

nonprofit agendas

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Board financial responsibilities

Put best practices in motion

Members of your nonprofit's board of directors likely joined because they had a passion for the organization's mission or another board member persuaded them to come aboard. But even if new members are enthusiastic, wise or skillful, they may not fully understand their fiduciary responsibility to be good stewards of the public's money, have a working knowledge of finances — or even be good with numbers.

With these challenges, how can a board assure fiscal responsibility? Strong board operating procedures, the right committee structures and appropriate training provide the platform for effective fiscal oversight and sound decision making.

THE BOARD TREASURER

One governance best practice is to make sure that at least one board member is a CPA or experienced equivalent — to provide insight into the nonprofit's finances and explain financial matters to less financially savvy board members. Typically designated the board treasurer, this person facilitates transparency of the organization's financial health to the full board and the public.

It's not, however, the treasurer's duty to maintain the nonprofit's books and records — the chief financial officer (CFO) generally handles that responsibility. (In a smaller organization, it may be a bookkeeper or an external CPA.) The treasurer typically interfaces with the CFO monthly, bimonthly or quarterly, depending on the frequency of board meetings, and reviews the financial information for accuracy.

The treasurer also compares actual and budgeted numbers and identifies any unusual activity, such as a drastic decrease in cash



contributions or significant expense variances. He or she then presents this information to the full board at its next meeting.

DESIGN BY COMMITTEE

Most boards are supported by committees, and that includes the financial front:

Finance committee. The finance committee, which is usually chaired by the board treasurer, comprises financially savvy individuals who aren't necessarily all board members. Typical oversight duties are to:

- * Set up or review annually the nonprofit's internal control policies and procedures,
- * Recommend an investment policy to be approved by the board and oversee the investment portfolio in the absence of an investment committee,
- * Prepare or review for board approval an annual operating budget at the beginning of the fiscal or calendar year,
- * Review and approve monthly financial statements, reconciliations and budget to actual reports,
- * Review the Form 990 tax return, and

- * Manage cash flow when planning future capital expenditures and during crises.

If the not-for-profit operates without a compensation committee, the finance committee should review and recommend the executive director's salary. This usually entails looking at salary surveys to see if the recommended compensation is reasonable.

Audit committee. If the organization has an annual audit, a best practice is to have an audit committee composed of individuals who have financial experience and are independent from the board and staff. (In the absence of an audit committee, the finance committee can fill this role.)

The audit committee's main responsibility is the oversight of the annual audit process, including interviewing audit firms, obtaining fee quotes and recommending the appointment of an independent auditor. The auditor selection process should be conducted without influence from management to avoid conflict of interest.

The audit committee will meet with the audit firm and discuss the nature, timing and scope

of the audit, including areas of focus. After the audit, the committee will meet with the auditor to review a draft of the audited financial statements, discuss any issues identified in the audit, and review any letter to management prepared by the auditor, including possible recommendations to strengthen internal controls.

Once the committee agrees with the audit results, it will recommend that the board accept the audit and findings as prepared. (Also see "The audit dance – Nonprofit and auditor roles are distinct but complementary" on page 5.)

FINANCIAL DOCUMENTS THE BOARD NEEDS TO UNDERSTAND

All board members will review a number of reports to gauge the nonprofit's financial health. Thus, they should possess at least a basic understanding of:

- * The *statement of financial position*, which summarizes the total assets, liabilities and net assets of the organization at a specific point in time,

Measure by measure — metrics your board should know

Your board members should have an understanding of the various financial reports your nonprofit is required to prepare. (See main article.) In addition, members should be familiar with these metrics:

Percentage of program expenses to total expenses. Generally this percentage should be 65% or more of total expenses. The higher the percentage, the more effective the organization is at delivering its program services.

Percentage of management and general and fundraising expenses to total expenses. This percentage generally should be 35% or less of total expenses, because many donors look to contribute to nonprofits that consistently maintain a low percentage.

Percentage of fundraising expenses to related contributions. The recommended percentage is 35% or less of total contributions raised. Again, a lower percentage likely will attract more donors.

Board members also should be familiar with the *liquid funds indicator*. To calculate the measure: 1) Combine your organization's unrestricted and temporarily restricted fund balances, 2) deduct property and equipment costs, and 3) divide that total by average monthly expenses.

The resulting indicator reveals how many months your not-for-profit can continue to operate before it will exhaust its liquid funds in the absence of new cash inflows. In general, an organization should have at least three to six months of cash operating reserves to see it through times of crisis.

- * The *statement of activities*, which sums up the nonprofit's activities for a specific period from a revenue and expense viewpoint,
- * The *statement of cash flows*, which summarizes the cash inflows and outflows during the year from operating, investing and financing activities, and
- * The *statement of functional expenses*, which groups expenses into program, management and general, and fundraising categories.

Additionally, comparisons of monthly budgeted amounts vs. actual figures identify where the

organization under- or overperformed in its fundraising efforts and was effective or inefficient in controlling various costs.

TRAINING AND CONSULTATION

Your board treasurer, staff and CPA can be useful in training board members who aren't well versed in the financial basics they need to know. And board members who are conversant in the financial business of your nonprofit will be positioned for effective fiscal oversight and sound decision making. *

Regaining tax-exempt status

Nearly 275,000 not-for-profits lost their tax-exempt status this year because they'd failed to file required annual reports for three consecutive years, the IRS recently announced. If your organization is on the revocation list and seeks to re-attain its exempt status, here's what you need to know.

WHAT FORM MUST YOU FILE?

If you lost your exempt status due to an automatic revocation, you must complete either Form 1023, "Application for Recognition of Exemption Under Section 501(c)(3)," or Form 1024, "Application for Recognition of Exemption Under Section 501(a)," to regain your status.

Unless you apply for *retroactive* reinstatement, all of your organization's activities between the revocation and the reinstatement date will be considered activities of a taxable entity. Thus, all contributions made during that period won't be deductible by donors — and all income to your organization will be taxable.

You may apply for retroactive reinstatement, effective the date of the automatic revocation, by filing the applicable form within 15 months of the later of the date of the IRS revocation letter or the date the IRS posted your organization's name on its website.

WHAT ELSE MUST YOU INCLUDE?

When you file the form, you must also attach the following items:

1. A detailed statement that explains and supports the reasonable cause (for example, if your organization's activities are substantially performed by an all-volunteer staff) for failing to file the required return in each of the three consecutive years and that describes the facts that led to each failure and the continuous failure, the discovery of the failures, and the steps taken to avoid or mitigate the failures,
2. A statement that describes the safeguards put in place and steps taken to avoid future failures,
3. Evidence to support all material aspects of the statements described in Nos. 1 and 2,



4. Properly completed and executed paper tax returns for all taxable years during and after the consecutive three-year period your organization failed to file, and
5. An original declaration dated and signed under penalties of perjury by an authorized person such as an officer or director. See IRS Notice 2011-44 for the wording required in the statement.

To expedite the application for reinstatement, write "AUTOMATICALLY REVOKED" on the top of the form and envelope. All organizations seeking reinstatement must pay a specified user fee, which depends on your gross receipts.

WHAT IF YOUR ORGANIZATION IS TINY?

Many small nonprofits are operated primarily by volunteers and, thus, face challenges keeping up with federal tax laws. Organizations the IRS considers small — typically with annual gross receipts of not more than \$50,000 in their most recently completed taxable year — may be eligible for transitional relief. This consists of retroactive reinstatement with reduced paperwork and a filing fee of only \$100.

To qualify for transitional relief, the organization must have been eligible to file the Form 990-N e-Postcard for 2007, 2008 and 2009. It also must *not* have been required to file an annual return (Form 990 or Form 990-EZ) for taxable years beginning before 2007. Additionally, the nonprofit must file Form 1023 or Form 1024 on or before Dec. 31, 2012.

MAKE IT THE PRIORITY

Reinstating your tax-exempt status should be your top priority. Being a taxable entity can drastically impact your funding and, consequently, your programs. Many individuals and entities want to attend events of, and make donations to, a *charitable* cause. *

The audit dance

Nonprofit and auditor roles are distinct but complementary

A nonprofit and its external auditor are somewhat like dance partners performing a well-choreographed routine. To execute the dance properly, each dancer must complete specific moves and coordinate timing with his or her partner. Likewise, your organization and its audit firm each have particular duties in the audit process but share the same end goal: a

set of financial statements that fairly present your financial condition and operating results.

DEFINING RESPONSIBILITIES

Your auditor is responsible for expressing an opinion on your financial statements. The opinion is based on planning and performing an

audit in line with required standards to obtain *reasonable assurance* that your financial statements are free of material misstatement — whether from error or fraud.

Your nonprofit, on the other hand, is responsible for preparing the financial statements and for related tasks, such as developing estimates (an allowance for bad debts, for example) and adopting accounting policies. It's also your job to establish, maintain and monitor effective internal controls over financial statement reporting and to prevent and detect fraud, as outlined in the American Institute of Certified Public Accountants' standards.

In designing the audit plan, the auditor considers the internal controls you have in place to guard against risks. But, in the audit opinion, he or she provides no assurance on the effectiveness of those controls.

The auditor may advise on appropriate accounting principles and their application, and may even assist in the preparation of the



financial statements at your request outside of the audit as a matter of convenience, as long as he or she has determined that your not-for-profit has the ability to understand and approve those statements.

The responsibility for the financial statements remains with your organization. You also are responsible for adjusting the financial statements to correct material misstatements.

Your auditor must maintain independence, in both fact and appearance. Although he or she can provide suggestions to help your not-for-profit develop policies, your auditor can't assist in selecting and implementing those policies.

The auditor also can't make the adjusting journal entries that might be required to close your books. Your nonprofit has the responsibility to maintain, adjust and close the financial records before the audit.

USING YOUR BOARD AS A RESOURCE

During the engagement, your board of directors — the audit committee in particular — can be a valuable resource for your not-for-profit. The board's significant fiduciary responsibilities dovetail with many of the audit-related duties. And a well-represented board may have members with accounting experience who can assist.

In particular, qualified board members may be able to confer with the independent auditor during the planning process, prepare the financial statements and reconcile accounts to limit the number of adjustments needed during the audit. (Also see "Board financial responsibilities — Put best practices in motion" on page 2.)

WELL WORTH IT

The time your nonprofit spends preparing for the audit can be significant, and coordinating the roles of your auditor and your organization may be a bit ticklish. But the end results — a fair assessment of your financial health, viable options to address any exposed vulnerabilities and transparency for your public — make it well worth the effort. *

NEWS FOR NONPROFITS

WHEN IS WEBSITE ACTIVITY UBI?

The Internet is a significant communication tool for your nonprofit. Through your website and e-mails, you can share with your public the organization's purpose, events and other important information. But while handy in disseminating information, the Internet also can create unrelated business income (UBI) and the tax liability that comes with it.

Website activities are subject to the same UBI rules as any other activities, so conducting an unrelated business activity over the Internet is subject to UBI tax as if it were done by any other method. Watch out for these activities:

Website advertising. Website advertising that's unrelated to your exempt purpose could be subject to tax. Banner advertising and graphic ads can be of concern. A moving banner or graphic ad is likely to be taxable if it promotes the goods or services of another.

Website sponsorship. A qualified sponsorship (a mere acknowledgment of the sponsor with no promotion of products or services) won't be subject to UBI tax. Your website, for example, can publish a listing of the sponsors of one of your activities. Or an outside party can sponsor all or part of your website as long as you don't make statements to induce the visitor to purchase or use a product or service of the sponsor. But, if the payment amount is based on pay-per-view, it won't be a qualified sponsorship and will be taxable.

Often, a nonprofit will provide a link from its website to a sponsor's site. Merely providing a link doesn't make the sponsorship payment taxable. If the sponsor's website contains an endorsement of its product or service by your

organization, however, the sponsorship payment becomes taxable advertising. *

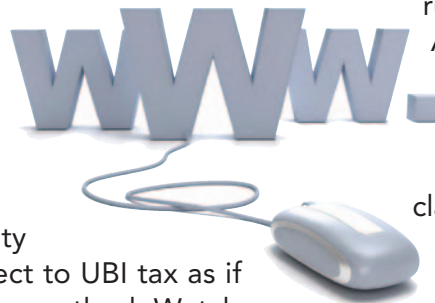
SEQUEL TO UPMIFA

The Uniform Law Commission, the organization that developed the Uniform Prudent Management of Institutional Funds Act (UPMIFA) in 2006, has proposed a new set of rules, the Protection of Charitable Assets Act (PCAA).

The purpose of the proposed act is to safeguard the role of the states in protecting charitable assets by further clarifying the role of the state attorney general, who is the charity "gatekeeper" in most states. The act would require charities to:

- * Register with their state attorney general, and
- * File a report with that office once a year.

Charities also would be directed to notify the state attorney general of certain events, including dissolution, disposition of assets, merger or transfer to another state. *



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