

NONPROFIT AGENDAS MARCH 2010

GETTING FINANCING IN TODAY'S ECONOMY

Nonprofit organizations, large and small, often consider borrowing money only as a last resort. But even in the current tight credit environment, there are certain times when going to the bank is the right answer.

When cash flows from contributions or program service fees are cyclical, but your expenses are fairly steady throughout the year, consider using a line of credit to help even out your cash flow. When you're planning a major capital addition or a new program that requires significant start-up costs, using debt financing up front may allow you to serve your constituents in a timelier manner.

The process

Even before you need the loan, begin building relationships with several local lenders. You may already have bank representatives on your board who can introduce you to the right people.

Before meeting with your loan officer, gather your organization's financial statements and tax returns for the past three years. You'll also need to prove to the bank that you can repay the loan. This will involve developing a cash flow projection that looks forward for three to five years as well as providing any budgets that may have been completed for the building or program that you're requesting financing for.

If tax-exempt bond financing is an option, the process may take longer due to the greater legal requirements in documenting and approving the transaction. While a line of credit or term loan can be approved in a matter of weeks, bond financing can take six months to a year before the papers are signed and the funds received by your organization.

The choices

The banker that you work with will help you decide which type of loan or debt facility makes the most sense. But there are some general guidelines to follow in determining the loan for which you should apply. The type of loan is usually driven by the underlying cash needs. While there are many types of loans, this article will primarily focus on tax-exempt bonds as they are often not considered by nonprofit organizations.

A *tax-exempt bond* is issued by a municipal, county or state government, whose interest payments aren't subject to federal income tax, and may be exempt from state or local income tax. Tax-exempt bond financing may benefit your organization because tax-exempt interest rates are generally two to three percentage points lower than on money raised from other sources. The Internal Revenue Code allows a nonprofit to use the proceeds, which are borrowed from the issuer, to further the organization's stated charitable purpose.

The first step in planning a bond issue is to identify which local government unit in your area has the ability to issue bonds on behalf of a not-for-profit. This agency (the issuer) then lends the bond proceeds to you.

The next step is selecting a team of specialists to work out the mechanics of the bond issue, including a bond counsel who will draft the documents and deliver an opinion. An underwriter advises on the bond issue's structure and then buys the bonds from the issuer and offers them to investors.

Tax-exempt bonds make the most sense for larger capital investments. Interest payments over the bond's term can be significantly lower than on a term loan, but up-front legal and other fees can be substantial.

The next step

In the current economy, every nonprofit is faced with strategic decisions that involve managing cash flow. Financing, whether it takes the shape of a line of credit, a term loan or a tax-exempt bond issue, may be the vehicle that allows you to take that next step toward accomplishing your mission.

Bond options under ARRA

The American Recovery and Reinvestment Act of 2009 (ARRA) offered a series of bond provisions that provide subsidies for some types of issuance, opened new markets to local government issuers, and offered an alternative minimum tax holiday for interest on private-activity bonds. This has opened up the opportunity through 2010 for nonprofits to access more attractive and cost-beneficial tax-exempt financing.

ARRA provides for tax-credit bonds as well as taxable bonds. Traditionally, state and local governments have issued tax-exempt obligations. If a bond issue is in your nonprofit's future, several of the options introduced in ARRA may affect you:

Taxable bond option (Build America Bonds). Issuers can elect to issue either taxable debt and collect a direct 35% subsidy from the Treasury Department *or* provide a 35% tax credit to investors in place of the traditional indirect subsidy of tax exemption. All of the tax laws applicable to tax-exempt bonds apply to taxable tax-credit governmental bonds. This option has opened up new markets, making the issuance of new bonds easier.

Recovery zone bonds. This category of tax-exempt, private activity bonds has been created for use in "recovery zones": designated areas with significant unemployment, poverty and home foreclosure rates. For nonprofits operating within a recovery zone, this option may provide more access to funds.

Qualified school construction bonds. These bonds may be used to finance new construction, or rehabilitate or repair public school facilities. The bonds can be much harder to take advantage of than the Build America Bonds, as fewer investors are finding them to be an attractive investment.

BEING "ACCOUNTABLE"

Certain expense reimbursements not taxable in accountable plans

Do your employees submit monthly expense reports? Do you give certain employees a car or phone allowance for business use of their personal auto or cell phone? If so, you're probably familiar with the term "accountable plan."

Certain expense reimbursements and allowances aren't viewed by the IRS as taxable income to the employee if they're made under an accountable plan. In turn, if these amounts aren't taxable income to the employee, they're not subject to the employer portion of FICA taxes either. There are four requirements for this type of plan:

1. The expenses must have a business connection.
2. The expenses must be reasonable.
3. There must be reasonable accounting for the expenses.
4. All excess reimbursements must be repaid in a reasonable time.

It's important to understand these requirements completely. Further explanation follows.

What qualifies as a business expense?

The IRS defines business expense as "the costs of carrying on a trade or business." Under the accountable plan rules, your organization can reimburse your employees for the following:

Auto expenses. Did an employee make an out-of-town trip solely on behalf of your organization and drive his or her own car? If so, you should reimburse that employee for every mile driven for your organization's benefit at the standard mileage reimbursement rate of 55 cents per mile. You also can reimburse employees for other expenses they're likely to incur, such as tolls or parking fees.

Travel expenses. Did that employee stay overnight on the trip out of town? If so, you should reimburse the individual for hotel costs and meals.

Other expenses. Reimbursement for a cell phone purchased by an employee for use by the organization also falls into this category, as well as employee-purchased supplies used by the organization.

What makes an expense “reasonable”?

You may wonder how the IRS determines if an expense reimbursement is “reasonable.” Here’s a straightforward example: Let’s say you reimbursed an employee at 70 cents per mile, 15 cents more than the 55-cents-per-mile rate currently allowed by the IRS. The agency would consider that extra 15 cents per mile excessive and treat it as taxable income. Also, an employer can’t reimburse the employee *more than* what he or she paid for any business expense.

What’s “reasonable accounting for expenses”?

According to IRS Publication 15, (*Circular E*), *Employer’s Tax Guide*, “[The employee] must substantiate these expenses to [the employer] within a reasonable period of time.” A receipt is, by far, the most common form of substantiation, or proof, that an expense was incurred. For mileage, the distance from Point A to Point B can be estimated using Internet search engines.

The IRS states that “amounts paid up to the allowable federal per diem rates for meals, expenses for incidental expenses and lodging are deemed substantiated, without the usual requirements for keeping records of the expenses with receipts.” These per diem rates generally change on an annual basis and can be found in Publication 1542 at <http://www.irs.gov>.

What’s a “reasonable time” for repayment?

In Publication 15, the IRS notes that “a reasonable period of time depends on the facts and circumstances.” Generally speaking, if an employee receives an advance for business expenditures as opposed to paying out-of-pocket first, the IRS imposes the following timeline:

- The employee receives an advance within 30 days of the time he/she incurs the expenses.
- The organization receives adequate accounting for the expenses within 60 days after the expenses were paid or incurred by the employee.
- The employee returns any amounts in excess of expenses within 120 days after the expenses were paid or incurred.

More commonly, an employee may pay for expenses first, and then receive reimbursement from the organization for amounts paid. In this case, the employee would generally need to adequately account for the expense within 60 days after the expenses were paid or incurred.

Follow the rules

It’s important to keep in mind that amounts paid under an accountable plan aren’t wages. As such, they’re not subject to normal employee and employer payroll taxes.

So, if you reimburse expenses under an accountable plan, be sure to follow the rules. Otherwise, you and your employee may have an unknown payroll tax liability. If you need more clarification, contact your financial advisor.

BOARD-STAFF HARMONY

Two planes flying in the same airspace need instruction from the tower to make sure they don’t collide. Likewise, you need to give direction to your board (and staff) — about “who does what” — to ensure you both reach your goals without distress. This can be especially important in a small organization. To avoid a collision, make sure your board members:

Receive a thorough orientation. The process will help board members understand their place in the big picture. Distribute a written description of their responsibilities and offer examples that illustrate the scope of their duties — for example, making business contacts in the community, fundraising and so on. Contrast this with staff duties (creating a budget, providing direction to staff, etc.). This will help them distinguish the complementary but separate roles of the board and employees.

Stress R-E-S-P-E-C-T. Staff members are partners with the board, helping it to advance goals and strategies. But board members don’t have the authority to direct employees. The staff reports to the executive director (ED), who reports to the board. So, if a board member wants an employee to compile a report, the request should go through the ED, because he or she manages the work flow and knows of any competing priorities. Similarly, board members who have employee-related suggestions should direct them to the ED, not the staff.

Encourage interaction. Board members can become more effective by understanding various employees' roles. Distribute an organization chart, and invite new board members to visit the office and observe key staff members at work. In turn, program managers or other senior staff also might attend board meetings to discuss developments in their areas and answer questions. By having direct interaction with staff, board members can get to know employees and gain insight into your organization's challenges and opportunities.

NEWS FOR NONPROFITS

New mergers & acquisitions accounting standard kicks in

How a nonprofit accounts for, and discloses, mergers and acquisitions (M&A) on its financial statement has changed. Statement of Financial Accounting Standards (SFAS) No. 164, *Not-for-Profit Entities: Mergers and Acquisitions*, is effective for such transactions on or after the start of an initial or annual reporting period, beginning on or after Dec. 15, 2009. So, for example, if your nonprofit has a June 30 fiscal year end, you'll need to follow the new standard for transactions on or after July 1, 2010.

Issued by the Financial Accounting Standards Board (FASB) in April 2009, SFAS 164 offers guidance on merger and acquisition accounting and disclosures specifically for nonprofits. When nonprofits combine, SFAS 164 clarifies whether the transaction is considered a merger or an acquisition and which accounting treatment to use.

A "merger" is the ceding of control by the governing bodies of two or more organizations. A new governing board *must* be newly formed. Using the carryover method of accounting, assets and liabilities are measured at their carrying amounts (not fair value) in the books of the combining entities on the date of the merger.

An "acquisition" is any combination not considered a merger. The acquirer obtains control. Assets and liabilities of the acquired entity are brought in at their fair value with few exceptions. SFAS 164 also addresses the treatment of goodwill — a significant move because much of the previous guidance on the goodwill that results from M&As wasn't effective for not-for-profit entities when first issued, including SFAS 142, *Goodwill and Other Intangible Assets*. Assets and liabilities, which are recorded at fair value, might create goodwill.

With the issuance of SFAS 164, these standards must now be applied prospectively to the first set of financial statements for an initial or annual reporting period beginning on or after Dec. 15, 2009. No early adoption is permitted.

Top Gun Salaries

Not all nonprofit executives have taken economic hits during the current downturn. The median compensation for CEOs at the nation's largest nonprofit organizations rose by 7% in 2008, according to a report by *The Chronicle of Philanthropy*. Nearly two-thirds of these 325 large nonprofits either maintained or increased the compensation for their top executives.

On the flip side, almost 30% of top executives at nonprofits took pay cuts, refused raises or bonuses, or froze their compensation in 2008. The average pay cut reported was 10%.

A similar survey of for-profit executives conducted by the *New York Times* by Equilar, an information services firm, reported a drop in compensation of 9% for the top executives in 2008.

SPOTLIGHT ON MP&S

Thought Leadership

Reducing IT Expenses

With the economy hurting the donor base of nonprofit organizations, charities need to reduce expenses and allocate the optimal amount of resources to achieving their mission. Richard Nathan, MP&S Principal and President of the firm's wholly owned subsidiary, Tailored Technologies, which provides external technology

and management consulting services, has written an article for the *Philanthropy Journal* to help nonprofits evaluate their existing information-technology environment, reduce inefficiencies and achieve cost savings.

Revenue Recovery

MP&S Partner Susan H. Nadler, CPA, has authored an article in *Commercial Investment Real Estate* that provides property owners with guidance about uncovering hidden revenue opportunities and ensuring that property portfolios are yielding maximum returns in this difficult economy.

Anti-Money Laundering Measures and Tax Fraud

Instances of money laundering and tax fraud seem to rise during a downturn. This economic downturn is no exception and has led to a surge in white collar crime. However, pinning the rise to a single factor is difficult to justify, and unlikely to be correct – ultimately, there are a myriad of drivers. MP&S Director David Gannaway, MBA, CFE, CAMS, EA, provides his perspective in an article in *Financier Worldwide*.

2010 Federal Estate Tax Repeal and Haiti Relief Update

In the firm's latest Tax Alert, MP&S outlines rules of the 2010 Federal Estate and Generation-Skipping Transfer (GST) taxes repeal and what it means for estate planning. In addition, the firm discusses President Obama's new measure that provides accelerated tax benefit for taxpayers making charitable cash contributions to the Haiti earthquake relief efforts.

People in the News

New Head of MP&S Westchester Office

Michael L. McNee, Partner-in-Charge of the MP&S Nonprofit Government Services Group, is now also the Partner-in-Charge of the firm's Westchester office, which is located at 660 White Plains Road in Tarrytown. *The Westchester County Business Journal* ranks Marks Paneth & Shron as the 7th largest firm in Westchester.

Valuation Specialist and Former MIT Professor Joins the Firm

Donald M. May, Ph.D., CPA, has joined the firm's Litigation and Corporate Financial Advisory Services Group. Dr. May brings global consulting and accounting experience in valuation, lost profits, opposing expert reports and deposition and trial preparation. He is also a former Assistant Professor of economics and accounting in the Sloan School of Management at the Massachusetts Institute of Technology.

MP&S Partner Elected to Transnational Auditors Committee

On January 1, William M. Stocker III, CPA, the Partner-in-Charge of the firm's Professional Practices Group, began serving a two-year term as a member of the Transnational Auditors Committee (TAC). In this global role, he represents the member firms of JHI, a leading worldwide association of independent accounting firms, business advisors and financial consultants. TAC is a committee of the International Federation of Accountants (IFAC).

MP&S FAST FACTS

- One of the 10 fastest-growing accounting firms in the United States (*INSIDE Public Accounting*)
- The 32nd largest accounting firm in the nation and a leader in accounting and auditing (*Accounting Today*)
- The 13th largest accounting firm in the New York Area (*Crain's New York Business*)

FOR FURTHER INFORMATION

If you have any questions, please contact **Michael L. McNee, CPA, Partner-in-Charge** of the MP&S Nonprofit and Government Services Group, at 212.503.8954 or mmcnee@markspaneth.com. You may also contact one of the following members of the group:

Partners**Hope Goldstein**

hgoldstein@markspaneth.com

Joseph J. Kanjamala

jkanjamala@markspaneth.com

Steven P. Monteferante

smonteferante@markspaneth.com

Warren Ruppel

wruppel@markspaneth.com

Directors**Howard Becker**

hbecker@markspaneth.com

Robert Lyons

rlyons@markspaneth.com

In addition, more information on the MP&S Nonprofit and Government Services Group can be found at **www.markspaneth.com**.

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