MARKS PANETH NONPROFIT AGENDAS NOVEMBER 2013: STRATEGIES AND SOLUTIONS FOR CONTINUING TO GROW YOUR NONPROFIT ORGANIZATION

KNOW THY ENEMY: UNDERSTAND RISKS AND HOW TO MITIGATE THEM

More than six out of ten (64%) not-for-profits haven't assessed their organizations for certain risks in the last year, according to a recent study by Crystal & Company, a strategic risk and insurance advisor. And nearly eight out of ten (78%) don't have an employee dedicated to managing such risks.

Those could be viewed as alarming statistics — many believe that inattention to risk was a contributing factor in the nation's recession and economic downturn.

Identifying your risks

Although some nonprofits don't seem to be paying enough attention to risks facing their organization, others are using the strategy of enterprise risk management (ERM) or similar methods to manage their risks.

The ERM process starts with identifying your organization's internal and external risks. Brainstorm with your staff. Think about all possible threats and dangers: from internal and external fraud to possible natural disasters, regulatory noncompliance, civil and criminal litigation, and economic and competitive forces.

Assessing the risks

Once you've pinpointed the not-for-profit's risks, evaluate and prioritize them. Ask yourself how likely these risks are to happen and what would be the consequences if they occurred.

Let's say that you're selling a member-written book that isn't related to your exempt purpose, and your income from the sales is considered unrelated business income (UBI) by the IRS — this is the identified risk. If you fail to report the income from the book sales, or if it becomes so substantial that your organization is no longer operating primarily for tax-exempt purposes, you could risk losing your tax-exempt status — which, of course, has far-reaching repercussions.

Here's another example: Your headquarters is in a flood zone and there are major floods in your immediate area on the average of every eight years. If a flood hits your facility, you face losing thousands of dollars in property damage. Worse, your facility might be unusable for months.

Developing responses

After your risk management team has assessed your organization's risks, decide how to respond to them. Some questions to pose include:

Can we avoid this risk? Using the possible flooding example above, you'll likely answer "no" — you have no control over Mother Nature. On the other hand, a decision to invest in quickly appreciating stock is a risk that could be avoided.

Can we share the risk? "Sharing risk" usually connotes having adequate insurance — this is a factor your organization can control. You can buy insurance that includes protection in case of a flood.

Can we reduce risk through policies and procedures? Often, the answer to this question is "yes." In the UBI example above, you could have certain procedures in place to keep track of and report book sales. An employee could be responsible for gathering this information and completing the form. And a deadline could be set for a manager to review the form before it's submitted to your CPA to include on Form 990-T.

Can we accept the risk and take no action? Sometimes the risk is so minimal — or the consequences so minor — that your team may decide to accept a risk and take no action. For example, your nonprofit is located in an area where earthquakes never hit. It's a simple decision to forgo special earthquake insurance, because you view the risk of your headquarters being affected by an earthquake as extremely low.

Creating controls

Controls — in the form of policies, procedures and other safeguards — can help contain risks. For example, let's say that your nonprofit is a food bank, which is located in an economically depressed area. Based on the crime rate in your area, you determine that there's a substantial risk of recipients, staff and volunteers becoming victims of theft or other crimes as they go to and from your facility.

So, you set a policy aimed at protecting these constituents from crime, which includes keeping your facility within a short walking distance of public transportation, operating only until 7 p.m. and offering free parking in a lot adjacent to your facility. You install bright lighting in the parking lot as a security measure. You also put various procedures in place, including having an employee escort visitors to their cars and requiring employees to walk in pairs to the parking lot.

Monitoring and reporting

It's critical to monitor the controls in your risk management program on an ongoing basis. For example, you could monitor the procedure of requiring two people to walk to the parking lot together by having everyone sign out when they leave the building. And a designated employee would review the sign-out log daily.

An annual audit report can help evaluate whether the control procedures are being followed and identify any additional risks. Auditors address such questions as, "Has *monitoring* people leaving the food bank in pairs improved that practice?" And, "Has the control affected the frequency of crimes reported by your constituents?" The results of your monitoring activities should be reported back to the ERM team.

Asking for help

No organization can eliminate risks altogether. But you can take certain steps to control them.

Additionally, certain threats call for special monitoring and reporting. For example, every nonprofit needs to create a set of internal controls to guard against fraud. Our specialists in the Nonprofit and Government Services Group can help formulate your risk management process and establish effective internal controls.

HOW SHOULD YOU VALUE DONATED PROPERTY?

With less cash in people's pockets, your nonprofit may see an increase in noncash donations. Whether you receive used computers, office furniture, a building or something else, the fair market value (FMV) of donated property needs to be recorded on your Form 990, state filings, and financial statements.

And if you received more than $25,000 in noncash contributions, or your organization received art, historical items or conservation easements, you must include "Schedule M — Noncash Contributions" with your 990. So how do you properly assess the FMV of the property as required by the IRS?

Define fair market value

The IRS defines FMV as the price that a willing knowledgeable buyer would pay a willing knowledgeable seller for the property, when neither has to buy or sell. For example, if a donor contributes used clothes, the FMV would be the price that typical buyers actually pay for clothes of the same age, condition, style and use.

Ultimately, FMV must consider all facts and circumstances connected with the property, such as its desirability, use and scarcity.

Consider the cost or selling price

According to the IRS, there are three particularly relevant factors that go into determining a gift's FMV, and *cost or selling price* is one of them. The cost of the item to the donor or the actual selling price received by your organization may be the best indication of the item's FMV. Because market conditions can change, though, the cost or price becomes less important the further in time the purchase or sale was from the date of contribution.

For instance, a donor may have paid $1,200 for a top-of-the-line smartphone in 2011. But that phone certainly isn't worth $1,200 in 2013. It may still have *some* value, though.

A documented arm's-length offer to buy the property — for example, real estate — close to the contribution date may help prove its value to the IRS. The offer must have been made by an independent, unrelated party willing and able to complete the transaction.

Look at comparable sales

The sales price of a property similar to the donated property — *a comparable sale* — often is critical in determining FMV. The weight that the IRS gives to a comparable sale depends on 1) the degree of similarity between the property sold and the donated property, 2) the time of the sale, 3) the circumstances of the sale (was it at arm's length?), and 4) the market conditions.

The degree of similarity must be close enough that reasonably well-informed buyers or sellers of the donated property would have considered that selling price. It's important that the transactions not be between related parties, and be considered arm's length sales. The greater the number of similar sales for comparable selling prices, the stronger the evidence of the FMV.

Determine replacement cost

FMV can consider the cost of buying, building or manufacturing property akin to the donated item, but the *replacement cost* must have a reasonable relationship with the FMV. And if the supply of the donated property is more or less than the demand for it, the replacement cost becomes less important to its value.

Get an appraisal

When it comes to getting an appraisal of the donated property, potential donors might be deterred because of the hassle involved. Yet appraisals generally aren't needed for items of property for which the donor will claim a deduction of $5,000 or less.

Donors who deduct more than $500 for any single item of clothing or any household item that's not in "good used condition" or better must include a qualified appraisal with their income tax return. In these cases, the donor should understand that the IRS will weigh the appraisal based on the report's completeness and the appraiser's qualifications and demonstrated knowledge of the donated property. The agency requires appraisals to provide all facts applicable to giving an "intelligent judgment" of the property's value, such as purchase price and comparable sales.

The IRS and courts are requiring donors to follow the requirements for appraisals — even when the value of the property is certain.

Do your duty

Properly valuing noncash gifts on financial statements, Form 990 and state filings and its attachments is one of your organization's financial reporting duties. For more information, see IRS Publication 561, *Determining the Value of Donated Property*. If you follow these IRS guidelines, you'll find the process fairly straightforward.

Valuing inventory has its own rules for donors

Let's say that your nonprofit needs several new computers, and a computer store is interested in donating some models to your organization as a "charitable donation." Here's how that would work:

If a business contributes inventory, it can deduct the smaller of its FMV on the day of the contribution or the inventory's basis. (The basis of donated inventory is any cost incurred for the inventory in an earlier year that the business would otherwise include in its opening inventory for the year of the contribution.) If the cost of donated inventory isn't included in the opening inventory, its basis is zero and the business can't claim a "charitable deduction." Instead, the cost would be included under "Cost of goods sold."

AUDITOR RECOMMENDATIONS CAN BE A TREASURE TROVE

Nonprofit leaders typically pay a lot of attention to the auditors' findings after an annual audit, and correct any "deficiencies" or "weaknesses" in internal controls. But the auditor's recommendations — formerly the "management letter" — provided in the report also can provide a gold mine of information.

Segregation of duties

Better segregation of staff duties is a common auditor recommendation, especially in small organizations. One recent audit, for example, discovered that the nonprofit's office manager makes bank deposits, reconciles bank statements and mails vendor payment checks. He also has check-signing authority for purchases under $500, and posts all cash receipts and disbursements to the general ledger.

Giving one person, no matter how honorable, all of these duties is a recipe for fraud or error. The idea behind segregation of duties is to avoid putting an employee in a position where he or she could both perpetrate and conceal fraudulent acts, or make mistakes that go undetected.

In this case, the auditor's recommendations included directly mailing the monthly bank statements (with images of the cleared checks) to the executive director or treasurer, who would then open and review them before giving them to the office manager. Another alternative is to offer those with oversight responsibilities "read only" access for on-line banking records.

Documentation of internal controls

Sometimes an audit might reveal that an organization has *adequate* internal controls, including various checks and balances. However, documentation of these controls may not be up to speed.

For example, a recent audit of a government-funded nonprofit revealed that it wasn't properly documenting its authorization of expenditures. The auditors recommended, among other measures, that the managers sign off on monthly bank reconciliations. Such steps not only might garner better results in the next annual audit, but also better prepare the organization for a site audit by its government funding sources.

NEWS FOR NONPROFITS

Volunteers more likely to find work

Here's something to point out to potential and current volunteers: Unemployed individuals who volunteer over the next year are 27% more likely to find jobs by year end than those who don't. And the relationship between volunteering and employment holds stable regardless of a person's gender, age, ethnicity, geographic area or job market conditions, according to the study *Volunteering as a Pathway to Employment: Does Volunteering Increase Odds of Finding a Job for the Out of Work?* by the Corporation for National and Community Service (CNCS).

CNCS, a federal agency associated with AmeriCorps and other volunteer programs, based the study on 10 years of data from the *2002–2012 Current Population Survey — September Volunteer Supplement* administered by the U.S. Census Bureau and Bureau of Labor Statistics.

Tool eases direct gifts from DAFs

Public charity Fidelity Charitable has released a free widget that enables donors to recommend grants from their donor-advised funds (DAFs) using the application found on a nonprofit's website. The donor completes the fund name, amount of the donation and any restrictions on its use — and 100% of the gift is sent to that nonprofit. The DAF Direct widget is available to all qualified public charities, is reportedly easy to install, and is being used by organizations such as the American Red Cross.

Effect of "Tea Party" probe on IRS work uncertain

The IRS has announced an "optional expedited process" for certain Section 501(c)(4) applicants in the wake of charges that the IRS used inappropriate criteria to review "Tea Party" and other organizations applying for tax-exempt status based on their names or policy positions.

The Exempt Organizations (EO) unit of the IRS's Tax Exempt and Government Entities Division announced on July 3 that the new process is available for 501(c)(4) applicants whose applications have been pending for more than 120 days as of May 28 and whose activities involved possible political campaign intervention or issue advocacy. Such organizations that receive "Letter 5228 Application Notification of Expedited 501(c)(4) Option" may be able to "self-certify" that their nonprofits meet certain criteria and obtain their exempt status within two weeks.

From an IRS insider's perspective, there could be a slowdown in application review work due to the controversy. In June, Marcus Owens, a former director of the EO unit, told an audience at the American Institute of Certified Public Accountants' Not-for-Profit Industry Conference that "everything shuts down, because there are allegations that your 501(c)(4) processing has been corrupt. . . . And maybe you go broader than that, because the 501(c)(3)s were playing in this field, too."

SPOTLIGHT ON MARKS PANETH

MARKS PANETH AGAIN VOTED A TOP FORENSIC ACCOUNTING PROVIDER BY THE *NEW YORK LAW JOURNAL*

In 2013, readers of the *New York Law Journal* (*NYLJ*) again ranked Marks Paneth as one of the top three forensic accounting providers serving the New York legal community in the publication's Annual Reader Ranking Survey. This is the fourth year in a row that we have received this honor and the first year we have been ranked #2.

INCREASED SCRUTINY ON FRAUD AT NONPROFITS

The rising incidence of fraud at nonprofit organizations continues to come under greater scrutiny. On October 26, *The Washington Post* published an article in entitled “Inside the Hidden World of Thefts, Scams and Phantom Purchases at the Nation's Nonprofits.”

Nonprofit boards and managers are facing mounting pressure in this regard and Marks Paneth has a cross-disciplinary team ready to help. Our team is comprised of recognized specialists in the nonprofit sector and in fraud and forensic accounting. For more information about our firm’s fraud and forensic accounting services for nonprofit organizations, please contact Michael L. McNee, Partner-in-Charge, Nonprofit and Government Services Group, at 212.503.8954 or mmcnee@markspaneth.com.

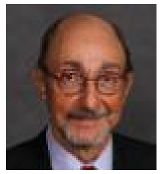
MARKS PANETH SPEAKING AT FAE EXEMPT ORGANIZATIONS CONFERENCE ON DECEMBER 4

Michael L. McNee, Partner-in-Charge of the of the Nonprofit and Government Services Group, and Robert Lyons, Managing Tax Director, will be speaking on the topic of “Do’s and Don’ts for Structuring Joint Ventures” at the Foundation for Accounting Education’s (FAE) Exempt Organizations Conference. This all-day conference will be held on Wednesday, December 4 at the New York Marriott Marquis

MEET THE NPG LEADERSHIP TEAM

Michael L. McNee
Partner-in-Charge
P: 212.503.8954
mmcnee@markspaneth.com

Hope Goldstein
Partner
P:212.503.6351
hgoldstein@markspaneth.com



Howard Becker
Director
212.710.1732
hbecker@markspaneth.com

Joseph J. Kanjamala
Partner
212.503.8952
jkanjamala@markspaneth.com

Robert Lyons
Director
212.710.1736
rlyons@markspaneth.com

Warren Ruppel
Partner
212.503.6391
wruppel@markspaneth.com

Anthony J. Tempesta
Partner
914.909.3415
ttempesta@markspaneth.com

If you have any questions, please contact any of the NPG leadership team listed above.
In addition, more information on the Marks Paneth Nonprofit and Government Services Group as well as all of
the firm’s services and industries can be found at **www.markspaneth.com**.

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