



Nonprofit Issues Newsletter Spring 2010

Executive Compensation Reporting in the New 990 World

Since the IRS redesigned Form 990 over a year ago, we've looked at hundreds of the new forms. We've found that one of the most troublesome areas of demanded information on the form is in Part VII (pages 7 and 8) and the whole arena of required compensation data. This article concentrates on Part VII of the core form, but you should be aware that Schedule J provides its own speed bumps.

We'll start with a word of caution: Do not over-report on Form 990, Part VII, Section A. It is likely that some of the folks you've included in the past, especially key employees, might not need to be shown on the 2009 form - and that's a good thing!

Prior to 2008, not-for-profits were required to report compensation amounts for officers, directors, trustees, and key employees on Part V of Form 990. Compensation amounts were broken down into Salaries, Contributions to Employee Benefit Plans, and Allowances. Further, 501(c)(3) organizations had to list the top five employees paid more than \$50,000 on Schedule A, Part I.

It's important to note that the 2009 Form 990 requires reporting on Part VII and Schedule J based upon Form W-2 and Form 1099-MISC. This constitutes *calendar year compensation reporting* and is required even if your organization operates on a fiscal year. To complicate matters, you will still report the compensation of those listed on Part VII on a fiscal-year basis when you complete Part IX, Line 5.

For years, the IRS's definition of key employee was "any person having responsibilities, powers, or influence similar to those of officers, directors, or trustees. The term includes the chief management and administrative officials of an organization." The chief executive officer/president, chief operations officer, and chief financial officer were generally considered key employees.

On the 2009 Form 990, total compensation for officers, directors, trustees, and key employees must be reported in Part VII in three columns: reportable compensation (from Form W-2, box 5) from the filing organization, reportable compensation from related organizations (defined in the *Form 990* Glossary),

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and other compensation (some benefits such as health insurance, employer contributions to retirement plans, etc.). In addition, the top five “other employees” making more than \$100,000 in reportable compensation must be reported in that section of the return. This means that organizations exempt under sections 501(c)(4), 501(c)(6), 501(c)(7), and others are required to list total compensation for “key employees” plus, potentially, five employees that they have not been required to disclose in the past.

In Form 990, Section VII, Section A, organizations are also required to check columnar boxes to indicate what offices the various listed individuals hold in the organization. This includes individual director/trustee, institutional trustee, officer, key employee, highest compensated employee, and/or former.

Note that the number of trustees checked in the first two columns should equal the number reported on Part I, Line 3 and Part VI, Line 1a of Form 990. This is one of the most frequently missed issues we find on the 2009 Form 990. If directors resigned or were added during the course of the year, we suggest you put “Part Year” next to their title and explain on Schedule O that they were added or “subtracted” during the year. This will help the reader of your Form 990 reconcile the number of governing board voting members reported.

Officers should only include those “officers of the organization” defined in the by-laws, articles of incorporation, or other organizing/board-driven documentation. Generally, the “Top Management Official” (president, CEO, executive director) and the “Top Financial Official” (CFO, VP-finance, controller) will be considered officers for purposes of Part VII, Section A.

The definition of “key employee” for the 2009 form is often misunderstood. No one with less than \$150,000 in reportable compensation (W-2, Box 5) from the filing organization and any related organizations will be considered a “key employee.” (Omit pay of less than \$10,000 from any related organization.) Note that compensation of “organization/corporate officers” will have to be reported on Part VII regardless of amount.

The 2009 Form 990 instructions use a three-facet test to define key employee as an employee of the organization who:

1. had reportable compensation exceeding \$150,000 for the year (the “\$150,000 test”);
2. had or shared organization-wide control or influence similar to that of an officer, director, or trustee, or managed or had authority or control over at least 10% of the organization’s activities (the “responsibility test”); and
3. was one of the organization’s top 20 highest-paid employees for the year who satisfied both the \$150,000 test and the responsibility test (“Top 20 Test”).

This definition should reduce the filing burden for Form 990, Part VII and Schedule J. (See instructions for Part VII for examples of key employees)

The column for “Highest Compensation Employee” should be checked for the top five employees who received reportable compensation (W-2, Box 5) of \$100,000 or more from the filing organization and all related organizations.

Column F of Part VII is where your organization will report “Other Compensation.” We see two common types of errors here. First, make sure you don’t “double report” amounts already included in Form W-2, Box 5 for the listed employees. Second, there are complicated rules regarding \$10,000 exemptions for some benefits. The instructions contain a three-and-a-half page grid that is designed (but maybe not destined) to help us sort out where to report possible elements of “Other Compensation.” We all generally have fun with this part!

Tax Department
317.885.2620

Atlanta
678.518.5301

Chicago
630.682.9797

Colorado Springs
719.528.6225

Dallas
214.624.5077

Denver
720.283.7326

Indianapolis
317.885.2620

Los Angeles
714.671.9300

Orlando
407.883.4671

San Diego
858.638.7220

If a person is listed on Part VII and makes \$150,000 in total compensation (automatic for a “key employee”), they will trigger additional, expanded reporting on Schedule J, Compensation Information. You will need to answer “yes” to Part VII, Section A, Line 4.

Note that a number of somewhat intrusive items of information must be provided for each officer, director, trustee, or key employee required to be included on Schedule J. This includes whether the organization paid for or provided first-class travel, travel for companions, tax indemnification/gross-up payments, a discretionary spending account, a housing allowance or residence, health or social club dues or initiation fees, personal services (such as a maid, chauffeur, or chef), or payments for business use of a personal residence.

Finally, Form 990, Part VI and Schedule J include questions about how the organization arrived at and approved the compensation of the CEO/ executive director. We suggest reviewing these questions and the IRS’s rebuttable presumption rules (Regulation Section 53.4958-6) before filing your 2009 Form 990.

If you have any questions regarding the new Form 990 and the associated schedules, please contact us. We are here to help!

Audited Financial Statements First Impressions

If you want to impress potential lenders and funders, you need to show them that you measure your organization’s financial health with care and frequency. Presenting timely audited financial statements upfront can make the difference between being turned down for a loan and getting one.

Annual financial statements, particularly audited ones, present sound measurement of your nonprofit’s financial stability. Here are some tips for preparing them:

1. Understand your auditor’s role. Your auditor is responsible for expressing an opinion on your financial statements. Beyond that, he or she is responsible for obtaining reasonable assurance that your financial statements are free of material misstatements - be it from error or fraud.

Management, on the other hand, is responsible for developing estimates, such as the allowance for bad debts, adopting sound accounting policies, and establishing, maintaining and monitoring internal controls, as outlined in the American Institute of Certified Public Accountants’ standards. Although your auditor may make suggestions about these items, it isn’t his or her responsibility to institute them or to ensure they’re working properly.

What your auditor is required to do is evaluate whether internal controls, accounting policies, and estimates are adequate to prevent or detect errors or fraud that could result in material misstatements of the financial statements. But remember, all decision-making is strictly management’s responsibility. If the audit is performed in accordance with Government Auditing Standards, the restrictions on what an auditor should do are even more stringent.

2. Understand the board’s role. Sometimes the board of directors’ role is overlooked in annual financial statement preparation, and that’s a mistake. Keep in mind that the board generally has a strategic and oversight role in the process, which is part of its overall fiduciary duty. But the board isn’t responsible for “completing the job.” Board members can, however, be a good resource for certain technical matters, depending on their professional background.

We Can Help!

The staff at CapinCrouse LLP works with hundreds of churches and not-for-profit organizations. This experience base allows us to quickly identify areas for improvement in many organizations. If your organization desires to improve its efficiency, please contact your Capin Crouse representative or one of our offices to discuss how we may help you.

About CapinCrouse LLP

With more than 500 not-for-profit organizations and 1,500 tax clients, CapinCrouse is the country’s leading accounting and advisory firm primarily serving the Christian not-for-profit community.

Since 1972, CapinCrouse has been serving not-for-profit entities including megachurches, institutions of higher education and secondary schools, and international missions agencies by providing a full range of audit, review, tax, and advisory services.

CapinCrouse is dedicated to helping our clients operate with financial integrity so that they can dedicate themselves to fulfilling their mission.

3. Understand statement formats. Annual financial statements are designed to help you manage your organization. Financial statement items - such as debt ratios, program vs. administrative expense ratios and restricted vs. unrestricted resources - can indicate how a nonprofit is doing. So when your organization's leadership team is preparing them, make sure the statements are as user-friendly as possible.

One of the best ways to see the big financial picture is to compare your budget, your year end internally generated financial statements, and the financial statements generated during the annual audit. This task can be completed more easily if the format of your annual audited statements is similar to that of your internal financial statements and budgets. Keep in mind that audited financial statements may be formatted differently than internally generated reports, so management may need to develop a bridge between the two reports, perhaps in the form of an internal memo.

When reviewing internal vs. audited statements, look for any large differences in individual accounts resulting from audit correcting adjustments - these are often an indication of an internal accounting deficiency. You'll also be able to spot any significant discrepancies between what was budgeted for the year and the actual outcome.

These variances will help you evaluate your nonprofit's performance and plan for the coming year. Also, your financial statements should make it fairly easy to determine which resources are restricted for particular purposes or time periods.

Fiscal Sponsorship Q&A

Your organization may be too new - or too small - to have obtained its tax-exempt status. Or, if you're well-established, you may have an opportunity to expand your programs by joining forces with a smaller or newer organization. In either case, fiscal sponsorship is a structural arrangement with another organization that you may want to consider. Here are the answers to some questions you may have about this special relationship.

Q: What is fiscal sponsorship?

A: It's a relationship in which a nonprofit with 501(c)(3) status sponsors a societal-minded project/group that doesn't have tax-exempt status. The fiscal sponsor is legally and financially responsible for the project. "Project" typically refers to either an ongoing group or a one-time project.

Q: How does it work?

A: The fiscal sponsor is responsible for managing funds and acts as a "guardian" for the donations and grants the project receives. Donations are made to the sponsor, which qualifies the donors for a tax deduction. The sponsor employs the staff that works on the project and monitors activities to the same extent it monitors any of its other programs. It's the sponsor's responsibility to ensure that the project is within its mission and doesn't adversely affect its tax-exempt status.

Q: What are the benefits for the "sponsee"?

A: Sponsorship allows an entity to fulfill a mission without going through the process of incorporating and applying for tax-exempt status. The sponsor can provide the back-office support that small nonprofits often lack. Also, because donations to a 501(c)(3) organization are tax-deductible, the potential for donations is greater. And the sponsor may have much greater name recognition than the smaller or newer organization.

Q: What are the pros and cons for the sponsor?

A: The sponsor benefits because the added project could bring additional recognition in the community for “doing more.” This, in turn, might attract new funders. The downside is that the sponsor may assume responsibilities that carry unanticipated risks or require additional infrastructure or cost not beneficial to the organization. The added responsibilities also might divert the sponsor from its primary programs and purpose.

Q: What types of groups are right for fiscal sponsorship?

A: New nonprofits who want to start operating, but have yet to receive 501(c)(3) status, are logical sponsoree candidates. So are very small groups that lack infrastructure. Sometimes even individuals are sponsored. For example, Fractured Atlas is a nonprofit that sponsors a national community of individual artists as well as art organizations.

Q: What’s the difference between a fiscal agent and a fiscal sponsor?

A: A fiscal agent accepts donations and merely moves them on to the intended recipients. The IRS regards such donations as a direct donation to the intended recipients. A fiscal sponsor is legally responsible for the project and the funds. The sponsor doesn’t merely receive the funds - it controls the project and accounts for the activity in its financial statements and on Form 990.

Q: What should you look for in a fiscal sponsor?

A: The two entities should have a similar mission and vision. And the sponsor should be financially strong enough to enable the sponsoree to run continuously without interruption. Look for elements - and your financial advisor can help you with this - such as: strong internal controls based on Generally Accepted Accounting Principles and other federal regulations, written policies and procedures for administration and risk management, and enough staff to fulfill agreed-upon services.

Q: How do you get started?

A: Both organizations need to work out the terms of the relationship before getting started, such as who will have the authority to make decisions. You’ll also need to determine how disbursing funds will be handled and who will take care of reporting requirements. For example, typically the sponsor is responsible for fiscal reporting to the foundations or other grant-giving bodies. You also should agree on how long the project will last, as well as how assets and activities will be severed from the sponsor when the two entities part ways.

What You Need to Know About the FASB Accounting Standards Codification

The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) **significantly changed the structure and hierarchy of accounting standards** for all audits having fiscal years ending after September 15, 2009. **Not-for-profit entities (NFP) need to become familiar with the new codification to increase the efficiency and effectiveness of their annual audits.**

The ASC is now the single source of authoritative, nongovernmental U.S. generally accepted accounting principles (GAAP). It’s no longer necessary to know the alphabet soup of acronyms we have grown accustomed to over the years, such as SFAS, FIN, APB, ARB, FTB, SOP, EITF, AcSEC PB, AI, QA, and FSP. All other accounting literature not included in the codification is now non-authoritative.

The ASC makes it easier than ever for your NFP to research and document U.S. GAAP questions and issues. Goals for the ASC included reducing time

and effort spent on research; clarifying authoritative status; improving usability; mitigating risk of noncompliance; updating subsequent new standards in real time; and assisting with international convergence.

How to Use the FASB ASC

The ASC is organized into a hierarchical structure using topics:

- 1.) General Principles (Topic codes 105-199)
- 2.) Presentation (Topic codes 205-299)
- 3.) Financial Statement Accounts (Topic codes 305-799)
- 4.) Broad Transactions (Topic codes 805-899)
- 5.) Industry (Topic codes 905-999)

Topic #958 is NFP. Subtopics represent subsets of one of the topics above and are distinguished by type or scope. The subtopics contain sections that represent the nature of the content in a subtopic, such as measurement, recognition, etc. Each section is further broken down into paragraphs, which contain your actual accounting guidance.

Where to Learn More

CapinCrouse has put together a handy **reference guide** for your NFP to use while getting used to the new ASC. This reference sheet is attached, and also available on our website.

The ASC can be accessed on the FASB website at asc.fasb.org. This website offers three options for viewing the ASC:

- Professional View - Annual subscription fee of \$850, with discounts for multiple users. Visit the website for a full list of features.
- Academic View - Free access to the Professional View for qualifying accounting program faculty and students. (See the website for guidelines.)
- Basic View - Free for everyone, but lacks the features of the Professional View.

A four-volume hardbound version is also available, but of course it will become outdated as new standards are adopted.

We recommend checking to see if your NFP is eligible to access the ASC using the Academic View. If not, you may want to begin by using the free Basic View to determine if it meets your current needs.

Please contact us if you have any questions regarding the new codification or the FASB viewing options.

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IRS releases “due date” tables

Do you know when your tax-exempt organization’s returns are due to the IRS? In case you need a nudge, the agency has put together several tables for finding out the due dates of various required forms and reports, including annual returns, Form 990 and its variants, excise tax returns (Forms 4720 and 6069) and employment tax returns.

For example, if your organization has a Dec. 31 year end, your Form 990-T has an initial return due date of May 15. Dates for filing special forms also are available, such as those used to report the donation of a motor vehicle. To find out the deadlines, go to www.irs.gov. Then, using the advanced search feature, type in “EO Update December 10, 2009.”

Raising funds at events - just ask

Most nonprofits use special events to help them raise awareness, but not all organizations capitalize on the opportunity for savvy fundraising. Event 360, a designer and director of events for nonprofits, suggests asking participants a direct question before they head out the door - for example, "Will you help support us by participating or donating?"

The consultants also suggest that you:

- Practice developing your "ask" by describing in one sentence what your organization does to improve the world,
- Create a well-articulated "ask" that's specific, concise, tailored to a defined outcome and hard to refuse, and
- Explain how participants can help you achieve your goal through specifics. For instance, saying "Your donation will put 50 dinners on the table next week" is much more compelling than saying "Your donation helps the homeless."

You should remember that many event participants don't donate directly but rather ask others for their support. So, for example, instead of asking participants to "raise money," you should query, "Will you ask 10 of your friends to donate to us?" Then be sure to equip participants with the training and materials to ask others for support on your behalf. And, of course, make sure that all checks are made out directly to your charity. For more fundraising tips, go to www.event360.com.

Exempt status steps

Updated IRS Rev. Proc. 2010-9 took effect Jan. 11, 2010, for the request, issuance and appeal of determination letters and rulings on the exempt status of organizations under Internal Revenue Code Sections 501 and 521.

The updated procedures also concern revocations and modifications of determination letters and rulings. And they supply guidance on the exhaustion of administrative remedies for purposes of declaratory judgment proceedings under Code Sec. 7428.