
Perspectives

Annual Audit, Accounting and IRS Compliance Update

Presented by GBQ Partners LLC

October 21, 2009



Session 1: NPO Accounting & Auditing Update

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Today's presenters:

Jennifer Osburn

Manager, Assurance and Business Advisory Services

Bob Stillman

Director, Assurance and Business Advisory Services

The Hierarchy of GAAP and the Accounting Standards Codification

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Statement of Financial Accounting Standards No. 162

Effective November 13, 2008

- FASB Statements of Financial Accounting Standards and Interpretations, FASB Statement 133 Implementation Issues, FASB Staff Positions, and AICPA Accounting Research Bulletins and Accounting Principles Board Opinions
- FASB Technical Bulletins and any FASB cleared AICPA Industry Audit and Accounting Guides and Statements of Position
- FASB cleared AICPA Accounting Standards Executive Committee Practice Bulletins, consensus positions of the FASB Emerging Issues Task Force (EITF), and EITF Abstracts
- Implementation guides published by FASB, AICPA Accounting Interpretations, AICPA Industry Audit and Accounting Guides and Statements of Position (not cleared by FASB), and practices that are widely recognized/prevalent either generally or in the industry

But, this was all superseded by FASB in July 2009

FASB Accounting Standards Codification (ASC)

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Statement of Financial Accounting Standards No. 168

- A replacement of SFAS 162
- The ASC is the source of authoritative US GAAP recognized by the FASB for nongovernmental units, with a few exceptions that have been grandfathered in
- Effective for financial statements issued for interim/annual periods ending after 9/15/09
- All new information will be Accounting Standards Updates
- Results in all ASC content being the same level
- Now GAAP is only two levels:
 - Authoritative (within the ASC)
 - Non-Authoritative (not within the ASC)

FASB Accounting Standards Codification (ASC) - continued

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Purpose:

- To organize and simplify authoritative GAAP literature
- Approximately 90 topics

Cost:

- Basic view of topics is available for free
- Research capabilities require a paid subscription
- FASB will eventually issue a printed version of the ASC

Citations:

- FASB ASC Topic – Subtopic – Section – Paragraph

For more information, see www.fasb.org

Subsequent Events

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Statement of Financial Accounting Standards No. 165

- Effective for all interim/annual financial periods ending after 6/15/09
- Entity shall recognize in the financial statements the effects of all subsequent events providing additional evidence about conditions existing at the date of the balance sheet, includes estimates
- Examples:
 - Litigation based on events occurring prior to year-end and litigation is settled subsequently but before the date of issuance, the settlement should be considered in estimating the liability at year-end
 - If a significant customer with slow paying accounts throughout the year files for bankruptcy between year-end and the issuance of the financial statements, the reserve for uncollectible accounts should be re-evaluated

Subsequent Events - continued

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- Entity shall not recognize in the financial statements the effects of all subsequent events that provide evidence about conditions that did not exist as of year-end but arose prior to issuance of the financial statements
 - Examples:
 - Settlement of a claim for which the event occurred after year-end but prior to the issuance of the financial statements
 - Loss of plant or inventories as a result of fire or natural disaster that occurred after year-end but prior to issuance of the financial statements

Recognition and Presentation of Other-Than-Temporary Impairments

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FASB Staff Position FAS 115-2 and FAS 124-2

- Issued in April 2009, effective for periods ending after 6/15/09
- Part of this position applies to debt securities and part applies to debt and equity securities
- Debt securities:
 - US Treasury securities
 - US government agency securities
 - Municipal securities
 - Corporate bonds
- Equity securities:
 - Ownership interest in an entity: common, preferred, or other capital stock
 - Right to acquire ownership interest: warrants, rights, and call options
 - Right to dispose ownership interest: put options

Recognition and Presentation of Other-Than-Temporary Impairments - continued

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Debt Securities:

- Assess impairment if Fair Value < Amortized Cost Basis
- If the entity intends to sell the debt security, an other-than-temporary impairment has occurred
- In the entity does not intend to sell the debt security, the entity shall consider available evidence to assess whether it more likely than not will be required to sell the security before the recovery of its amortized basis
 - If so, an other-than-temporary impairment has occurred.

Recognition and Presentation of Other-Than-Temporary Impairments - continued

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Debt Securities (continued):

- Considerations:
 - The present value of cash flows expected to be collected
 - Changes to the rating of the security
 - Length of time and extent to which the fair value has been less than the amortized cost basis
 - Adverse conditions specifically related to the security, industry, or geographic area
- Amounts recognized in earnings
- Amounts recognized outside of earnings
- Adjusting the cost value of the investment

Recognition and Presentation of Other-Than-Temporary Impairments - continued

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Debt and Equity Securities:

- Present the total other-than-temporary impairment in the statement of earnings/activities with an offset for the amount not recognized in operating income
- Disclose information that enables the users of the FS to understand types of debt and equity securities held, including information about investments in an unrealized loss position for which an other-than-temporary impairment has or has not been recognized
- Disclose the reasons and significant inputs to determine and calculate the amount of the impairment that was recognized and not recognized in earnings
- Additional disclosures if recognizing credit losses for debt securities

Recognition and Presentation of Other-Than-Temporary Impairments - continued

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Process:

- 1) Determine whether an investment is impaired
 - Assess at the individual security level
 - Investment is impaired if the fair value is less than its cost

- 2) Evaluate whether an impairment is other than temporary
 - If there is impairment exists, it is either temporary or other than temporary
 - Equity Securities
 - Debt Securities

Recognition and Presentation of Other-Than-Temporary Impairments - continued

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Process (continued):

3) Recognition of an Other-Than-Temporary Impairment

- Equity Securities – Recognize (in earnings) a loss equal to the different between the cost basis and fair value
- Debt Securities – Recognize (in earnings) similarly if intending to sell the security, or more likely than not will be required to sell the security before recovery
- Debt Securities – If not intending to sell the security and is not more likely than not will be required to sell the security before recovery, the impairment shall be separated into:
 - The amount representing the credit loss – recognized in earnings
 - The amount related to all other factors – recognized outside of earnings (OCI)
- The cost basis should be adjusted for all impairments recognized in earnings

Disclosure of Uncertain Tax Positions

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FASB Interpretation No. 48

- Issued in 2006 and finally effective for nonpublic entities for fiscal years beginning after 12/15/08
- Must determine and disclose if a material position taken or expected to be taken is uncertain
- Disclosures include tabular reconciliation of unrecognized tax benefit/liability, penalties and interest, reasonable changes that could occur in the next 12 months, etc.
- Amount must be quantified, with interest and penalties accounted for, and disclosed in the financial statements and on the Form 990

Disclosure of Uncertain Tax Positions - continued

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Top Ten Uncertain Tax Positions for NPOs

- 1) Excess lobbying activity
- 2) Failure to substantially conduct the tax-exempt purpose approved by the IRS
- 3) UBIT – Advertising Revenue
- 4) UBIT – Rental Income
- 5) UBIT – Merchandise Sales
- 6) Political campaign intervention
- 7) Changes in law
- 8) Illegal activity/Noncompliance with law
- 9) Improper expense allocations to offset unrelated activities
- 10) Substantial private benefit

Disclosure of Uncertain Tax Positions - continued

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Process:

- Determine if there are any uncertain tax positions
- Evaluate materiality of those uncertain positions
- If material, is it more-likely-than-not that the position would be upheld if reviewed by tax authority or upon examination
- Aggregate all material, uncertain positions to determine the total liability to be recorded
- This should be done for all open tax years, generally the last three years
- Should also consider state income taxes

Endowments of Not-for-Profit Organizations

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FASB Staff Position 117-1 (FASB ASC 958-205-05-8)

Two purposes:

- Provide guidance on net asset classification of donor-restricted endowment funds for Not-for-Profit Organizations subject to Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) – Ohio has enacted UPMIFA effective June 1, 2009
- Improves disclosure about an Organization's endowment funds (donor-restricted or board-designated), whether the Organization is subject to UPMIFA or not

Effective for fiscal years ending after 12/15/08

Endowments of Not-for-Profit Organizations - continued

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Key Points for UPMIFA:

- UPMIFA abolishes the historic dollar value limitation on expenditures
- UPMIFA defines prudent use as being no more than 5% of the fair market value of the gift, calculated quarterly over the past 12 quarters (3 years)
- Also defines prudent use as diversifying investments, adhering to prudent person standard, and considering various factors when investing
- New procedures for releasing restrictions on small institutional funds (< \$25k) held for a long period of time (20 years) requiring notice to the Attorney General 60 days in advance of the release

Endowments of Not-for-Profit Organizations - continued

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Key Points for UPMIFA (continued):

- Applies to funds held in any form, including nonprofit corporate form, except charitable trusts, with a commercial or individual trustee.
- Most provisions of UPMIFA only apply to donor-designated endowments, not board-designated endowments
- UPMIFA applies to all funds in existence, not just new funds
- The specific provisions of UPMIFA apply only in the absence of explicit donor stipulations

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- Endowment Fund Definition:
 - Established fund of cash, securities or other assets
 - Provide income for the maintenance of the Organization
 - Use of assets may be unrestricted, temporarily restricted or permanently restricted
 - Generally established by donor-restricted gifts:
 - Permanent endowment – provides a permanent source of income – Permanently restricted
 - Term endowment – provides income for a specified period of time – Temporarily restricted
 - Governing board may earmark a portion of its unrestricted net assets as a board-designated endowment, to be invested to provide income for a long but unspecified period (accounted for as unrestricted net assets)

Endowments of Not-for-Profit Organizations - continued

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- Continues to require classification of donor-restricted endowment funds of perpetual duration as permanently restricted
 - Requires classification of the portion of the fund that is not permanently restricted as temporarily restricted until appropriated for expenditure
 - This may require reclassification of assets from unrestricted to temporarily restricted
 - Permanently restricted net assets are not diminished by investment losses or organizational appropriations for spending
 - Temporarily restricted or unrestricted net assets would be charged within the endowment

Endowments of Not-for-Profit Organizations - continued

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- Time restrictions for net asset investment gains or losses, classified as temporarily restricted net assets, lapse upon appropriation
 - Appropriation is approval for expenditure, unless the approval is for a future period
 - Purpose Restrictions:
 - If there are no purpose restrictions, the reclassification to unrestricted funds occurs at that time
 - If there are purpose restrictions, the reclassification can only occur when funds are spent or deemed spent for that purpose
 - Purpose restrictions cannot be released until amounts are appropriated

Examples from the Government Audit Quality Center website
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- A new gift comes in for endowment with no explicit donor language affecting initial net asset classification
 - All or some classified as permanently restricted net assets with the remainder classified as temporarily restricted net assets
 - Investment activity generally does not increase/decrease the permanently restricted net assets unless required by the donor or law to maintain purchasing power
 - Increase/decrease gets recorded as temporarily restricted activity, unless in underwater situations, where it would be recorded as unrestricted net assets
 - If moneys are spent elsewhere for the endowment purpose, the funds remain where they are with a time restriction still in place until appropriation

Endowments of Not-for-Profit Organizations – continued

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Examples from the Government Audit Quality Center website - continued

- If Board were to approve funding from the endowment for next year's budget, the net asset classification would not change until the next year (future period)
- The "next year" is reached and the amount approved in the prior year are now available for spending
 - The fund balance is reduced by the amount, even if the cash is not yet transferred
- If no purpose restriction (besides being an endowment), the amounts should be reclassified from temporarily restricted to unrestricted
- If there is purpose restriction, the reclassification would not occur until the amounts are spent or deemed spent for that purpose

Endowments of Not-for-Profit Organizations – continued

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- Net asset reclassifications from initial application of the FSP are a cumulative change adjustment in the year which the law is effective
 - Reported in a separate line item in the SOA, outside operating activity
 - May involve a significant reclassification of net assets from unrestricted to temporarily restricted in the year of UPMIFA becoming effective

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Disclosure Requirements:

- Nature and types of permanent and temporary restrictions on net assets of the endowment funds
 - Any deficiencies of any endowment funds when comparing fair value to levels required by laws
 - Description of the governing board's interpretation of the law that underlies net asset classification of donor-restricted endowment funds
 - Description of the Organization's policy for appropriation of endowment assets for expenditure
 - Description of endowment investment policies, including return and risk objectives, the spending policy and the strategies employed to achieve the objectives
 - Composition of endowment by net asset class at the end of the period
 - Reconciliation of beginning to ending balance by net asset class showing components of activity
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- Review FSP 117-1 for examples of disclosures in tabular format and narratives

Statement of Accounting Standards No. 115
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- Effective for audits of financial statements for periods ending on or after 12/15/09

- The auditor is not required to:
 - Perform procedures to identify deficiencies in internal control
 - Express an opinion on the effectiveness of the entity's internal control

- Auditor must communicate, in writing, significant deficiencies and material weaknesses to management and those charged with governance, by the report release date

Communicating Internal Control Related Matters Identified in an Audit - 27 continued

Definitions:

- Deficiency in internal controls is when the design or operation of a control does not allow management/employees to prevent, detect and correct misstatements on a timely basis in the normal course of performing their assigned functions
- Deficiency in design:
 - A control necessary to meet the control objective is missing, or
 - An existing control is not properly designed to that, even if the control operates as designed, the control objective would not be met
- Deficiency in operation:
 - A properly designed control does not operate as designed, or
 - The person performing the control does not possess the necessary authority or competence to perform the control effectively

Communicating Internal Control Related Matters Identified in an Audit - 28 continued

More Definitions:

- Material Weakness – deficiency or combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement will not be prevented, or detected and corrected on a timely basis
- Significant Deficiency – deficiency or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance
- The severity of the deficiency depends on:
 - The magnitude of the potential misstatement resulting from the deficiency or deficiencies
 - Whether there is a reasonable possibility that the entity's controls will fail to prevent, or detect and correct a misstatement of an account balance or disclosure
- The severity of the deficiency does not depend on whether a misstatement actually occurred

Communicating Internal Control Related Matters Identified in an Audit - 29 continued

Indicators of material weaknesses in internal controls:

- Identification of fraud, whether or not material, on the part of senior management
- Restatement of previously issued financial statements
- Identification by the auditor of a material misstatement
- Ineffective oversight of the entity's financial reporting and internal control by those charged with governance

- Objective of Standard is to improve:
 - Relevance
 - Representational faithfulness
 - Comparability
 - Of the information that a NPO provides in its financial reports about a combination with one or more other NPO, businesses or nonprofit activities

- Establishes principles and requirements for how a NPO:
 - Determines whether a combination is
a MERGER or an ACQUISITION
 - Applies the CARRYOVER METHOD for a merger
 - Applies the ACQUISITION METHOD for an acquisition
 - Establishes disclosures to help reader evaluate nature and
financial effects

Not-for –Profit Entities: Mergers and Acquisitions Financial Accounting Standard No. 164

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- Applies to: An entity combination that meets the definition of:
 - A **Merger** of NPOs, or
 - An **Acquisition** by a NPO
- Does NOT apply to:
 - Formation of Joint Ventures
 - Acquisition of an asset or group of assets that does not constitute either a business or a nonprofit activity
 - Combination between NPO, under common control
 - Transaction or event in which a NPO obtains control of another entity but does not consolidate that entity as there is no financial interest (typically through a contract).

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Not-for –Profit Entities: Mergers and Acquisitions Financial Accounting Standard No. 164

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- Why the separate standard for NPOs?
 - FAS 141 and FAS 141r, but NPOs were exempt until new standard
- Fundamental difference between NPOs and For Profit businesses
- NPO M and A do not involve a transfer of consideration, generally.
 - Not “fair value” exchanges
 - Are non-reciprocal transfers
- Negotiations in NPO mergers and acquisitions focus on furtherance for the benefit of the public of the mission, governance and programs of the entity, rather than on maximizing returns for equity holders.

- **Merger**

- Transaction or other event
- Between governing bodies of 2 or more NPOs cede control of those NPOs to create a NEW NPO
- Cede control requires that the merging entities not retain shared control of the new entity
- The combined entity must have a newly formed governing body
- New entity often is but need not be a new legal entity.

- **Acquisition**

- Of and entity by a NPO, is a transaction or event
- NPO acquirer obtains control of one or more NPO activities or businesses
- Initially recognizes their assets and liabilities in the Acquirer's FS.

Not-for –Profit Entities: Mergers and Acquisitions Financial Accounting Standard No. 164

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- Merger: Must use the “Carryover Method”
- New NPO shall recognize the assets and liabilities reported in the separate FS of the merging entities as of the merger date
- No additional assets or liabilities are recognized such as intangible assets (i.e. goodwill)
- Must reflect a consistent method of measurement thus may result in adjustments
- Not a “fresh start” option, meaning the new NPO can not completely change or opt for a different measurement technique
- Loads of disclosures

Not-for –Profit Entities: Mergers and Acquisitions Financial Accounting Standard No. 164

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- Acquisition: Must use the “Acquisition Method”
- Same as the acquisition method described in FAS 141r
- Additional guidance/terms unique to NPOs
- Requires
 - Identify acquirer
 - Determine acquisition date
 - Recognize and measure the identifiable assets acquired (separate from goodwill), the liabilities assumed and any non-controlling interest in the acquiree
 - Recognize and measuring of goodwill
 - Loads and loads of disclosures

- Effective for:
 - Mergers for which the merger date is on or after the beginning of an initial reporting period beginning on or after December 15, 2009
 - Acquisitions for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2009
 - Means the first set of financial statements for a reporting period **beginning** on or after December 15, 2009
 - So if you are a December 31 year end,
then December 31, 2010 financial statements
- Earlier application is prohibited

- Recovery Act Grant Applications
- New funding source
- Be very cognizant of the terms of the agreement
- Subject to Government Auditing Standards
- Subject to OMB A-133 Standards for Federal Awards
- May need a Program Specific engagement
- Read the application and contract terms
- Seek guidance/Call me!

- Beginning with the 2009 Form 5500 filings
- Large plans will be required to be audited
- Large is any plan with 100 or more eligible participants at the beginning of the plan year
- Generally excludes:
 - Government plans
 - Church plans
 - Annuity contracts
 - Custodial accounts solely through salary reduction agreements

GBQ performs over 80 benefit plan audits!

**End of Session 1:
NPO Accounting & Auditing Update**

**Questions?
Thank You!**



Session 2: NPO Tax Compliance Update

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Today's presenter:

Andy Arend

Manager, Tax Services

IRS Circular 230 Disclosure: To ensure compliance with requirements imposed by the IRS, please be informed that to the extent this communication and any attachments contain any federal tax advice, such advice is not intended or written to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or promoting, marketing, or recommending to another person any transaction, arrangement or matter addressed herein.

Exempt Status Considerations – Are you at Risk?

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- Tax Exempt Status
 - Lobbying / Political Campaign Activities
 - Private Inurement/Excess Benefit Transactions
 - Unrelated Business Income Tax
 - FIN 48

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- Types of Exempt Organizations
 - 501(c)(3) Organizations
 - Charitable Organizations
 - Educational Organizations
 - Religious Organizations
 - Scientific Organizations
 - Other Charitable Organizations
 - Private Foundations
 - Social Welfare Organizations – (c)(4)
 - Associations & Business Leagues – (c)(6)
 - Social Clubs – (c)(7)
 - Labor, Agricultural, and Horticultural Organizations – (c)(5)
 - Employee Benefit Funds
 - Political Organizations
 - Other Exempt Organizations

- Charitable Organizations (501(c)(3))
 - In order to be recognized as a charitable organization, must pass the following tests
 - Organizational Test
 - Operational Test
 - Primary Purpose Test

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- Organizational Test
 - Organization must be organized and operated exclusively for one or more permissible exempt purposes
 - Articles of Incorporation must limit the organization's purpose to one or more exempt purposes and cannot empower it to engage in activities that are not in furtherance of its exempt purpose
 - Unless the other activities are an insubstantial part of its activities
 - Organization is not considered organized exclusively for exempt charitable purpose if its articles of organization authorize it to:
 - Devote more than a insubstantial part of its activities to attempting to influence legislation;
 - Directly/indirectly participate in political activities; or
 - Engage in activities that characterize it as an "action" organization (PAC, etc.)

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- Operational Test
 - Organization's resources must be devoted to purposes that qualify as exclusively charitable within the meaning of IRC Sec. 501(c)(3) and applicable regulations (Rev. Rul. 72-369)
 - Focus on organization's actual activities rather than its statement of purpose

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- Primary Purpose Test
 - Must be organized and operated exclusively (primarily) for an exempt purpose
 - The presence of a substantial nonexempt purpose will “destroy” the exemption (Better Business Bureau of Washington, D.C. v. United States, 236 U.S. 279, 283 (1945))
 - Nonexempt activity will not result in loss of exempt status where it is less than substantial (St. Louis Union Trust Co. v. United States, 274 F.2d 427, 431-432)
 - What is “substantial”?
 - Courts have ruled in separate decisions:
 - Less than 10% of total efforts would not violate primary purpose
 - More than 1/3 of total revenue from unrelated business could not qualify for tax-exempt status

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- Lobbying Activities
 - Organization is attempting to influence legislation if it (Treas. Reg. Sec. 1.501(c)(3)-1(c)(3)(ii):
 - Contacts or urges the public to contact members of a legislative body for the purpose of proposing, supporting, or opposing legislation; or
 - Advocates the adoption or rejection of legislation
 - Public charities may engage in lobbying activities that do not result in a substantial part of their overall function
 - If substantial part of the activities are to attempt to influence legislation, the organization may be deemed to be an action organization and not qualify as a charitable entity.

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- Social Welfare Organizations
 - No limitations to attempting to influence legislation by social welfare organizations as long as the organization is primarily engaged in promoting social welfare
 - Associations
 - No limitations on lobbying activities by Association
 - No business expense permitted for portion of membership dues paid that represents lobbying activities

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- Political Campaign Activities
 - Charitable organizations must not participate in any political campaign on behalf of or in opposition to any candidate for public office (IRC Sec. 501(c)(3))
 - May be classified as an action organization and lose tax-exempt status
 - Political Expenditures
 - Amount paid/incurred by a charitable organization in any participation/intervention in any political campaign
 - Amounts paid/incurred by an individual for speeches or other services
 - Travel expenses
 - Expenses of conducting polls, surveys or other studies
 - Advertising, publications, fundraising for an individual
 - Any other expense that has effect of promoting public recognition
 - Internet!

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- Private Inurement
 - Tax-Exempt organizations are to be organized/operated so that no part of their net profits benefit any individual
 - Private inurement transaction is between the organization and person who has a “close” relationship to the organization
 - Founders
 - Trustees
 - Directors
 - Key Employees
 - Members of the family of these individuals

- Types of Private Inurement
 - Excessive compensation
 - Rental arrangements
 - Lending arrangements
 - Sales of assets
 - Equity distributions
 - Assumptions of liabilities
 - Employee benefits
 - Services rendered

- Excess Benefit Transaction
 - Any transaction in which an economic benefit is provided by a tax-exempt organization to or for the use of any disqualified person if the value of the benefit exceeds the value of the consideration received for providing the benefit (IRC Sec. 4958(c)(1)(A))
- Disqualified Person
 - Any person who was (during 5 year period) in a position to exercise influence over the affairs of the organization
 - Voting member
 - Officer
 - Founder / substantial contributor
 - Family member
 - Entity owned 35% or more

- Excess Benefit Tax (penalty)
 - Initial Tax
 - Disqualified person who benefited subject to 25% of the amount of excess benefit
 - Organization manager who participated in excess benefit subject to tax of 10% of excess benefit
 - Tax not imposed if there was a correction within taxable period
 - Tax not imposed if participation was not willful and was due to reasonable cause
 - Additional Tax
 - Disqualified person subject to 200% additional tax if there was no correction to excess benefit within specified period

- Unrelated Business Income – Concepts
 - Activities that are unrelated to the organization's primary exempt purpose are to be segregated from related business activities
 - Net income from unrelated business income (UBI) are taxed in same manner as income earned by a for-profit entity
- Who is subject to UBIT?
 - Virtually all exempt organizations
 - Excludes:
 - Political organizations
 - Farmers' Cooperatives

- What is Unrelated Business Income?
 - Three factors (IRC Sec. 513(b)):
 - Income is from a Trade or Business
 - Business is regularly carried on
 - Conduct of the business is not substantially related to the organization's primary exempt purpose

- Trade or Business
 - Profit Motive
 - Any activity which is carried on for the production of income from the sale of goods or the performance of services (IRC Sec. 513(c))
 - Income producing activity must have general characteristics of a trade or business
 - Competitive with for-profit business?
 - Is activity operated in similar manner to for-profit business?

- Regularly Carried On
 - Look at the frequency and continuity with which the activity is conducted and manner it is pursued
 - To be compared to same activities conducted by a for-profit entity
 - Preparatory time should be considered
 - Once a year most likely not “regularly carried on”

- Substantially Related
 - Relationship between the business activity that generates the income and the accomplishment of primary exempt purpose
 - Do not look at whether the organization uses these funds to further its exempt purpose
 - Substantially related if the conduct of the business activity has a casual relationship to the achievement of an exempt purpose and that relationship is “substantial”

- Exceptions to UBIT
 - Passive Income
 - Interest/Dividends/Capital Gains
 - Royalties
 - Rent (unless debt-financed or personal property)
 - Businesses conducted by volunteers
 - Substantially all of the work is performed without compensation (85-90%)
 - Convenience of organization's members, students, patients, officers or employees
 - Sale of items received by organization as charitable donations
 - Trade show activities (by (c)(5) or (c)(6) organizations)
 - Bingo
 - Mailing Lists
 - Sponsorship (vs. advertising)

- UBI – Expense Allocation
 - What expenses are permitted?
 - Ordinary and necessary business expenses
 - Directly connected to UBI activity
 - Direct Expenses
 - Solely attributable to UBI activities
 - Dual Use Expenses
 - Portion of an expense that is proximately and primarily related to UBI activity
 - Method must be reasonable

- UBI Net Operating Losses (NOLs)
 - Can generally offset NOLs from previous/future years against current year UBI
 - Caution!
 - If an activity is determined to not be an UBI activity (based on the three rules), then cannot generate NOLs to offset other UBI
 - i.e. if no profit motive, not UBI

- How much UBI is too much?
 - Too much UBI can terminate exempt status
 - Exempt purpose is no longer organization's primary purpose
 - UBI has become more than insubstantial
 - Courts have ruled anywhere from 20% to 50% of UBI activities vs. total activities is substantial

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- Is exempt status at risk?
 - Is organization operating under its primary exempt purpose(s)
 - Excess lobbying
 - Political campaign activities
 - Private inurement / excess benefit transactions
 - Non-compliance with law
 - Unrelated Business Income
 - All items of income reported?
 - Expenses properly deducted?
 - Does state/international tax apply?

- Open tax years
 - Three years after return filed
 - Form 990T is not “closed” just because Form 990 was filed
 - “Incomplete” return = no return filed
- Form 990 disclosure
 - FIN 48 footnote to financial statements to be included on revised Form 990, Schedule D

**End of Session 2:
NPO Tax Compliance Update**

Questions?

Thank You!



3:00 to 3:30

Refreshment Break And Networking





“Stretching Your IT Dollar”
Wednesday, October 21, 2009

Presented by:
John Hrusovsky, CEO
GroundWork group



AGENDA

- Technology Principles

- TAAP (Technology Assessment, Advancement & evaluation Process)
- Business Functions

Technology Principles

- Create the right organizational mindset.
- Understand that IT is an investment, not an expense.
- Align the business and IT.
- Small investments can bring significant returns.

TAAP (Technology Assessment, Advancement & evaluation Process)

- Use the GroundWork group Continuum of Technology Maturity (CTM) to access business functions.
- Develop a plan to advance capacity.
- Evaluate progress, re-evaluate as necessary.

Business Function

- **Strategic Planning**

- Technology as part of strategic plan and regularly updated.

- Technology not part of strategic plan.
- Insufficient funds to implement technology initiatives.

- Technology part of Strategic Planning process.
- Technology tied to mission objectives.
- Technology seen as a strategic investment.
- Technology presence at the board level.

Business Function

- Marketing

- Interactive & updated websites and consistent messages among web & print communications.

- Website not effectively linked to marketing of organization or updated on a regular basis.

- Interactive web presence.
- Web and hard copy marketing material is consistent.
- Enhance web site on a regular basis.

Business Function

- **Constituent Management**

- Management of client/constituent information and relationships.

- Constituent management not strategic to organization.
- Utilizing excel or access to manage constituents.

- Embrace a comprehensive Constituent Relationship Management system.

Business Function

- **Communications**

- eNewsletters, blast email and social media.

- Not effectively utilizing eCommunication methods.
- Not utilizing or inconsistently utilizing social media.

- Engage in communities of practice, social media.
- Utilize eCommunication tools.

Business Function

- Fundraising

- Automated, integrated fundraising applications.

- Do not utilize a fundraising system.
- Inefficient utilization of technology for events.

- Utilize a fundraising system.
- Embrace technology for events.

Business Function

- Service Delivery

- Technology integrated into service delivery, mobile computing, advanced data security, service delivery continuity planning.

- Mobile computing not part of service delivery.
- Limited data security of client information.
- No service delivery continuity plan.

- Secure client data.
- Utilize mobile computing when appropriate.
- Create a service delivery continuity plan.

Business Function

- Reporting

- Organizational, financial and management reporting with advanced tools.

- Organizational reporting requirements not well understood.
- Data not accessible or accurate, no metrics.
- Outcome, Management, Financial & Board reporting developed in a manual manner.

- Data accessible, accurate.
- Metrics in place.
- Reporting developed with advanced tools.

Business Function

- Day-to-day Operations

- Software applications, automated processes, network reliability & security, disaster recovery, upgrades, data back-ups, and policies, procedures & documentation.

- Dependency on volunteer support.
- Unreliable network.
- Data not secure or backed up.
- No IT policies, procedures or documentation.
- Applications not integrated.
- Manual business processes.
- No business continuity or disaster recovery plan.
- Used equipment.

Business Function

- Day-to-day Operations (continued)

- Analyze open source applications.
- Backup data on a regular basis.
- Utilize effective used equipment, stay away from junk.
- Develop IT policies and procedures.
- Analyze telecom spend on a regular basis.
- Share IT resources when possible.
- Utilize common applications for back office processes.

Business Function

- Training and Education

- Technology training and education plan for staff.

- Technology not part of training and education.
- No budget for technology training and education.
- No formal alignment of skill requirement to technology.

- Look into cost effective educational opportunities.

Session 4: Fraud Risks and Internal Control

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Today's presenter:

Bob Stillman

*Director, Assurance and
Business Advisory Services*

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- Prevalence of fraud in NPOs
 - Why does fraud occur
 - Opportunity created by segregation of duties conflicts
 - High-level review of certain major processes
 - Recommendations: Assessment and re-design

-
- Intentional misstatement of financial numbers
and/or....
 - Intentional taking of financial assets
followed by....
 - Overt acts of concealment

-
- Typical Theft:
 - Committed by a female employee
 - No criminal record
 - Earned less than \$50,000 annually
 - Employed at NPO at least 3 years
 - Amount stolen < \$40,000

 - Most Costly Thefts:
 - Committed by a male employee
 - Typically executive level
 - Earned > \$100,000 to \$149,000 annually
 - Employed at NPO the longest

Findings from a 2006 Report Published by Professors of New York University who specialize in NPO accounting, using data from the Association of Certified Fraud Examiners

- Estimate of Overall Annual Cost to NPO's
 - \$40 Billion for 2006
 - Or 13% of \$300 Billion given to charity in 2006
 - Equivalent to all donations from Corporations and Foundations

Findings from a 2006 Report Published by Professors of New York University who specialize in NPO accounting, using data from the Association of Certified Fraud Examiners

- Association of Certified Fraud Examiners Study in 2007
 - Random survey of sampled NPOs nationally
 - 58 cases reported
 - Losses ranged from \$200 to \$17 million
 - Median loss \$100,000
 - 95% of cases were a loss of cash
 - Majority of cases were:
 - Inflated invoices
 - Billing for expenses not incurred
 - Check tampering

Opportunity



Incentive or Pressure

Rationalization or Attitude

- We feel good about our internal controls because:
 - “We have an audit every year....
they have never found fraud.”
 - “We have very loyal employees.”
 - “We trust everybody.”
 - “Nothing like that would ever occur here.”

-
- The 3 areas that create “**Opportunity**”
 - Access to assets
 - Ability to authorize
 - Access to record entries and prepare financial statements
 - **Must:**
 - **ELIMINATE** the opportunity
 - **MITIGATE** the opportunity
 - Establish Detection and Deterrence Controls

- **“We are a non-profitlimited resources....
there is just the two of us....”**
- **“We are not comfortable having him/her in
that process...”**
- **“He/she is too busy with other responsibilities....”**

Segregation of Duties Conflicts Revenue/Receivables/Receipts Process

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Does any **ONE** individual have:

- **Access to Assets:**
 - Physically handle the check?
- **Access to Authorize:**
 - Review and approve transactions?
 - Authorize credit memos?
 - Authorize write-offs?
- **Access to Record/Report:**
 - General ledger journal entries?
 - Adjustments to sub-ledgers?
 - Donor database
 - Accounts receivable detail report
 - Revenue detail report
 - Financial statement format/export?

Segregation of Duties Conflicts Trade Payable/Expenses/Disbursements Process

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Does any **ONE** individual have:

- **Access to Assets?**
 - Master vendor files?
 - Disbursement/check printing software?
 - Check stock?
 - EFT/ACH/Wire?
 - Credit cards?
- **Access to Authorize?**
 - Signor on the bank account?
 - Signature stamp
 - Encrypted signature password?
- **Access to Record/Report?**
 - General ledger journal entries?
 - Adjustments to sub-ledgers?
 - Financial statement format/export?

Segregation of Duties Conflicts Payroll Liabilities/Expenses/Disbursements Process

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Does any **ONE** individual have:

- **Access to Assets:**
 - Master payroll files?
 - Disbursement/check printing software?
 - Check stock?
 - EFT/ACH/Wire?
- **Access to Authorize:**
 - Signor on the bank account?
 - Signature stamp?
 - Encrypted signature password?
- **Access to Record/Report:**
 - General ledger journal entries?
 - Adjustments to supporting payroll sub-ledgers?
 - Financial statement format/export?

- Document your major processes
 - Revenue, receivables and receipts
 - Could be multiple
 - Trade payables, expenses and disbursements
 - Payroll related liabilities and disbursements
 - Investments
 - Cash reconciliations and management
 - Month-end accounting and financial reporting

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Segregation of Duties Conflicts Identification and Assessment of Mitigating Controls Sufficiency Recommendations

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- Step 1: Document each major process:
 - Who does what?
 - What software?
 - What sub-ledgers, reconciliation summaries and reports?
 - Who authorizes?
 - Who has access?
 - Who reviews?
 - What does the review entail?
 - Is it documented/initialed?

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**Segregation of Duties Conflicts Identification and
Assessment of Mitigating Controls Sufficiency
Recommendations**
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- Step 2: Assess each major process:
 - Search and highlight segregation of duties conflicts
 - Brainstorm how something could go wrong
 - Design
 - Personnel Assessment:
 - Personal pressures/Attitude/Justification
 - The level of risk impacting
 - Financial statements reporting
 - Safeguarding of assets
 - Identify Existing Mitigating controls
 - Detection
 - Deterrence

.....

Segregation of Duties Conflicts Identification and Assessment of Mitigating Controls Sufficiency Recommendations

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- Step 3: Redesign Processes:
 - Re-assign certain duties
 - Add detection and deterrence controls
 - Seek guidance/assistance
 - Update all documentation

- Other Considerations
 - Assess each time you reorganize responsibilities
 - Hire personnel
 - Do not replace personnel
 - Re-organize a department
 - Assess each time you implement:
 - New software
 - Outsourced services
 - Assess Routinely (annually)
 - Engage all levels of management
 - Educate your Board of Directors
 - Fiduciary Responsibility

**End of Session 4:
Fraud Risks and Internal Control**

Questions?

Thank You!

