

NONPROFIT AGENDAS SEPTEMBER 2008

THE MOST CRITICAL POLICIES FOR YOUR NONPROFIT

Two influences shape the policies your nonprofit develops, uses and keeps current over time. Outside forces such as the IRS, other federal and state bodies, and major funders require that you put specific policies in place. At the same time, your own board develops policies to address key issues — aiming for best practices as it fulfills its fiduciary responsibilities. Here's an overview of the most critical policies your nonprofit must have in place, review regularly and update as needed.

Avoiding Conflicts of Interest

This is probably the hardest policy that nonprofits have to tackle. But it's essential that you do. Organizations seeking an exemption as a 501(c)(3) charity will notice that a significant part of the IRS application deals with questions of possible conflicts with key employees and board members.

The application directly asks if your organization has adopted a conflict of interest policy consistent with the IRS's sample policy included in the application instructions. Accordingly, the following are examples of the types of questions that the policy should address:

- Are any of your officers, directors or trustees connected to each other through family or business relationships?
- Do the individuals who approve compensation arrangements follow a conflict of interest policy?

Similarly, the expected final version of the revised Form 990 for 2008 includes questions asking whether key employees, officers and board members are required to annually disclose interests that could give rise to conflicts. The form also asks how your organization monitors and enforces compliance with its conflict of interest policies.

Outlining Compensation Practices

Another important policy surrounds your not-for-profit's compensation practices. This has been an area of IRS scrutiny during the exempt-status process for some time. For example, the application asks: "Do you or will you record in writing the decision made by each individual who decided or voted on compensation arrangements?"

And Form 990 requires detailed information on your process for determining compensation for your top executive.

Factoring in Sarbanes-Oxley

Sections of the Sarbanes-Oxley Act (SOX) require all not-for-profits to keep policies on document destruction. Your document destruction policy should: 1) include a document retention guide, and 2) make it clear that employees, volunteers and board members are not to alter or destroy records with the intent of obstructing a government investigation, or for any other purpose in conflict with the document retention guide.

SOX also requires organizations to establish a "whistle blower" protection policy. The act makes it unlawful to discharge, demote or discriminate against in any other manner an employee who provides information on conduct he or she reasonably believes is fraudulent or a violation of law. Your organization must comply with this directive and have a policy in place for employees to report related complaints or concerns. The policy should:

- Allow employees to make such reports in a confidential manner, and
- Address how these reports will be followed up on, investigated and acted upon if appropriate—for example, many organizations have set up anonymous telephone hotlines, created Web site reporting locations or outsourced part of this function.

It's important to educate employees on the policy and train them on how to file a report.

Recognizing Your Needs

The next priority should be a set of policies outlining the authority and responsibilities of your board, its committees and your staff.

In doing this, you must define the limitations of executive management and what must be deferred to board-level authority. This can be a sticky issue for nonprofits whose executive director was a driver in the organization's origination; this person may tend to dominate the nonprofit's affairs.

For this reason, define the financial authority of the executive director, CEO or other key staff member through appropriate board policies. Those policies should address the staff's authority to approve expenditures, enter into funding arrangements and otherwise contractually commit the organization.

Along the same lines, develop policies on management travel, expense reimbursements and the approval of those items. Other high-priority policies include:

- Terms for providing financial information to the board and its finance and/or audit committee,
- Responsibilities of these committees,
- Annual budgeting process,
- Annual audit procedures,
- Banking and investment procedures, and
- Endowment and investment spending.

A gift acceptance policy is also a good idea.

Covering All the Bases

Whether your nonprofit is just starting out or looking to revise a policies and procedures handbook, be sure to address these requirements from all sides. Use your professional advisors to review these policies as needed.

Remember to Satisfy Your State

No discussion of policies would be complete without a warning that states have differing policy requirements. For example, states have different requirements about the need for an annual audit and whether you must have an audit committee in place. Depending on your state, you also may need policies on the use of outside fundraising organizations, and how to select and monitor their work on your behalf.

It's important to familiarize yourself with the requirements of the state or states where your organization operates, and then stay on top of any changes.

NEW RETIREMENT PLAN REGS ADD EMPLOYER RESPONSIBILITIES

New regulations for 403(b) retirement plans put more responsibility on plan sponsors. And that includes producing a written explanation of the plan and possibly opening the plan to more employees.

Document Your Plan

Employers offering 403(b) plans must have a written document in place for their plans by Dec. 31 of this year. Eligibility rules and distribution and loan requirements must be listed. So must rules

that spell out the duties of the plan sponsor, the contract's issuer and anyone else involved with the plan's administration. And various benefits, such as employer funding, must be explained.

If your nonprofit doesn't have a written document, this is the time to start gathering information: employee handbooks, collective bargaining agreements, administrative procedures, the contract itself and so on. Public school employers should be aware that the IRS and Treasury Department expect to jointly publish a model plan that schools may use to avoid administrative expense.

Make Your Plan Available

Under the new rules, almost all of a participating nonprofit's employees must be allowed to make salary deferral contributions. And employees must be notified of their "effective opportunity" to make or change their elective salary deferrals, as well as the conditions required to make them.

One exception to inclusion is an employee who normally works less than 20 hours per week. This creates problems for some school districts, since many exclude substitute teachers from retirement plans. If substitutes work 20 hours or more per week, their exclusion from a plan would violate the "universal availability" requirement that ensures the plan is available to a variety of employees. So it's important to include substitute teachers if they meet the hours requirement.

Bus drivers also are often excluded from 403(b) plans, even though they may work 20 hours or more per week. Again, it will be important to consider the hours these employees work — and not merely exclude them based upon their job status.

Deadlines on the Horizon

The final regulations for 403(b) plans apply to plan years starting Jan. 1, 2009, and later. But employers who offer these plans may rely on them now.

One notable exception to the deadline is for 403(b)s that are part of collective bargaining agreements in effect on July 26, 2007. For these plans, the regulations don't apply until the earlier of:

1. The date the collective bargaining agreement terminates, or
2. July 26, 2010.

Another exception involves church-related organizations whose church convention holds the authority to amend the plan. In these cases, the regulations apply to plan years starting Jan. 1, 2010, and later.

Make Sure You Comply

The IRS has launched a compliance project to examine school districts' adherence to the universal availability rule. A school district targeted by the IRS for the project could have a costly surprise if the agency were to impose sanctions. Consult with your professional advisors about this or any other compliance concerns you may have.

IS YOUR ORGANIZATION CERTAIN ABOUT ITS TAX POSITIONS?

A common cliché states that the only things certain in life are death and taxes. A new accounting rule will require nonprofits to evaluate and disclose how "certain" they are about the tax positions they've taken on their annual tax filings of Forms 990 and 990T as well as on their organization's activities.

This recent accounting rule, issued by the Financial Accounting Standards Board (FASB) as Accounting for Uncertainty in Income Taxes and designated Interpretation No. 48 (FIN 48), is effective for fiscal years starting after Dec. 15, 2007. Generally, FIN 48 requires your nonprofit to recognize a liability when you're uncertain if all income is exempt from income tax — provided you issue your financial statements according to Generally Accepted Accounting Principles (GAAP).

Evaluation in Two Steps

The evaluation of a tax position is a two-step process. The first step is either recognition or derecognizing. That is, your organization must determine whether a tax position would be upheld if the taxing authority questioned it.

The second step is *measurement*. Once an organization determines it meets the recognition threshold, it must then calculate the amount of tax benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the taxing authority. The difference, or unrecognized tax benefit, is recorded as a liability.

Exempt Status

A nonprofit having an exempt status with the IRS is in *itself* a tax position. Therefore, your organization needs to, at a minimum, evaluate if it has done anything that could jeopardize that status.

Remember: Political campaign intervention and not attempting to further your exempt purpose are both potential reasons for your status to be revoked.

Unrelated Business Income

The second — and more likely — reason a nonprofit could be affected by FIN 48 is its unrelated business income (UBI). A required “more likely than not” exercise should focus on whether the IRS or a state taxing authority could consider certain income to be unrelated to your exempt purpose and subject to unrelated business income tax (UBIT).

This will likely involve more than a quick “yes” or “no” answer: Opinions and interpretations set by the IRS and state taxing authorities aren’t always black and white. Thus, you may need to evaluate whether you should still record some UBIT liability even if it’s more than 50% likely that income received from a particular activity will be upheld as tax-exempt. Your nonprofit may have to negotiate something less than 100% if an examination takes place. If you decide a liability should be recorded, interest and penalties also have to be considered and accrued.

Sooner Rather than Later

Complying with FIN 48 will require you to have some discussions with your board members and professional advisors. So, you should begin the evaluation process sooner rather than later to comply with this new standard.

LOBBYING AND CHARITIES: KNOWING THE LIMITS

You need to keep tabs on how much lobbying you’re doing if you want to keep your tax-exempt status.

According to the Internal Revenue Code, no substantial part of a charity’s activities can consist of attempting to influence legislation by contacting, or urging the public to contact, a member of a legislative body. Nor can a *substantial* part of activities comprise proposing, supporting or opposing legislation. Unfortunately, substantial has never been defined — and this makes lobbying decisions all the harder.

In auditing a charity, the IRS looks at a variety of factors to see if a lobbying activity is substantial. Agents consider how much time — paid and volunteer — was devoted to the activity and how much money was spent. So, even if all of your lobbying-related activities were cost-free, the lobbying still could be substantial if enough time was devoted to it.

Is It Lobbying — Or Not?

Both direct and grassroots lobbying can cause a charity problems. *Direct lobbying* includes directly contacting legislators and advocating a specific action in regard to a piece of legislation. Direct lobbying also can mean communicating with your members, in the case of membership organizations, and encouraging them to lobby for specific legislation. With grassroots *lobbying*, you appeal to the general public to contact legislators.

Mere analysis, study or research isn't considered lobbying. For instance, you could hold educational forums to discuss the potential impact of legislation to change our national bird from the American eagle to the American turkey (as Benjamin Franklin suggested) and this wouldn't be considered lobbying. You just couldn't advocate one position or another in relation to the legislation. Here are some other activities that aren't considered lobbying:

- An appearance before, or communication to, a legislative body about a decision it might make that could affect your charity's existence or its operations, and
- Routine communications with government officials or their employees, such as a letter advocating the removal of an IRS penalty on your organization.

Responding to a written request from a legislative body or committee for technical advice or assistance also wouldn't be considered lobbying.

What's the Price of Lobbying?

The penalty for substantial lobbying is high: the loss of your tax-exempt status. A monetary penalty of 5% of the lobbying expenditures also could be assessed against your organization. Plus, your managers could be fined an additional 5%, if they intentionally agreed to the expenditures leading to revocation.

If your organization wants a more measurable method of determining excessive lobbying, you can make a 501(h) election, which outlines specific limitations and penalties for exceeding these limitations. If you take this road, you can spend up to a defined percentage of your budget on lobbying without jeopardizing your tax-exempt status. So if you engage in a considerable amount of lobbying, discuss this option with your tax advisor.

NEWS FOR NONPROFITS

Stricter Recordkeeping for Contributions

Generally since 2007, even donors making cash contributions of less than \$250 have needed certain documentation if they want to deduct the contribution. Previously, guidance on small donations was sketchy. Acceptable documentation includes a bank record or a written communication from the charity. A recent IRS notice clarifies that taxpayers donating less than \$250 to a combined fund organization such as the United Way or Combined Federal Campaign must also meet the stricter recordkeeping rules. The combined fund organization is considered the donee — even if it then distributes the donation to one or more other charities.

In addition, the combined fund organization must report to the taxpayer the name of the donee organization that ultimately gets the contribution. Future regulations may require the combined fund organization to disclose the actual amount distributed to the ultimate recipient(s) and the date of the distribution, the IRS has indicated.

Fundraisers: Prepare For Scrutiny

Fundraising is once again under a magnifying glass. In hearings by the House Committee on Oversight and Government Reform, the focus was on charities that raise millions of dollars in donations, with up to 90% going to professional fundraisers and key personnel.

In her testimony to the committee, Tracy McCurdy, director of the Pennsylvania Department of State's Bureau of Charitable Organizations, made three recommendations:

1. Beef up efforts in public outreach and education-educate the public to ask questions of the charities they support.
2. Require increased oral and written disclosures at the point of solicitation. Professional fundraisers should be required to tell prospective donors that a portion of their contribution will be used to pay fundraising costs. The fundraiser also should be required to disclose the minimum amount of contributions guaranteed to be retained by the charity.
3. Increase federal oversight

The committee has suggested that all charities be required to reveal to donors how much of their contribution will be spent on programs related to the group's mission. As a result, charities paying large percentages of their donations in fundraising expenses could see a drop in donor support.

IRS Updates Exempt Process

On Jan. 14, the IRS issued Revenue Procedure 2008-9, spelling out the exempt status application process from filing to the determination letter. The procedure also describes recent changes, such as the centralization of applications processing in the Exempt Organizations Determinations office in Cincinnati.

The procedure outlines the steps for requesting recognition of exempt status, including filing Forms 1023, 1024, 1028, and 8271, along with a letter of application. And it specifies which type of form each type of nonprofit needs to file to request exempt status.

The procedure includes an explanation of the withdrawal of an application, which can be done anytime prior to the issuance of the determination letter or ruling. It also explains what to do if your exemption is denied or revoked.

Any organization going through the exemption application process — or experiencing a problem with their exempt status — should look to this procedure for guidance.

FOR FURTHER INFORMATION

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

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

MP&S MEDIA HIGHLIGHTS:

The MP&S Nonprofit and Government Group continue to make media headlines. This month:

- **Warren Ruppel** is featured on the cover of the August 1st issue of the *Trusted Professional* taking part in the discussion at the May 2008 FAE Government Accounting and Auditing Conference in the GAO's continued efforts to improve single audits.

- **Hope Goldstein** is featured as a columnist in the Aug/Sept. issue of *Worth Magazine* discussing precautions one should consider before joining a nonprofit board.

MP&S WELCOMES ITS NEWEST CLIENTS:

- Catalyst
- New York City Tax Lien Trusts
- Vaughn College of Aeronautics and Technology

MP&S FAST FACTS:

- Nationally, the 29th largest accounting firm and a leader in accounting and auditing (*Accounting Today*)
- The New York Area's 15th largest accounting firm and one of the top five fastest growing firms in our market (*Crain's New York Business*)

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