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NONPROFIT AGENDAS - DECEMBER, 2015

WHO'S A SCHEDULE L "INTERESTED PERSON"?

Schedule L is applicable for both Form 990 and 990-EZ filers. While the *form* has remained substantially unchanged for the past seven years, the *instructions* have changed four times. The most significant change involves the definition of an "interested person". In February 2014, the IRS streamlined the definition of "interested person". Prior to that, each of the four sections had a different definition.

Schedule L has received significant attention by the IRS with the hope of ensuring that nonprofit insiders (those able to exert influence over the organization's decision making) are not benefiting from their position. In general, the streamlining of the definition will make the gathering of information easier, with a common definition. On the other hand, it may pull more individuals into the classification and possibly cause more disclosures in the Form 990 and 990-EZ.

Standardizing the Definition

Schedule L is used by organizations that file form 990 or 990-EZ to provide information on certain financial transactions or arrangements between the organization and an "interested person". From a governance perspective, Schedule L is also used to determine whether a member of the organization's governing body is an independent member of the Board of Directors. A "taint" remains for individuals, their family members and companies that they own for a period of five years.

For 2014, Schedule L uses two definitions to identify an "interested person". The first definition applies to Part I (Excess Benefit Transactions) and continues to use the definition of a "disqualified person" found in Code Sec. 4958. For the purpose of Part I, the definition is more restrictive and generally includes any person who was, at any time during the five-year period ending on the date of the transaction, in a position to exercise substantial influence over the affairs of the organization. This would also include family members and 35% controlled entities.

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Parts II Through IV

In the revised IRS definitions, an "interested person" now includes:

• Current or former officers, directors trustees or key employees required to be listed on Form 990, Part VII, Section A or on form 990-EZ, Part IV;
• The creator or founder of the organization, including the sponsoring organizations of a Voluntary Employees" Beneficiary Association (VEBA);
• A substantial contributor, which is defined as an individual or organization that made contributions during the tax year in the aggregate of at least $5,000 and is required to be reported on Form 990 Schedule , "Schedule of Contributors";
• For the purposes of Part III, a member of the organization's grant selection committee;
• A family member of any individual previously described above;
• A 35% controlled entity of one or more individuals described above; and,
• For purposes of Part III, (Grants or Assistance Benefiting Interested Persons), an employee (or child of an employee) of a substantial contributor or of a 35% controlled entity of such person.

The instructions also list a number of exceptions for the various parts. For example, Part III would not list loans to an "interested person" because they would have been listed in Part II (Loans to and/or From Interested Persons). Various compensation transactions are also excluded, along with some grants made on an objection selection process not favoring the "interested person". Part II modifications exempt transactions reported in Part I, advances under an accountable plan, pledges receivable and certain loans made under the same terms and conditions as offered to other members.

Conclusion

Expanding the term "interested persons" to include substantial contributors creates some inherent problems that the IRS did not think through when they expanded the list. Asking substantial contributors to disclose transactions of a nature described in Part II, III and IV would appear to be rather intrusive, overwhelming and potentially harmful to the donor's relationship with the organization. Schedule L calls for a reasonable effort in obtaining the information from the parties involved. This could possibly call for disclosure of information that a substantial contributor may wish to avoid.

Parts II, III, and IV are calling for information only if applicable. For example, were loans, reported in Part II, made to the individual, a family member or a 35% controlled entity? As to Part III, were grants, scholarships or awards offered to a donor, a family member or a 35% controlled entity? It is important to remember the exception where selection was made on an objective basis without influence of the "interested person".

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For officers, directors, trustees, and key employees, the Conflict of Interest questionnaire could be expanded by nonprofits to address the needed information for Parts II and III. In the case of substantial contributors, a separate letter could be sent or incorporated into a "thank you" letter affirming that there were no loans, grants etc. between the "interested person" and the organization.

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KEEP YOUR EYES ON THE PRIZE

6 tips for finding and keeping event sponsors

Pay attention to what your nonprofit's offices sound like when staff is preparing for your annual event. Are the halls abuzz with talk about which flowers will decorate the dinner tables? Are there lively arguments over color schemes and food selections?

While such details of an annual, or special, event are of some aesthetic importance, they're not the key element that determines your event's success, in particular its *financial* success. That distinction typically falls to the event's sponsors, those companies (and individuals) that foot a large percentage of the expenses involved in holding the event.

Here are six suggestions for lining up event sponsors — and retaining them once you have their allegiance.

1. ***Be an early bird.*** Many nonprofits compete for the same philanthropic dollars. It wouldn't be overly ambitious to have your fundraising plan in place a year in advance. And you should lock in your sponsors four to six months before your special event.

2. ***Target the right sponsors.*** Holding a magnifying glass to your organization's mission statement is the best way to develop your list of potential sponsors. Think in terms of appropriateness and quality. For example, a reputable publisher of English as a Second Language curricula might make an excellent

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sponsor for a literacy organization's annual gala. A cereal company might be just the right target for a food bank's silent auction.

3. *Assemble a powerful team.* This is the time to ask board and committee members to use their connections in the community and solicit funds from your targets. Belts are fastened tight these days, so make sure your fundraisers are well prepared with complete information about the benefits each target company will receive.

4. *Have facts at your fingertips.* The team lining up sponsorships should be armed with data on the event's attendees. Use historical information to convince potential sponsors that the audience at your event is the same demographic they target for their products and services. Include information on where attendees live, along with their age, sex, and buying power. Be factual in your approach — don't exaggerate.

5. *Present attractive options.* Sponsors will contribute money to help finance your event in exchange for exposure to your audience. Here are some possible sponsorship opportunities:

- Include the sponsors' names on event materials, such as signs, banners, brochures, table tents, tickets, newsletters, program books and auction guides.
- Give verbal recognition — there are usually plenty of opportunities to thank sponsors during an event, including during opening and closing remarks.
- Offer free attendance to at least one representative of the sponsoring company so the sponsor will get a chance to mingle with attendees, gather information and build connections.
- Present speaking opportunities.

This last option works well at an annual conference or meeting. Ideally the sponsor will present information that's valuable to attendees while promoting that company's profile.

6. *Offer* levels *of sponsorship.* Develop a package of sponsorship options. In general, those companies paying the most should receive the most visibility at your event. For example, the top

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sponsorship tier might include the display of a large banner with the company's name while a lower-level sponsor might only be listed in the event program.

Consider the landing of a sponsorship as only a beginning, and stay in touch with that sponsor throughout the year. Try to get your new sponsor's employees involved in other aspects of your operation — for instance, volunteer work or your monthly magazine. Last, attempt to grow the sponsorship by thoughtfully asking for a larger contribution each year.

Be Careful

When considering how to treat sponsorships for tax purposes, it is possible that, while intended to be treated as a contribution, they can also contain elements of advertising which would have to be reported as unrelated business taxable income. This is generally based on whether the sponsorship, in part, represents an "exchange transaction" generally involving advertising or endorsements which would create a taxable element. To remain nontaxable, sponsorships are normally treated as a "supporting" acknowledgment to the charity without receiving a direct benefit back other than the public acknowledgment of the support.

NEWS FOR NONPROFITS

Millennials reach workplace milestone

Millennials in the workforce reached 53.5 million in the first quarter of the year, surpassing Generation X as the biggest age group in the US workplace. Millennials — ages 18 to 34 in 2015 — now comprise more than one-third of all employees, according to an analysis of US Census Bureau data by Pew Research Center, an independent think tank.

There's good news and bad news about this fact. The bad news is that most Millennials ranked pay as the most important factor in accepting a job, according to a 2014 study by Business Insider and News to Live By, a site highlighting career lessons, and most nonprofits can't compete with for-profits in the salary arena.

The good news is that knowing an organization was involved in "cause work," or programs that help people and communities, influenced job decisions for more than half of the Millennials surveyed in the 2014 Millennial Impact Report. Additionally, this age group aspires to succeed both at work and at home; for

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example, nearly 20% of fathers who responded said an ideal career would provide time off to be with their children, according to another study of Millennials by Bentley University.

What's the message here? Your nonprofit may be able to draw Millennials to the workplace through your mission and by offering flexible paths and time frames for advancement. One example: Let parents work less hours while their children are young, yet remain eligible for promotions.

Same-sex marriage ruling could change employee benefits

The US Supreme Court in June ruled that same-sex couples have a constitutional right to marry, effectively making same-sex marriage legal in all 50 states. If your nonprofit is in a state that previously hadn't recognized same-sex marriage, this legal recognition could mean a change in employee benefits in some areas:

Group health care plans. Group health care plans will now need to cover same-sex spouses if they cover opposite-sex spouses. Self-insured health plans can arguably continue to exclude same-sex spouses, but employers could invite discrimination lawsuits by doing so. And costs could grow as more same-sex couples exercise their right to marry and subsequently seek spousal benefits.

Family and medical leave. Employers subject to the Family and Medical Leave Act or state family and medical leave laws will be required to extend family and medical leave to employees to care for same-sex spouses, regardless of where the couple was married or resides. These employees also will be entitled to bereavement leave for their spouses, where it's provided.

Consult with your attorney if you have questions about how your nonprofit may be affected.

MAKING A PUBLIC APPEARANCE VIA YOUR FOOTNOTES

Your annual financial statements are available to anyone interested in finding out more about your nonprofit. Potential private donors, governmental supporters and others only need visit an online nonprofit-information service, such as GuideStar, to gather financial information on your organization. So your leadership needs to understand everything that goes into financial statements, including the footnotes.

Summarize your mission, revenue sources and policies

The summary of significant accounting policies, provided in footnote form, includes two sections: a brief description of your operations (including your chief purpose and sources of revenue) and a list of the significant accounting policies that have been applied in preparing the financial statements.

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A policy is generally considered significant if it could materially affect the determination of financial position, cash flows or changes in net assets.

The summary outlines specific policies such as the accounting method used in your not-for-profit's financial statements (accrual, cash basis or modified cash basis), classification of cash equivalents, fixed asset capitalization levels and depreciation methods. Other policies that should be listed include those on investments, uncertain tax positions, recognition of contributions and grants as revenue, and recognition of in-kind contributions, among others.

The disclosure of your accounting policies should describe the principles and methods that have been selected from acceptable alternatives. It should also explain industry peculiarities or unusual applications of Generally Accepted Accounting Principles that you use.

Disclose investment information and business deals

Nonprofits must disclose in the footnotes information related to investments, beginning with the types of investments held, such as equities, US Treasury securities and real estate. Among other information, the notes must disclose the your value for each major type of investment you own, current year income, realized and unrealized gains and losses.

Constituents may look to the related party transaction disclosure to determine if the not-for-profit is susceptible to conflicts of interest. The note describes transactions entered into with related parties such as board members, senior management and major donors. The description should include the nature of the relationship between the parties, the dollar amount of the transaction and any amounts owed to or from the related party as of the date of the financial statements, and the terms and manner of settlement. Guarantees between related parties also must be disclosed.

Reveal contingencies

Your not-for-profit also must disclose any reasonably possible loss contingencies. Contingencies are existing conditions that could create an obligation in the future and that arise from past transactions or events. Constituents may find loss contingencies of particular interest because of their potential negative effect on financial position and net assets. The financial statement notes must disclose the nature of the contingency and provide an estimate of the loss (or state that an estimate can't be made). In certain circumstances, gain contingencies also may need to be disclosed.

Nonprofits' contingencies include pending or threatened lawsuits or claims against your organization. Another could be costs or expenditures already incurred where reimbursement could be disallowed under a government grant. Other examples include current IRS examinations related to tax-exempt status, unrelated business income, and excise or other taxes. Even agreements with banks, such as

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guarantees of someone else's debt, should be disclosed. And any time that your organization hasn't used funds in compliance with donor restrictions also needs disclosure.

Report fundraising expense

Contributors, funding sources and regulators tend to be keenly interested in fundraising costs. Your financial statements should disclose information that allows users to compare the total amount of fundraising costs with the related proceeds — and, if a ratio of fundraising expenses to funds raised is disclosed, the method used to compute it. Also, when any expenses are allocated between program, management and fundraising (joint costs), the method used to allocate them must be disclosed.

Prepare carefully

The disclosures in your financial statements reveal a picture of your nonprofit that can influence your constituents' opinion of you, so present these facts carefully. Your CPA can provide objective feedback on what this information says about your nonprofit's financial well-being and how the organization is managed.

Cap rates in a nutshell

A property's capitalization rate represents its rate of return, based on the expected income generated by the property. It's used to estimate the potential return on an investment and quantify the risk related to actually attaining that return. The cap rate is calculated by dividing the expected income (after fixed and variable costs, not including debt costs), or net operating income (NOI), by the total value of the property.

The impact on valuation

The interrelationship of NOI, cap rate and property value means that a property's value can be determined using the NOI and the cap rate — property value equals the NOI divided by the cap rate. A higher cap rate will therefore result in a lower property value, NOI being equal. Obviously, then, application of a cap rate that is too high to the subject property will result in an underestimate of the property's value, and vice versa.

Disputes over the proper cap rate to use when valuing a property can stem from different approaches to developing a cap rate from comparable properties, particularly when calculating the properties' NOI. For example, if one party takes account of management company fees in computing the NOI, and the other doesn't, they will arrive at different cap rates. Excluding the fees produces a higher rate that reflects the increased risk from the lack of professional management. The inclusion or exclusion of replacement reserves in the NOI calculation can likewise affect a comparable property's cap rate.

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Discrepancies can also arise if one party derives the cap rate from data on comparable properties using historical income. Developing a cap rate from historical data and then applying it to the subject property's year-1 income projections will overvalue the property because projected income is riskier than historical income. Instead, the cap rate should be based on comparable properties' pro forma projections, which will have risk similar to that of the year-1 projections.

Beyond the numbers

No single approach for calculating cap rates exists — income and expense projections are treated differently by different parties and for different purposes. With the cap rate having such a significant effect on a property's value, it's vital that you ensure an appropriate cap rate is employed for your valuation.

IT ALL ADDS UP - DIRECTOR PROFILE

John D'Amico, CPA

John D'Amico is a director with the firm's Professional Standards Group and provides quality control services to the firm's Nonprofit and Government Group. To this role, he brings more than 20 years' experience providing accounting and auditing services to nonprofit organizations and higher education and governmental entities. He is based in Marks Paneth's midtown Manhattan headquarters.

As a sought out thought leader in his areas of expertise, John is an instructor for the American Institute of Certified Public Accountants (AICPA) and has led numerous seminars on topics relevant to the nonprofit community.

In addition to his professional activities, John is an adjunct professor at St. John's University and a dedicated volunteer who regularly donates his time to charitable organizations. He currently serves on the boards of directors and audit committees of several of City University of New York's (CUNY) related entities and foundations.

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LEVERAGE OUR EXPERTISE

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