CAPINCROUSE LLP Certified Public Accountants

Nonprofit Issues Newsletter
Summer 2011

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In This Issue

Using Creative Structures Without Raising IRS Suspicions

Unfortunately, there are individuals in the United States and abroad who openly express hostility toward religion and specific religious groups. Internationally, animosity can be directed against organizations just because they are based in the U.S.

This hostility is often expressed through extensive regulations, prohibitions, and lawsuits. As a result, charities and ministries often consider using a corporate or other structure to work around these issues. There are several approaches that comply with the laws of the U.S. and other countries.

Planning and implementing these structures requires some form of cost-benefit analysis, however. Changing the structure of an organization typically involves additional costs, and the more elaborate the structure is, the greater the cost. Understandably, most organizations find themselves wondering how little they can safely get by with.

The answer usually involves an assessment of the issues surrounding the change, the potential governmental involvement, and the overall scope of the project.

While the Internal Revenue Code and other tax laws are normally part of this planning, we believe the Internal Revenue Service enforcement environment should be considered as well. Rather than trying to determine whether or not they will get "caught," organizations should **focus on demonstrating integrity to a suspicious IRS.**

With that in mind, you need to be aware of some issues that are currently top of mind with the IRS.

The IRS periodically issues what it calls the "Dirty Dozen Tax Scams," a list of the 12 worst tax scams it is currently seeing throughout its enforcement jurisdiction. Three of the "Dirty Dozen" on the 2011 list (IR 2011-39) **involve transactions that might be confused with an exempt organization's use of alternate structures**, either in the U.S. or internationally.

These three scams are hiding income offshore, abuse of charitable organizations and deductions, and disguised corporate ownership. The IRS explains each in its 2011 list, dated April 7, 2011:

Hiding Income Offshore
The IRS aggressively pursues taxpayers involved in abusive offshore transactions as well as the promoters, professionals, and others who facilitate or enable these schemes. Taxpayers have tried to avoid or evade U.S. income tax by hiding income in offshore banks, brokerage accounts, or through the use of nominee entities. Taxpayers also evade taxes by using offshore debit cards, credit cards, wire transfers, foreign trusts, employee-leasing schemes, private annuities, or insurance plans.

In early February, the IRS announced a special voluntary disclosure initiative designed to bring offshore money back into the U.S. tax system and help people with undisclosed income from hidden offshore accounts get current with their taxes. The new voluntary disclosure initiative will be available through August 31, 2011. The IRS decision to open a second special disclosure initiative follows continuing interest from taxpayers with foreign accounts. In response to numerous requests, information about this initiative is available on IRS.gov in eight different languages.

Abuse of Charitable Organizations and Deductions
The IRS continues to observe the misuse of tax-exempt organizations. Abuse includes arrangements to improperly shield income or assets from taxation and attempts by donors to maintain control over donated assets or income from donated property. The IRS also continues to investigate various schemes involving the donation of non-cash assets including situations where several organizations claim the full value for both the receipt and distribution of the same non-cash contribution. Often these donations are highly overvalued or the organization receiving the donation promises that the donor can repurchase the items later at a price set by the donor. The Pension Protection Act of 2006 imposed increased penalties for inaccurate appraisals and set new definitions of qualified appraisals and qualified appraisers for taxpayers claiming charitable contributions.

Disguised Corporate Ownership
Corporations and other entities are formed and operated in certain states for the purpose of disguising the ownership of the business or financial activity by means such as improperly using a third party to request an employer identification number.

Such entities can be used to facilitate underreporting of income, fictitious deductions, non-filing of tax returns, participating in listed transactions, money laundering, financial crimes and even terrorist financing. The IRS is working with state authorities to identify these entities and to bring the owners of these entities into compliance with the law.

It's important to note that this does not prohibit the use of alternate approaches. But it does mean that you need to be careful. A **poorly developed or implemented plan that impacts one of these areas could appear illegal to the IRS.** Straightening out the situation could be expensive, time consuming, or even unsuccessful.

No one wants to be an example of how ***not*** to do something. If you decide to pursue alternate strategies, it's critical to use careful planning and implementation. The legal, financial and tax issues often require a team approach. Our U.S and international experience enables us to be effective members of your team. Please contact our tax team at info@capincrouse.com if we can help in respect to this or any other tax matters.

Checklist for an Effective Audit Committee

Unless you're a small nonprofit with no outside audit, or the function of the audit committee is fulfilled by the entire board, it's likely that your organization has an audit committee. No matter how long it's been up and running, the board should monitor the committee's performance.

The audit committee's main responsibilities are to assist the board in its oversight of the organization's processes for financial reporting, internal controls, and the audit and to see that the not-for-profit complies with applicable laws and regulations and a code of conduct. The following checklist will give you a broad reading on how your audit committee is doing - and any "no" answers will help to pinpoint areas for improvement.

Committee members

- Are committee members independent of outside interests and objective about their committee decisions?
- Do they address issues proactively and with integrity and strong interpersonal skills?

Upcoming Events

Webcasts
Please visit our website at www.capincrouse.com to register today!

Thursday, June 23
1:00 pm EDT
Unrelated Business Activities: Setting up Efficient System of Accountability for Your Organization

Save the Date!
Stay tuned for more information about these upcoming events.

Fall Church Seminars

Wednesday, September 7
Dallas, TX

Tuesday, September 20
Indianapolis, IN

Tuesday, October 18
Fort Lauderdale, FL

Fall Financial Forums

Tuesday, October 11
Atlanta, GA

Tuesday, November 8
Brea, CA

Wednesday, November 9
San Diego, CA

Wednesday, November 9
Lombard, IL

Thursday, November 10
Livermore, CA

Detail Financial Health via Cash Flow Analysis

With so many nonprofits finding themselves in a cash crunch, you should add another report to your repertoire: a cash flow analysis. You can present your total cash for the period in a simple spreadsheet, as well as anticipated cash inflows and outflows for the coming month. This can help your board make important short-term decisions, such as applying for, or drawing down on, a line of credit.

- Are all committee members financially literate? Is at least one member a financial expert - that is, has considerable experience analyzing, preparing, or auditing financial statements?
- If the committee doesn't include a financial expert, has the board considered adding a CPA to the committee - someone not affiliated with the organization's auditing firm?

Committee meetings

- Does the committee meet at least three times a year?
- Does management forward to the committee all information that's relevant to the agenda (or that should be added to the agenda)?
- Does it do so in plenty of time for members to review the information before the meeting?
- Are meetings long enough for the committee to thoroughly discuss all items on the agenda?

Communication with management

- Does the committee meet regularly with the CFO (and other financial team members such as an internal auditor, as appropriate) to keep abreast of key issues?
- Does management keep the committee up-to-date on organizational changes, particularly turnover within the financial or management team or the external audit team?
- Does the committee know how to effectively question, when necessary, management choices related to the organization's finances and financial reporting?

Communication with the full board

- Has the board been clear to the committee in its expectations of the organization's key financial managers, including the CFO?
- Does the committee provide information to the full board concerning key financial management competency and issues identified?
- Does the committee report its proceedings and recommendations to the full board after each committee meeting sufficient for the board to exercise its fiduciary responsibilities?

Communication with outside auditors

- Does the committee regularly schedule meetings with the independent auditors and communicate with them before, during, and after the engagement?
- Does the committee understand the coordination of work between the independent and internal auditors? Are committee members able to relay that information to both sides and to the board accurately?

And much more . . .

There are many other components of a strong audit committee, including having effective processes in place to orient new committee members, investigate allegations, and recommend the approval or modification of the annual audit to the board. Your CPA can review with your board best practices as well as state and national audit committee requirements.

Does Your Board "Get" Your Financials?

For nonprofit executives and board members, accurate, relevant and timely financial information is key to making good decisions. But do all of your board members really

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 700 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.

understand the numbers they receive and what they mean to your organization? And do the numbers provide the right information - for example, when you're trying to determine how and when to initiate a new program?

If your answers to these questions are "no" — or "I'm not sure" — you may want to reassess the usefulness of the financial information you provide.

Consider your audience

Your board members probably come from different walks of life and different positions in the community. Some of them may have financial backgrounds, but many of them might not. And it's this latter point you need to keep in mind as you supply financial data.

For example, don't assume that everyone on your board of directors understands financial language. Provide them with some working definitions to help them along. Here are some commonly used financial terms and ways you can describe them in everyday language:

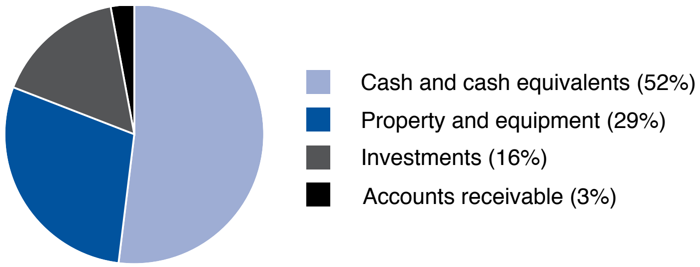
- ***Liquidity*** — the nearness of an asset or liability to cash or cash conversion, or to a requirement to satisfy an obligation in cash.
- ***Board-designated net assets*** — net assets set aside for a particular purpose or period by the board, such as safety reserves or a capital replacement fund, that have no external restriction by donors or by law.
- ***Net assets released from restrictions*** — the transfer of funds from donor-restricted to unrestricted status based on satisfying donor-imposed stipulations with respect to the timing or purpose of the contribution (or, in rare cases, due to permission of a donor of permanently restricted funds).

Also consider providing your board with financial training. Bringing in outside speakers, such as accountants, investment advisors, and bankers, is a good start. Additionally, financially savvy individuals on your board - they may make up a separate finance committee - can be asked to share their financial expertise with the rest of the board.

Serve the message with a pie chart

One of the most common financial documents to circulate is the statement of financial position (the balance sheet). It shows an organization's assets (cash, accounts receivable, and property and equipment), liabilities (accounts payable and long-term debt) and net assets (unrestricted, temporarily restricted, and permanently restricted resources). Long lists of numbers can have a dizzying effect on readers.

But adding a pie chart can quickly show your board the composition of your nonprofit's assets. See the chart "Breakdown of total assets." At a glance, anyone can see that cash and cash equivalents are the largest part of this nonprofit's total assets and a much smaller percentage is composed of investments and accounts receivable.



Or, you could create a two-slice pie chart that shows what portion of total assets can quickly be converted to cash (cash equivalents, investments, and accounts receivable) vs. the portion that cannot (property and equipment).

A different example: You could create a pie chart to show how your annual event was funded last year: money from attendees, sponsors, and general contributions. This tool can help a board make quicker and better-informed decisions - in this case, guiding them in setting or readjusting their funding expectations this year.

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

Use bar charts to show change

The statement of activities (the income statement) is another commonly circulated financial document. It generally starts with total support and revenue, including reclassifications from restricted to unrestricted. Then expenses, including program, management and general, and fundraising, are deducted to arrive at the overall change in net assets.

A bar chart is a good way to present this information: It can visually compare current revenues and expenses with those of previous periods. By updating the bar graphs on, say, a monthly basis, you can help nonfinancial board members easily compare revenues and expenses to the budget on a continuing basis.

Your annual budget assumes a particular level of support and revenue. If you don't obtain certain grants — or if you sell less in program services than anticipated - your board will need to revisit anticipated expenses and make adjustments accordingly. An informational graphic is one way to quickly relay a heads-up.

Track expectations by comparing ratios

Many entities have experienced cuts in funding and donations in the sluggish economy and, as a result, have reduced costs. If you supply board members with ratios for both the current year and prior year, they can see at a glance if these costs have been cut sufficiently.

Useful ratios include 1) management and general costs to total support and revenue, 2) program services to total support and revenue, 3) fundraising expenses to total support and revenue, and 4) fundraising expenses to donations (including deferred gifts). These ratios allow your board to see if the nonprofit's costs and revenues are in line with its expectations, as expressed, for example, in the budget.

Let's say that your management and general costs are $200,000 for the coming year and the total support and revenue for the organization is $2 million. You'd have a highly impressive ratio of 1:10 - 10% of every dollar earned is spent on administrative costs, with the remaining 90% available to fund programs and supporting activities.

Another useful ratio is the "current ratio." This comparison of current assets to current liabilities is commonly used as a measure of short-term liquidity. For example, a ratio of 1:1 means an organization would have just enough cash to cover current liabilities if it ceased operations and converted current assets to cash.

Give them the chance

Members of the community agree to become board members because they want to make a difference. And it's up to you to supply them with information they fully understand so that the decisions they make are informed ones.

Creating Policies: Don't Reinvent the Wheel

Since the revised IRS Form 990 debuted a few years ago, many nonprofits have been reviewing the policies on their books, improving them, and adding new policies to their collections. Form 990 doesn't state that these policies are required, but asking about them implies that they should be in place. Form 990 aside, the public - concerned by stories of nonprofit mismanagement - has put more emphasis on nonprofit governance, including policy adoption and enforcement.

There's good news about this policy-making uptick: Because so many organizations already have policies on the books, you can learn from their successes.

Types of policies
What types of policies do nonprofits need? Form 990 asks nonprofits if they have policies on:

- Conflicts of interest
- Whistleblower protection
- Document retention and destruction

- Chief executive compensation
- Activities of chapters, affiliates, and branches

Policies on gift acceptance, investment practices, and joint ventures also have become more popular in recent years.

Learning from peers
Here is a selected listing of organizations and websites that can help you in developing or improving your nonprofit's policies:

BoardSource. At www.boardsource.org, you can purchase policy samplers on a variety of topics. An extensive policy sampler contains 241 policies on 48 topics under the categories of ethics and accountability, board and board members, chief executive, finance and investments, fundraising, personnel, communications, and committees.

Independent Sector. This nonpartisan coalition of approximately 600 national organizations, foundations, and corporate philanthropy programs posts model policies at independentsector.org under "The Principles for Good Governance and Ethical Practice Resource Center." You can download them for free.

National Council of Nonprofits. At www.councilofnonprofits.org, members have access to a variety of policy-related information, including a Form 990-related "governance practices" checklist and sample policies on conflict of interest, document retention and destruction, board review of compensation policy, joint venture and partnership, and other topics.

ECFA. Founded in 1979, ECFA provides accreditation to leading Christian nonprofit organizations that faithfully demonstrate compliance with established standards for financial accountability, fundraising and board governance. ECFA's Seven Standards of Responsible Stewardship™ focus on board governance, financial transparency, integrity in fundraising, and proper use of charity resources. For information on standards and best practices, see www.ecfa.org.

Customize, customize, customize
Although you should customize your own policies - rather than go with a boilerplate - there's something to be said about not reinventing the wheel. Just be sure to carefully adjust policies from other sources to fit your operation. Make sure, for example, that the processes are practical for your size and structure, and that the titles and positions listed for policy oversight are correct.

Your CPA can help you customize a policy or review the one you devise. Your lawyer also should review any policy before it's adopted.

In the Spotlight: The Church Consulting Review
by Myra Miller

"In the Spotlight" is a new column that will highlight one of our many outstanding clients or staff members, or one of our non-audit or attest services and how it may benefit you. We hope you find each article informative. And, as always, please feel free to contact us if you have any questions.

The Church Consulting Review
The following article is an interview with Rick LeBrun, Partner and National Director of Church Services, about our Church Consulting Review. Rick is based in our Los Angeles office.

MM: Why was the Church Consulting Review (CCR) created?

RL: The CCR was developed several years ago to fill a specific need. I'd received numerous phone calls from smaller churches asking for an audit, but after further inquiry it became apparent they didn't need one. Rather, they were seeking confidence and reassurance that their internal controls, financial reporting, and tax issues were in good order. As I kept hearing these and similar requests, I decided to come up with a product that would satisfy those needs.

MM: Who can benefit from a CCR? Is it mainly for smaller churches?

RL: No — a church of any size can benefit. Smaller churches will probably see the most benefit, as the staff doesn't always have the skill level necessary to insure that they have the right controls and reporting in place.

MM: What are the benefits or the outcomes that can help a church?

RL: The goal of the CCR is to improve on the church's internal controls and financial reporting, and to reduce wasted effort. So it benefits those in leadership, including the board, senior pastor, bookkeeper.

For example, a few years ago a pastor was very excited because the CCR opened up capacity for his administrative assistant. The church had unnecessary, duplicative efforts and processes in place. The CCR identified and eliminated these, saving time and money. The review essentially doubled the church's administrative capacity without adding more staff.

MM: How is a CCR different than a regular review?

RL: A financial statement review is intended to report that the financial statements are prepared in accordance with specific accounting principals. This type of review, while important to the board, a lender or other interested party, has limited use because it is based on historical information

On the other hand, a consulting review is in real time, giving church leadership findings and recommendations that can be implemented right away. It has significant use internally in helping the church with internal controls, accounting procedures, internal financial reporting, and tax compliance. Basically, a consulting review consists of several diagnostic tools designed to help churches implement immediate changes to improve their current processes and procedures.

MM: How is a CCR conducted?

RL: A skilled accountant with significant church experience uses a number of diagnostic tools to review the church's processes and procedures. This includes reviewing documentation such as minutes, bylaws, the constitution, financial statements, personnel manuals, and accounting policies and procedures. The accountant also conducts interviews with the appropriate staff members, mainly the senior pastor and accounting personnel.

MM: How long does it take?

RL: We typically spend two to three days at the church, and then several days writing the report, depending on the size of the church.

MM: When is the optimum time for a church to consider a consulting review, or what is the decision trigger?

RL: People don't know they need it. Usually, a church calls thinking they need an audit, and throughout the course of the conversation this option is brought up.

However, there could be triggers that develop over time, such as:

- The church is struggling with financial reporting.
- The church is concerned whether its internal controls are adequate.
- The church wants to be sensitive to constituents, to reassure them.
- The church is wondering about tax issues.
- There is a small amount of debt.
- The staff does not have the skills or is unsure of what it is doing.

Folks are used to hearing the word "audit" so that's what is asked for - but it may not be what's needed or necessary. Audits can be expensive. CCRs are designed to provide tangible results at a reasonable price.

MM: Tell me more about the report and what it looks like.

RL: There are four modules:

- Corporate and administrative matters
- Internal controls
- Financial Accounting and reporting
- Tax compliance

The report provides findings and recommendations for each module.

MM: Does a church have to purchase all four modules?

RL: No. The church decides which areas it wants reviewed. It could be one, or it could be all four. We've had a situation where, due to monetary constraints, two areas were reviewed one year and the other two the next year. Also, the CCR can be performed any time during the year. It does not have to be in conjunction with the church's fiscal year-end.

MM: Does it prepare a church for an audit, and if so, how?

RL: It can. If an audit is anticipated, a CCR is beneficial because it helps get things in order and geared up for what's asked in an audit.

For example, if a church accounts for transactions on a cash-basis and an audit will be needed for a capital campaign or a loan, the consulting review will uncover any accounting issues or areas to shore up and improve on.

If the church implements the recommendations from the report, the audit process will run more smoothly. Of course this is in a situation where there is sufficient time to implement the recommendations.

A CCR can also be beneficial to the audit process because the church will know more about its financial situation going into the audit.

MM: Do you have any closing remarks regarding the Church Consulting Review?

RL: The CCR is a very helpful and powerful tool designed to ensure that churches have in place appropriate controls and good financial reporting, and are in compliance with tax rules. We've never had a client say that a consulting review was a waste of time or money.

If you are interested in talking with someone about a Consulting Review for your church, please contact us at info@capincrouse.com .

Newsbits

IRS Initiates Program to Check for 403(b) Plan Compliance

The IRS Employee Plans Compliance Unit (EPCU) launched a Compliance Check project for 403(b) plans of higher education organizations, in April. This includes an assessment of compliance with non-discrimination rules and new plan document requirements.

A random sample of 300 large, medium, and small public and private higher education organizations sponsoring 403(b) plans have been selected. Those selected will receive a notification from EPCU. The request package includes a questionnaire and guidance for administering 403(b) plans. The questionnaire has 21 questions, focusing on universal availability and plan document requirements.

This compliance check is not the same as an IRS audit.

With all the new regulations for 403(b) plans, the IRS is taking steps to help these organizations get into compliance. This Compliance Check is intended to help plan sponsors understand the requirements and bring to light any corrections that should be made. If the sponsoring organization appears compliant, the contact will be resolved, and a closing letter will be issued notifying the sponsoring organization. If a potential problem is identified, the IRS will correspond with the sponsoring organization to help it analyze its 403(b) plan to determine if it is in noncompliance. If the sponsoring organization finds a problem, they should use one of the correction methods outlined in the IRS follow-up letter, such as correcting under the Voluntary Correction Program (VCP).

What if your organization receives a compliance check package?

It is important that the questionnaire be completed and returned promptly. Failure to respond can result in an IRS audit. Once an IRS audit begins, any findings from the audit must been corrected in the Audit Closing Agreement Program (Audit CAP). Corrections are mandated and sanctions are more significant that fees related to the VCP.

For further guidance, visit the EPCU website at http://www.irs.gov/retirement/article/0,,id=239304,00.html .

For additional information on how CapinCrouse can assist you with questions relative to your 403(b) plan, please see our website at www.capincrouse.com/what_we_offer/ebpa/, or contact Emily Powers at info@capincrouse.com.

U.S. nonprofits report mixed signs of economic resilience

Of U.S. nonprofits responding to a recent survey, 60% reported that they have only three months or less of cash on hand, and 10% said they have no cash reserves.

The 2011 Nonprofit Finance Fund (NFF) survey, sponsored by the Bank of America Charitable Foundation, also showed that 85% of respondents expect an increase in service demand this year. But only 46% of those who expected an increase said they'd be able to meet the growing demand.

While economic uncertainty apparently played a role in the responses, some positive economic signs also surfaced. Of the respondents:

- 55% added or expanded programs or services
- 49% increased the number of clients served
- 47% partnered with another organization to improve or increase services
- 44% reported ending 2010 with a surplus compared to only 35% who had a surplus in 2009
- 39% reduced annual expenses
- 36% relied more on volunteers
- 35% said they raised more revenue in 2010 than anticipated
- 25% added to reserve funds in 2010.

"Years of economic uncertainty have forced nonprofits to adjust to the 'new normal' of scarce resources and increased demand," said NFF vice president of consulting services Rebecca Thomas.

Clarifying employer health care coverage reporting

The ***Patient Protection and Affordable Care Act*** requires employers to report the cost of employer-provided health care coverage on Form W-2 starting next year. (That cost is still excluded from an employee's taxable income.)

The good news is that IRS Notice 2010-69, issued last fall, made reporting the cost of health coverage on the 2011 Form W-2 (furnished to employees in 2012) voluntary for all employers. And IRS Notice 2011-28, issued this year, makes it optional for small employers (those filing fewer than 250 W-2 forms) for 2012 and until further IRS guidance is issued.

Repeal of New Form 1099 reporting requirements

The ***Patient Protection and Affordable Care Act*** added a requirements to report payments for goods and payments to corporations. These were repealed before ever going into effect. This restored the prior requirements of reporting payments for services, with payments to most corporations exempt reporting.

Small Employer Health Care Credit

The *Patient Protection and Affordable Care Act* added one great benefit for small employers, both business and nonprofit. For qualifying businesses, a portion of the premiums (up to 35%) paid for health insurance may be used as a credit against taxes. Qualifying nonprofit organizations can receive a refund of a portion (up to 25%) of the premiums they paid.

An employer is eligible for the credit or refund if it meets all three of these requirements:

- It has fewer than 25 **full-time equivalent** employees for the tax year in which the credit/refund is taken
- The **average annual wages** are less than $50,000.
- The employer pays at least 50% of the premiums.

The health insurance benefit cannot discriminate. This requirement was waived for plan years beginning in 2010, but will apply to future years.