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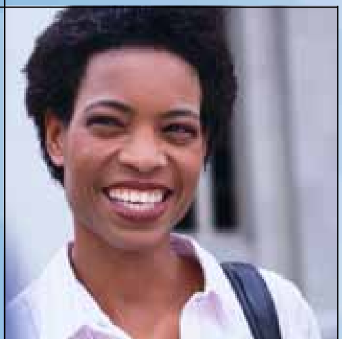

Not-For-Profit *Insider*

Insights & Observations for Not-For-Profit Organizations
Volume 7 :: Issue 1

In This Issue

Tax Exempt Bonds – Post-issuance Concerns

The Office of Tax Exempt Bonds (TEB), a branch of the IRS, has been utilizing questionnaires to evaluate the level of understanding that issuers of tax exempt bonds have regarding post-issuance compliance tax requirements. During a recent study, the TEB sent questionnaires to 207 501(c)(3) organizations, focusing on the following two main categories of post issuance compliance:

- Qualified use of proceeds and financed property requiring the monitoring of the various direct and indirect uses of bond financed property over the life of the bond and calculations of the percentages of non-qualified use.
- Arbitrage yield restrictions and rebate which requires monitoring over the life of the bond to determine whether both the yield on investment acquired with the bond proceeds are properly restricted and whether the issuer must file a form 8038-T to pay a yield reduction payment and/or rebate payment.

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Tax Exempt Bonds – Post-issuance Concerns *Continued from Page 1...*

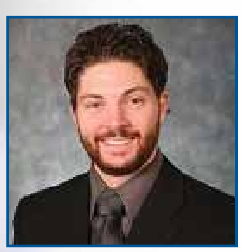
The questionnaires asked the organizations about their written procedures, recordkeeping and retention policies and who performed the post-issuance compliance monitoring. The results were mixed, but the TEB concluded that there was significant need for improvement in post issuance compliance, particularly with respect to the maintenance of records throughout the life of the bonds.

The IRS stresses that it is important for organizations to adopt written procedures, which go beyond reliance on tax certifications included in the bond documentation provided at time of issuance. Sole reliance on these documents may result in insufficiently detailed procedures or result in the documents not being incorporated into the organization's operations at all. According to the IRS, written procedures should contain certain key characteristics, including making provisions for:

- Due diligence review at regular intervals;
- Identifying the official(s) or employee(s) responsible;
- Training of those individuals responsible;
- Retention of adequate records to substantiate compliance (such as expenditure of proceeds);
- Procedures reasonably expected to timely identify noncompliance, and;
- Procedures to ensure that the issuer will take steps to timely correct noncompliance.

The goal of establishing and following written procedures is to identify and resolve noncompliance on a timely basis so that there is no danger of losing the tax exempt status of the bond. An organization with written guidelines is less likely to be noncompliant than one without. The IRS believes it is important to have clearly defined procedures and to implement and review them over time. It is important to insure that the current person(s) responsible for post issuance compliance will be able to fulfill their duties. Since bonds are usually issued for a long period (sometimes spanning decades), it is completely in the realm of possibilities that several individuals could be responsible for oversight over the life of the bond. Sufficient records are needed to be maintained so that the new personnel can continue with the compliance monitoring. The IRS also believes that the monitoring and recordkeeping should be integrated into the existing accounting system, if practical. Formal record retention policies for tax exempt bond records can provide a strong foundation for ensuring continuity in maintaining effective compliance practices.

The TEB has several programs in place to help promote post issuance compliance. The TEB administers the Voluntary Closing Agreement Program (TEB VCAP) to assist issuers in resolving federal tax violations related to their bonds. Generally, an issuer will receive a more favorable resolution under the TEB VCAP than for the same tax violation if it were to be discovered during an IRS examination of those bonds. Issuers of tax exempt bonds are required to file a form 8038 series of informational returns. These returns include questions regarding whether the issuer has established written procedures to timely identify and correct any violations. There are also questions on these forms to help the issuer with compliance relating to the arbitrage yield restrictions and rebate requirements. If your organization has issued tax exempt bonds, you will want to review the policies and procedures that are in place, and determine whether they are sufficient to identify and correct any noncompliance with IRS requirements timely.



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Not-for-Profit Reporting Rules Could Be Changing

It seems like just yesterday that the not-for-profit world was shaken up by imposition of all those new accounting and reporting rules. Organizations had to go back into deep storage to determine if gifts were unrestricted, temporarily restricted or permanently restricted. We struggled with the definitions of restrictions. We had to explain to boards why they could not restrict under the new rules. They could only designate. We had to deal with the absurd concept of recording as current revenue, promises for gifts in the future. We studied and read and finally implemented.

Despite seeming like yesterday, it has been almost two decades since the rules changed. Leslie Seidman, Chairman of the Financial Accounting Standards Board (FASB), pointed that out on November 9, 2011, when she announced the addition of two agenda projects – a standard-setting project and a research project—intended to improve the financial reporting of not-for-profit organizations.

The objective of the standard setting project is to reexamine financial statement presentation in order to improve net asset classification, better address financial performance in the statements of activities and cash flows, and improve information about liquidity.

The research project involves studying other means of communicating an NFP's financial story including looking at best practices in communications to enhance understanding of donors, creditors, and other stakeholders about financial health and performance and to consider the role of FASB in promoting such communications.

FASB reached this decision based on suggestions made by the FASB Not-for-Profit Advisory Committee (NAC) at their meeting in September 2011. NAC was established in October 2009 to serve as a standing resource for the FASB in obtaining input from the NFP sector. It has 17 members, plus three participating observers. Representation consists of NFP financial officers, auditors, foundation and other donors, watchdog agency, charities regulator and attorney. There is also the FASB NFP Resource Group, currently with approximately 150 members, that provides feedback to questions from NAC and NAC staff.

Three NAC subgroups were charged at the February 2011 NAC meeting with the task of identifying potential improvements in NFP financial reporting for discussion at the September 2011 NAC meeting. The subgroups reported back with four sets of recommendations:

- Revisiting current net asset classifications, and how they may be relabeled or redefined, in conjunction with improving how liquidity is portrayed in a not-for-profit's statement of financial position and related notes;
- Improving the statements of activities and cash flows to more clearly communicate financial performance;
- Creating a framework for not-for-profit directors and managers to provide commentary and analysis about the organization's financial health and operations, somewhat similar to the "Management Discussion and Analysis" provided by publicly traded companies in their annual reports, to help them bring context to their financial story; and
- Streamlining, where possible, existing not-for-profit-specific disclosure requirements to improve their relevance and clarity.

FASB took these recommendations under consideration and then issued the November press release announcing the two projects. It will be very interesting to see what develops.

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Not-for-Profit Entities Compliance Issues: Membership Dues Deductibility Notice Requirements

Part V of Form 990, the annual information return most exempt organizations are required to file with the IRS and often with state regulatory agencies, contains numerous questions about other IRS filings and tax compliance. Question 6 in this part, in both the 2010 and 2011 versions of the form, asks if the organization solicited any contributions that were not tax deductible. If so, 6b asks whether a required express statement of non-deductibility was included with every solicitation.

The two most common types of exempt organizations for which Forms 990 are filed are I.R.C. Section 501(c)(3) public charities and Section 501(c)(6) membership organizations. Public charities are allowed to receive tax deductible contributions from the public and would happily answer this question "no," and move on. Sec. 501(c)(6) membership organizations are generally supported by member dues and often solicit or receive no contributions, so they too would like to happily answer "no" and move on.

The happy ending works for the (c)(3)s but, unfortunately, not for many (c)(6)s. A look at the instructions for this line would reveal that the question applies to any "fundraising solicitation (including solicitation of member dues)." The 990 question asks about "contributions." Most people do not think of membership dues as "contributions" or dues notices as "fundraising solicitations." "Dues" clearly denotes a non-negotiable obligation to pay, while "contributions" equally clearly implies volition as opposed to obligation.

So is the 990 question poorly worded and would that constitute "reasonable cause" when they come looking with handcuffs? I am inclined to agree with the first part but wouldn't want to bet on the second. In search of further enlightenment, one could go read the 990 instructions (often a good idea when all else fails). Further along the road to enlightenment one would encounter Notice 88-120, the promise of a "Safe Harbour," Code section 6113, the mother of this evil, and Code section 6710, the Greater Evil promised to those who will not take heed.

Now if that weren't enough headache for one 990 501(c)(6)s, being membership organizations, often conduct lobbying activities to further the interests of their membership. Lobbying is not prohibited for the (c)(3)s but definitely needs to be kept on a tight leash or it can lead to trouble. Lobbying is fine for the (c)(6)s and is often an important part of their exempt purpose. However, the law denies a tax deduction as business expenses for any membership dues that paid for lobbying. Most membership organizations are required to advise their members of the percentage of their dues that is not deductible as a business expense.

So what must a (501)(c)(6) exempt organization do if it wants to be around to see its grandchildren grow up? In addition to keeping its blood pressure and cholesterol under watch its membership dues and any other funds solicitation must include an "express statement in a conspicuous and easily recognizable format" (that means no small print and no burying the disclosure in a whole lot of extraneous text). The statement must contain the two required elements of disclosure: the nondeductibility as charitable contributions of membership dues and the (possibly) limited deductibility as business expenses or job expenses. Something along the following lines should work: "Membership dues, contributions or gifts to (name of organization) are not deductible as charitable contributions. However, they may be tax deductible as ordinary and necessary business expenses except to the extent allocable to lobbying or political expenditures. For 20XX the percentage of non-deductible membership dues is XX."

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Fraud Happens...Deal With It!

Just about any organization, including not-for-profits, can be the victim of fraud. Good internal controls and diligent management of resources can reduce fraud losses through early detection, but more likely than not, eventually every organization will be forced to respond to fraudulent activities. This short question and answer guide can help you respond to fraud indicators and provides tips for uncovering fraud schemes.

How do I respond to fraud hotline tips without getting burned?

Establishing a fraud hotline is a proven way to reduce the chances of fraud occurring in an organization. Unfortunately, the hotline will not eliminate the risk and more likely than not, you will receive calls that indicate the potential for fraud. Your organization's response to these calls should follow an established and well-documented procedure. The procedures should include provisions to ensure that:

- the caller's identity is protected;
- the fact that a hotline tip led to an investigation is not widely disseminated;
- the appropriate people in the organization are made aware of the situation; and
- the informed group is as small as possible and does not include anyone potentially implicated with the issue described by the caller.

Beyond those basic provisions, the course of the investigation is dependent on the nature of the comments provided by the caller. If it is determined that an investigation is not required, then it is still important to document the call and why an investigation was not performed. You may receive additional tips that allow you to fully understand previous calls. Putting all the pieces together may allow you to uncover patterns of behavior and complex issues that would otherwise go unnoticed because they are observed only in small parts by several individuals.

If an organization suspects fraud, how should it proceed? What steps should it take when conducting an internal investigation?

When an organization is alerted to the possibility that fraud may be occurring, it needs to proceed cautiously, yet deliberately to gather sufficient facts to verify the existence of fraud. The organization should consult with counsel and discreetly develop a plan to address the issues. It is critical to restrict the number of people with knowledge of the situation to avoid compromising the investigation. Counsel should retain an appropriate multi-disciplinary team, including forensic accountants, to gather facts, identify sources, as well as take immediate steps to preserve any electronic and other information that may be relevant to the investigation.

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Fraud Happens...Deal With It! Continued from Page 5...

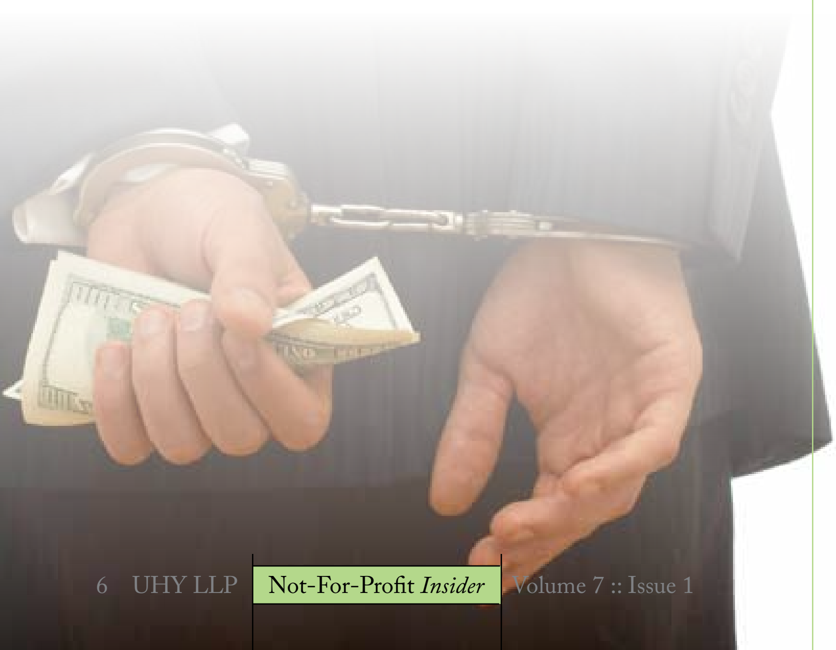
After the initial fact-finding stage, it may be necessary to take additional steps, such as issuing non-destruction orders to employees or interviewing potential witnesses or suspects. Generally, all investigations include gathering key evidence, conducting in-depth interviews and documenting the findings. However, the process is almost never linear; one almost always needs to cycle between documents, electronic data and interviews to determine if a material issue actually exists. Throughout the investigation, it is essential that the company comply with applicable laws, regulations and internal policies to ensure that the investigation is impartial, fair and preserves confidentiality and privilege as appropriate.

Are financial frauds more likely to occur during weak or strong economic conditions?

Studies have found that during economic downturns, instances of fraudulent behavior increase. There are a number of factors driving this trend, including mounting financial pressure on individuals and organizations. Recessionary periods exert additional pressures on individuals and executives at not-for-profit organizations in the form of tightening finances, fear of being laid off and unrealistic fundraising goals. These pressures cause some individuals who would not think of stealing or who would be easily dissuaded by the simplest of controls to be more willing to take the risk to secure something for themselves or to protect their positions in the company by manipulation of financial data. In addition, as not-for-profits face budget pressures, compliance and internal audit departments, like all others, are stretched thin, allowing more opportunity to circumvent controls. For some organizations, fraud actually increases during times of prosperity. Management becomes less vigilant about controls and more focused on results. This lax oversight provides opportunity for fraudsters that are eager to "share" in funds raised by an organization. The need for adequate internal controls and a culture of integrity are critical in all economic environments to protect not-for-profits from the often irreparable turmoil resulting from financial fraud.

How do we increase our chances of detecting fraud schemes?

Our experience has been that even in organizations with excellent internal controls and high quality management, fraud still occurs. Oftentimes, the fraudulent activity occurs over several accounting periods because the individual committing the fraud knows the organization, how the controls operate and what amounts and transactions can be concealed or mischaracterized. These individuals are typically caught when something unexpected happens. For example, when an auditor approaches the internal controls review differently from previous years or when a sudden downturn in the economy causes an in-depth review of expenses, fraudulent activity often becomes visible. The lesson for both auditors and management is simple, to increase your chances of detecting fraudulent activity, do the unexpected. Look in places that have not been examined in the past and use methods not previously employed. You may be surprised by what you find!



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The Many Faces of Compensation on Form 990

Is your tax preparer driving you nuts with requests related to the Form 990? Well, you are not alone. The revised Form 990 is very extensive when it comes to information gathering, in particular, the sections related to compensation. Part VII of the 990 (Compensation of officers, directors, key employees and highly compensated employees) is proving to be one of the more challenging areas of the revamped form. The IRS recently came out with a list of the more common filing errors on the 990 and several relate to compensation. In addition, if you are a fiscal year filer, have you wondered why your tax preparer asks for compensation information on both a calendar year and fiscal year basis? It is because the IRS requires calendar year information in one part of the 990 and fiscal year compensation in another part.

Below are some of the more common questions related to compensation on Form 990. There is also an explanation about the required information on a calendar year basis and fiscal year basis.

1. **How many boxes are checked: Officer, Key Employee, Highest Compensated Employee?** Sometimes an individual appears to qualify for more than one of these. A careful reading of the definitions of each in the 990 instructions reveals that the three are mutually exclusive. The "key employee" definition includes the phrase "other than officer, director or trustee." The highest compensated employee definition states that these are "not also officers, directors, trustees or key employees." So if someone is an officer, they will not also be a key employee or highest compensated employee for Part VII of the 990. And what about that "former" box? If an individual meets the definition of "former," only the former box should be checked, and not also the box that represents their former position.
2. **What's included in compensation?** It takes 10 pages to answer this question in the 990 instructions for Part VII, so it's not a simple answer. In essence, compensation is more than just wages. It should include all forms of salary and benefits paid by the organization on behalf of the individual (e.g., wages, bonus, employer retirement plan contributions, employer-paid health insurance and other benefits, whether or not taxable to the individual). Incidentally, total compensation per individual is the same on Part VII and Schedule J. Schedule J, on the other hand, includes a breakdown of compensation in more detail, and does not include individuals with less than $150,000 of reportable compensation.

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The Many Faces of Compensation on Form 990 *Continued from Page 7...*

3. **On what basis is compensation reported?** For taxpayers with a fiscal year end other than December 31st, there is another wrinkle related to compensation. Part VII and Schedule J of the 990 reports compensation on a calendar year basis, even if the organization's year-end isn't December 31st. The Statement of Functional Expenses (Part IX) is prepared on a fiscal year basis and requires a break-out of compensation for officers, directors and key employees on a separate line. If your year-end isn't December 31st, this requires two calculations of salary, retirement and other benefits for officers, directors and key employees.
4. **What's reported in "Compensation Reported in Prior Form 990" (Schedule J, Column F)?** This field is another source of the common filing errors reported by the IRS. It should include any compensation on an individual's current W-2 that was reported as deferred compensation on a previous year's 990. For example, the organization has a supplemental retirement plan for its President. In 2009, the organization paid $10,000 into the plan, and reported this as deferred compensation on Part VII of its 2009 Form 990. In 2011, the President received a payment of $7,000 out of the supplemental plan and it was reported on the President's W-2. The organization would include this payment as compensation to the President on its 2011 Form 990. It would also report it in Column F of Schedule J, since it was previously reported as compensation on the 2009 Form 990.

So, when your tax preparer asks all those questions about your directors, officers, key employees and highest compensated employees, you still might get upset but maybe now you can understand why it seems so complicated.

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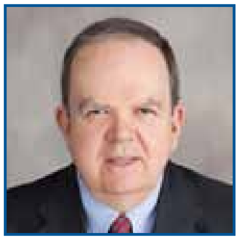
Does Quality Matter?

Untangling the Maze and Mystery of Reporting on Quality in Accounting Firms



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The Phone Call

Nearly a year ago, my phone rang. It was someone who identified himself as a managing director in a very well known investment banking firm. He told me that his firm was doing due diligence on one of our clients that he identified only by its general location. He asked me if our firm had a peer review report and, if so, whether he could have a copy. I answered that we did and that he certainly could have a copy. I then asked him whether the due diligence that he was doing was on a public company; he said that it was. I asked whether he realized that an audit firm's peer review no longer covered public company engagements, which are now the exclusive jurisdiction of the Public Company Accounting Oversight Board (PCAOB); he said that he did not realize that. I suggested that in addition to our firm's peer review report, he probably would want our PCAOB inspection report. He agreed that both would be very helpful to him. I then added for his general information that our firm's peer review and PCAOB inspection reports are available to the public—on the AICPA and PCAOB websites. I also noted that that these websites contain peer reviews and PCAOB inspection reports for most firms.

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Does Quality Matter? *Continued from Page 9...*

I have mentioned this story a few times to colleagues as an example of financial statement users' lack of knowledge and understanding about audit firm quality review information available for use within the financial and business community. In this short article, I hope to shed some light on those misunderstandings.

Peer Review and Its Origin

Over thirty years ago, responding to concerns about quality, the American Institute of Certified Public Accountants (AICPA) initiated a voluntary program called peer review whereby audit firms could voluntarily subject themselves to the scrutiny of their audit practice by another audit firm. When peer review began, it was completely voluntary. Over the years, the peer review process has expanded to cover all forms of attest services (audits, reviews, compilations, and agreed-upon procedures engagements, among others), and now has become mandatory in almost every jurisdiction in the United States. The AICPA also made peer review mandatory for its various audit practice sections, the first being the SEC Practice Section, which all firms who audited public companies were required to join. As peer review expanded, the process became more formalized as did the requirements for those doing the reviews. Peer reviews are a triennial event for the firms that have them.

SOX Reforms and the PCAOB

In the wake of the Enron scandal, Congress looked into the oversight of audit firms and devised a number of reforms set into law in the Sarbanes Oxley Act of 2002 (SOX). SOX created the PCAOB to, among other things, set auditing standards for public company audits and to inspect and investigate audit firms that audit public companies. The Act and its implementation rules make clear that the inspection of public company audit engagements is the exclusive jurisdiction of the PCAOB. Thus, SOX legislation marked the era of a new sheriff in town to inspect audits of public companies and ended any further involvement of peer reviewers with public company audits. Firms that issue 100 or more public company audits are inspected annually; those firms that issue less are inspected at least triennially.

Peer review still remains under the administration of the AICPA (and AICPA sponsored report acceptance bodies that are administered by state CPA societies), but now must exclude any audit work on public companies. That is the exclusive jurisdiction of the PCAOB.

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Common Areas

Both peer review and PCAOB inspections address certain functional areas, including integrity and independence, education and training, professional certification and continuing professional education, hiring, advancement, and compensation, as well as resolution of professional differences. While specific rules may differ in auditing a public vs. a non-public entity, these functional areas apply to the firm and its personnel and are manifest in all engagements. For this reason, these areas are reviewed both in AICPA peer reviews and PCAOB inspections.

Peer Review Reports

Peer review reports have changed in form over the years. Currently, a firm is assigned one of three ratings by its reviewer: pass, pass with deficiency(ies), or fail. We at UHY LLP are proud to report that our latest peer review report issued in October 2011 carried a rating of "pass"—the best possible outcome! That outcome is consistent with that of our previous peer review. Our latest peer review report is available to the general public on the AICPA's Peer Review Firm Search Website: www.peerreview.aicpaservices.org/firmfile/DocDefault.aspx.

PCAOB Inspection Reports

PCAOB inspection reports differ from peer review reports inasmuch as they do not contain a rating. Rather, they identify the number of engagements inspected, and the engagements that have findings, and then identify the findings by general description. We at UHY LLP are pleased to report that our latest PCAOB inspection report issued in August 2011 contained no engagement findings—again the best possible outcome and an outcome consistent with our initial PCAOB inspection report three years earlier. Both our 2011 and 2009 PCAOB inspection reports are available to the general public at the PCAOB's Firm Inspection Reports Website: www.pcaobus.org/Inspections/Reports/Pages/default.aspx.

Where to Get the Reports

To locate a peer review report for any firm participating in the AICPA's national peer review program, go to AICPA Peer Review Firm Search Website: www.peerreview.aicpaservices.org/firmfile/DocDefault.aspx.

To locate a PCAOB inspection report for any firm registered with the PCAOB that has performed an audit of a public company or played a significant role in another firm's audit of a public company, go to the PCAOB's Firm Inspection Reports Website: www.pcaobus.org/Inspections/Reports/Pages/default.aspx.

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Not-For-Profit Industry Insight

With the increasing complexity of laws and regulations, it's important for associations, foundations, charities, hospitals, schools and other tax-exempt entities to seek out professionals with extensive experience in not-for-profit compliance issues.

- Accounting/Assurance
- Audit, Reviews & Compilations
- Financial Management Consulting
- Internal Controls & Forensic Accounting
- Compliance/Governance Capabilities
- Accounting Policies and Procedures Updates
- Design, Implementation & Testing of Internal Controls
- Sarbanes-Oxley Education
- Tax & Management Consulting
- Cost Allocation Planning Assistance
- Financial Forecasting Analysis
- Implementation of New Accounting Standards
- IRS Controversy
- State, Federal and Local Tax Planning
- Unrelated Business Income Tax Analysis

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New Jersey	Oakland	201.644.2767
New York	Albany	518.449.3171
	New York	212.381.4800
	White Plains	914.697.4966
Texas	Dallas	214.243.2900
	Houston	713.561.6500

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Texas	Houston	713.548.0900
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