiscal years beginning after Dec. 15, 2017. Early adoption is permitted for any entity that chooses to adopt the new standard as of the original effective date.

However, as noted in our Spring 2015 special edition newsletter, entities should begin preparing to implement the provisions of ASU 2014-09 now, as there is a lot of work involved to adopt the provisions of ASU 2014-09.

FASB's Not-for-Profit Financial Reporting Exposure Draft

As noted in the article entitled "Liquidity – What's All The Fuss About?" the FASB issued the proposed Accounting Standards Update, *Not-for-Profit (Topic 958) and Health Care Entities (Topic 954) – Presentation of Financial Statements for Not-for-Profit Entities* for public comment. All comments were due on Aug. 20. The FASB is now reviewing the comment letters and continuing to conduct outreach with stakeholders as it works through the comments received.

Review the provisions of the exposure draft and keep up to date on the latest news on this FASB project by visiting our new Nonprofit Financial Reporting Resource Center.

Read more

NONPROFIT FACTS: DID YOU KNOW....

- The percentage of nonprofit board members with backgrounds in the finance industry has more than doubled in the past 25 years, according to a study from ***Ohio State University***.
- A study of IRS records by researchers at ***William & Mary, Rutgers University and University of California at Davis***, found that nonprofit recipients of restricted donations, such as grants, were 20 percent less likely to fall victim to fraud.
- Wealthy donors gave over $700 million more to nonprofits in the first five months of 2015 than they did in the same period last year, according to a tally by the ***Chronicle of Philanthropy***.
- According to "***Giving USA 2015: The Annual Report on Philanthropy for the Year 2014***," the 2009- 2014 recovery of donation figures is the fastest growth on record in the past 40 years.
- Ninety-four percent of claims costs against nonprofits relate to employment practices, compared to only 1 percent related to fiduciary responsibility, according to a recent ***Nonprofit Quarterly*** study.
- Eighty-four percent of the 1,584 millennial workers surveyed made at least one charitable donation last year, according to the ***2015 Millennial Impact Report***.
- Major aid charities have more than tripled their spending on fundraising during the past 10 years, amid a boom in international aid and increasing competition to draw donors, according to reports from the ***Thomson Reuters Foundation***.
- There was nearly $7 trillion in socially responsible investment assets in the United States last year, a 76 percent increase over 2012, according to a report from the ***Forum for Sustainable and Responsible Investment***.
- Mega-giving experienced a boom in the first half of 2015, reaching more than $4 billion and making up nearly 2 percent of total U.S. charitable giving, according to the recent ***Atlas of Giving*** study.
- While millennial giving is on the rise, baby boomers remain the most generous generation, making up 43 percent of charitable giving, according to a recent ***Blackbaud*** study.

▶Read more

INSTITUTE PERSONNEL CONTACTS:

WILLIAM EISIG
Executive Director,
BDO Institute for Nonprofit Excellence℠
301-634-4923 / weisig@bdo.com

PATRICIA DUPERRON
Director, National Governmental
Assurance Practice,
BDO Institute for Nonprofit Excellence℠
616-776-3692 / pduperron@bdo.com

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

LAURA KALICK
Director, National Nonprofit Tax
Consulting Services,
BDO Institute for Nonprofit Excellence℠
703-336-1492 / lkalick@bdo.com

LEE KLUMPP
Director, National Nonprofit
Assurance Practice,
BDO Institute of Nonprofit Excellence℠
301-634-4921 / lklumpp@bdo.com

TAMMY RICCIARDELLA
Director, National Nonprofit
Assurance Practice,
BDO Institute for Nonprofit Excellence℠
703-336-1531 / tricciardella@bdo.com

MIKE SORRELLS
Director, National Nonprofit Tax Services/
Tax Director,
BDO Institute for Nonprofit Excellence℠
703-336-1543 / msorrells@bdo.com

For more information on BDO USA's service offerings to this industry, please contact one of the following national practice leaders who will direct your inquiry to the appropriate partner in your market:

WILLIAM EISIG
National Practice Leader, Nonprofit
& Education Industry Group
301-634-4923
weisig@bdo.com

ADAM COLE
National Nonprofit & Education
Industry Group Catalyst, New York
212-885-8327
acole@bdo.com

LAURIE DE ARMOND
National Nonprofit & Education
Industry Group Catalyst, Greater
Washington, D.C.
703-336-1453
ldearmond@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

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, financial advisory and consulting services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through 63 offices and more than 450 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multi-national clients through a global network of 1,328 offices in 152 countries.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. For more information please visit: www.bdo.com.