

THE NEWSLETTER OF THE BDO NONPROFIT & EDUCATION PRACTICE

# NONPROFIT STANDARD



## MY APPLICATION FOR TAX EXEMPTION WAS SUBMITTED TO THE IRS – WHY IS IT TAKING SO LONG?

By Paul E. Hammerschmidt, CPA, MS (Taxation)

Perhaps you submitted an application for recognition of tax exemption to the IRS months ago and wonder why it's taking so long for the agency to process and send a determination letter. Tax-exempt organizations are currently experiencing significant delays after submission of their applications to the IRS. This article explores the reasons for the delay and offers suggestions to those who have submitted, or plan to submit, an application for exemption.

Most charitable organizations are required to submit an application for exemption (Form 1023) to the IRS to be recognized as tax-exempt under Section 501(c)(3) of the Internal Revenue Code. Exceptions include

religious organizations that are not required to submit an application of exemption to the IRS. Other organizations, such as social welfare organizations and trade associations, may file Form 1024 for a determination of exempt status. However, these organizations can operate as tax-exempt without filing an exemption application (Form 1024). These so-called "self-declared" Section 501(c)(4), (5) and (6) organizations have not filed an application for exemption but operate as not-for-profits and annually file Form 990. However, most trade associations and social welfare organizations do, in fact, file Form 1024 to receive positive assurance that they are tax-exempt.

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## TAX EXEMPTION

Organizations applying for recognition of tax-exempt status under Section 501(c)(3) will typically face fundraising challenges without an IRS determination letter. Understandably, many donors are reluctant to make contributions (especially large contributions) to such organizations. Contributions from private foundations (PFs) and donor advised funds (DAFs) are subject to rules that prohibit taxable expenditures and grants to organizations that are not classified as public charities under 501(c)(3). Such grants count as taxable expenditures unless the grantor exercises expenditure responsibility over those grants. Typically, PFs and DAFs do not want this responsibility.

In addition to fundraising from the public, many states require charitable organizations to have a determination letter issued by the IRS prior to charitable solicitation or to obtain a sales tax exemption.

The recent and significant delays in processing exemption applications at the IRS are perhaps a *perfect storm* and can be attributed to the following factors:

### ▶DELAYS IN PROCESSING APPLICATIONS FOR TAX EXEMPTION ARE ATTRIBUTABLE TO:

- **Automatic Revocation of Exemption Under Pension Protection Act** – Beginning in 2011 the IRS [automatically revoked approximately 275,000 exemptions](#) under the provisions passed by Congress in the Pension Protection Act (PPA) of 2006 because they did not file legally required annual reports (i.e., Form 990, 990-EZ or 990-N, as applicable) for three consecutive years. Many of these organizations have submitted applications for reinstatement of exemption. GuideStar published, "[What Automatic Revocation of Nonprofit Tax Exemptions Means for You](#)" that provides guidance for nonprofits, grant makers and donors.
- **IRS Scrutiny of Self-Declared 501(c)(4), (5) and (6) Organizations** – In early 2013 the IRS sent [nine-page questionnaires](#) to more than 1,300 organizations that declared themselves tax-exempt without a

## INSTITUTE PROFESSIONAL PROFILE

## PAUL HAMMERSCHMIDT



Paul is the director of the Exempt Organization Tax Practice in the BDO Greater New York Nonprofit industry group. He has more than 25 years of taxation experience with nonprofit organizations. Paul's knowledge covers all facets of nonprofit taxation and includes assisting nonprofit organizations commence their tax planning at the inception of the organization and assisting with the completion of applications for exemption to be filed with the IRS.

Paul is responsible for the Greater New York nonprofit taxation practice's overall service approach and directing its day-to-day work. He works closely with client management and those charged with governance to ensure that organizations have complied with all tax requirements to protect their tax-exempt status.

Paul's experience includes reviewing nonprofit operations to ensure compliance with tax regulations, assisting organizations in analyzing proposed transactions to identify any potential excess benefit transactions and ensuring compliance with intermediate sanctions. Paul also has experience in the evaluation of fundraising activities to determine compliance with IRS and state requirements.

Paul is currently an active member of the Exempt Organization Committee of the New York State Society of Certified Public Accountants (NYSSCPA) and is on the response team that provides technical guidance to NYSSCPA members on exempt organization tax matters. Paul has previously chaired the Exempt Organization Tax Committee of the NYSSCPA.

Paul is a graduate of Long Island University with a bachelor's in Accounting and an M.S. in Taxation from Pace University. He is a member of the American Institute of Certified Public Accountants and the NYSSCPA.

determination letter. The IRS indicated that completing the questionnaire was optional, but encouraged. This recent IRS scrutiny likely caused a number of self-declarers to apply for tax exemption.

- **IRS Resignations, Dismissals and Staffing Shortages** – According to a [report from the Treasury Inspector General for Tax Administration](#) (TIGTA), the IRS used inappropriate criteria that identified for review Tea Party and other organizations applying for tax-exempt status based upon their names or policy positions instead of indications of potential political campaign

intervention. As a result according to TIGTA, their applications were subjected to unnecessary scrutiny and inappropriate questions. After this report was released, the IRS Commissioner resigned and many senior leaders in the IRS EO Group have subsequently resigned or retired.

- **The IRS' self-certification process** – This new process is available to certain 501(c)(4)s (see below) and is likely to create delays in processing other applications as the IRS attempts to prioritize applications rather than process applications in the order received.

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## TAX EXEMPTION

### ▶WHAT ORGANIZATIONS CAN DO TO EXPEDITE THE PROCESSING OF THEIR APPLICATION

#### Background

First, it would be helpful to understand a little about the IRS determination application process. Upon receipt of the application at the IRS, exemption applications accompanied by the required user fee are initially separated into four categories: (1) those that can be approved immediately based on the information submitted, (2) those that need minor additional information to be resolved, (3) those that are submitted on obsolete forms or do not include the items specified on the Form 1023 Checklist found at the end of [IRS Form 1023 Instructions](#), and (4) those that require development.

It should be the goal of all applicants to be in the first category as their applications can be processed efficiently. The IRS currently indicates that applications that fall within one of the first three categories will receive either their determination letter or a request for additional information, via phone, fax or letter, within approximately 90 days of the date the application was submitted. Applicants will want to avoid the fourth category as “further development” can mean substantial additional time to process.

The IRS website provides the month from which it is currently assigning applications it received. “[Where Is My Exemption Application](#)”? For example, mid-September 2013 the IRS indicated it was currently assigning applications received in April 2012.

#### The Application

- Make sure the application is accurate, complete and includes all required schedules and copies of the organizing documents, bylaws and the correct user fee.
- Request [IRS expedited processing](#) if any of the following compelling reasons exist:
  - A pending grant, where failure to secure the grant will have an adverse impact on the organization’s ability to continue operating

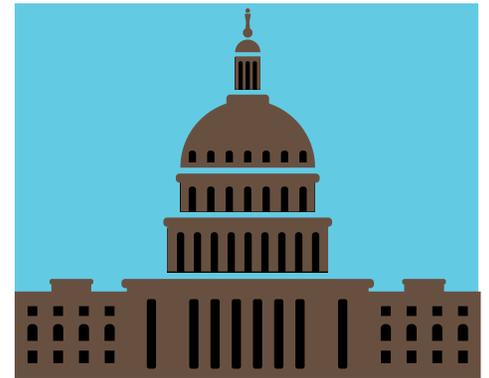
- A newly created organization providing disaster relief to victims of emergencies
- IRS errors have caused undue delays in issuing a determination letter

#### After Submission

- **501(c)(4), (5) and (6) organizations can self-declare** – If they filed an application for exemption but have experienced delays in processing, they may withdraw their application at the IRS and “self-declare” that they qualify for tax-exempt status.
- **Self-Certification process for certain 501(c)(4) organizations** – The IRS has recently offered a [streamlined “hybrid” approach that combines the self-declaration with a formal recognition of tax-exempt status](#). This is available to organizations whose application had been pending for more than 120 days as of May 28, 2013, and the organization’s activities involve possible political campaign intervention or issue advocacy. The applicant organization may “self-certify” and make the following representations under penalties of perjury:
  - The organization devotes 60 percent or more of both spending and time to activities that promote “social welfare” within the meaning of Section 501(c)(4).
  - The organization devotes less than 40 percent of both spending and time to political campaign intervention.
  - The organization ensures the above thresholds apply for past, current and future activities.

If the organization is able and willing to make these representations, it may return the appropriate Letter 5228 to the IRS. The IRS has indicated that it will issue a favorable determination letter within two weeks of receiving the signed representations. This expedited process is optional and organizations may choose to seek recognition of exemption under their previously submitted Form 1024.

- **501(c)(3) organizations can seek a declaratory judgment** – Charities that have applied for tax-exemption under Section 501(c)(3) have a right to bring suit if the IRS does not respond to the application within



## FEDERAL GOVERNMENT SHUTDOWN

The federal government, including the Internal Revenue Service, shut down Oct. 1 as Congress failed to pass a government funding bill. Approximately 800,000 federal workers, including more than 85,000 IRS employees, are now furloughed until spending is reauthorized. The IRS did issue a contingency plan on Sept. 27 noting that the following activities would cease during the shutdown: refunds, examinations, operation of taxpayer services and centers, operation of the Practitioner Priority Service and processing of paper returns that do not require remittance. Unfortunately, based on this information there will be no work on the backlog of the applications for exemption at this point.

270 days.<sup>1</sup> Organizations that are confident of their position and whose application for recognition of exempt status under 501(c)(3) has been denied, or not acted on within 270 days, may file an action in the U.S. Tax Court, the U.S. Court of Federal Claims or the U.S. District Court for the District of

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## TAX EXEMPTION

Columbia for a declaratory judgment that it is entitled to recognition of exempt status.

A declaratory judgment can be issued only when the court determines that the organization has exhausted administrative remedies available to it within the IRS. In addition, the cost of litigation would generally preclude smaller organizations from seeking a declaratory judgment.

- **Provide a prompt and complete response to the IRS' request for additional information during its review of the application** – Organizations should be responsive to requests from the IRS in order to help it process the application.

### Moving Forward

On May 15, 2013, President Obama appointed Daniel Werfel as acting IRS Commissioner. On May 24, 2013, IRS acting Commissioner Daniel Werfel announced two appointments. Michael Julianelle was appointed IRS Acting Commissioner of Tax Exempt and Government Entities (TE/GE) and Ken Corbin was appointed to be acting director of Exempt Organizations. Most recently, on June 10, Karen Schiller, a 25-year veteran with the IRS, became the Director of Exempt Organizations Rulings and Agreements.

At the annual public meeting of the Advisory Committee on Tax Exempt and Government Entities (ACT) held Sept. 12, acting Commissioner Werfel indicated that the IRS made significant progress in addressing the problems in the 501(c)(4) application process identified in the TIGTA May 14 report.

The IRS has charted a path forward with intermediate actions which is available on its [website](#). In addition an [83-page report](#) from acting Commissioner Werfel dated June 24, 2013, is in response to the request by the Secretary of the Treasury for an update, addresses the findings of TIGTA and acknowledges both organizational and individual failures within the IRS.

On June 26, 2013, National Taxpayer Advocate Nina E. Olson released a statutorily mandated [mid-year report to Congress](#) that identifies the priority issues the Taxpayer Advocate Service (TAS) will address during the upcoming fiscal



## IRS UPDATES

### TAX-EXEMPT ORGANIZATIONS WITH POLITICAL ACTIVITY – EXAMINATIONS SUSPENDED:

In a Sept. 18 House Ways and Means Oversight Subcommittee hearing, the IRS Acting Commissioner Werfel announced the suspension of all examinations of tax-exempt organizations involving possible political campaign activity. New leadership of the Tax Exempt and Government Entities (TE/GE) has decided that a review of the examination processes and procedures is needed. They decided to suspend such examination activity until the review is completed.

### TAX-EXEMPT ORGANIZATIONS – ONLINE EXEMPTION APPLICATION:

An online application process for new Section 501(c)(3) organizations is under development by the IRS. The intent is to guide preparers through the process to ensure a more complete and accurate application. The program is expected to be released later this year, but in the meantime, the IRS is inviting users to test and comment on the interactive version of the application on the IRS website at [www.stayexempt.irs.gov](http://www.stayexempt.irs.gov). The test version is quite limited in function. It guides you through a process to identify the needed forms and steps. It does not facilitate the creation of the application except to provide fill-in versions of the forms. The forms are not interactive at this point.

year. The report stated that there is a lack of guidance and transparency in connection with the legal standard “primarily” required for section 501(c)(4) organizations to qualify for tax-exempt status. Treasury regulations provide that an “organization is operated exclusively for the promotion of social welfare if it is *primarily* engaged in promoting in some way the common good and general welfare of the people of the community” (emphasis added).

It may be too early to tell if these IRS actions are substantive and whether they will substantially reduce the amount of time it takes them to review exemption applications.

Marcus Owens, former head of the IRS' Exempt Organizations division, didn't appear

to be optimistic when he commented, “It's outrageous that the IRS is so dysfunctional in processing applications.”<sup>2</sup> He attributed the delays to staffing shortages and no plan for resolving hard technical issues raised by the applications. Owens said that the process is slowing down even more now, due to management shake-ups over the scandal involving the handling of conservative groups, in which senior management of the exempt unit at the IRS was replaced with people who have no familiarity with the area.

<sup>1</sup> IRC § 7428.

<sup>2</sup> [Bloomberg BNA Daily Tax Report Article, August 21, 2013 and republished by Caplin & Drysdale in Client Alert](#)

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# USING OUTCOMES TO MEASURE NONPROFIT SUCCESS

By Richard Larkin, CPA



Those who donate to nonprofit organizations naturally want to feel their gifts will be used successfully in a way that will improve society or some part of it, like children, the sick, students, etc. But how can donors evaluate whether or not a charity will ultimately deliver on their promise or mission?

Success in the business world is generally measured by the amount of profit—the bottom line—that is reported in the business's financial statements. There are other aspects that can mark a successful business: Does it treat its workers fairly? Does it protect the environment? Is its advertising truthful, and are its products or services of good quality? But failure in these aspects eventually leads to diminished profits, as workers, customers and investors desert that business for more socially responsible companies whose products or services are of better quality.

In the nonprofit world, however, there is no common, easily understood measure of success. In fact, having a large positive bottom line may be an indicator that the organization is not doing as much as it could to fulfil its mission. The true measures of success for most nonprofits are statistics related to its programs, but such data are difficult even for management to obtain and understand, much less outsiders. For example, an obvious measure of success for an educational institution would be how much students learn from attending classes. But, much to the chagrin of educators and public policy makers,

actually measuring this learning is very difficult for a variety of reasons. (Think about how a church might measure its own success. Souls saved per pew-hour preached? And where would *those* data points come from?)

## ► THE SUCCESS METRIC CONUNDRUM

There are three types of data that might be used to measure a nonprofit's success, but only one of them is a true measure:

- Inputs describe how much in the way of resources (both financial and non-financial, such as volunteer time, materials, equipment, etc.) was used to conduct an activity.
- Outputs measure the activities conducted by the organization, such as the number of classes held, the number of students enrolled or graduated, the number of concerts performed and number of concertgoers attending, the number of members enrolled and the like. The problem with this type of data is that, while it shows the quantity of program services provided, it does not indicate whether any real benefits resulted. Did the students learn anything? What was the quality of the concerts? How well were the members served?
- Outcomes measure how much better off the organization's clients or society as a whole are as a result of the organization's

activities. For example, by how much has the teenage pregnancy rate in a community been reduced through the efforts of a charity whose mission includes educating children about the undesirable results of getting pregnant so young?

Of these three types of data, only the first is traditionally found in financial statements, although some organizations present certain output data in footnotes, as supplementary schedules or in management reports. However, true success is measured only by outcomes, and these data are never found in financial statements, if they can be obtained at all.

## ► EVALUATING NONPROFIT OVERHEAD

So, lacking access to most output data and almost all outcome data, donors are often left with input data as a surrogate for measuring success for nonprofits. But these data are very flawed when used for this purpose, as they do not necessarily have any direct relationship to true organizational success. For example, in a hospital, input data show how much money is spent treating patients, but not whether any patients are actually cured of the conditions that brought them to the hospital in the first place. Further, these data are necessarily past-oriented, and do not offer any assurance that the gift I make today will be used the same way in the future.

The particular input data that have been widely used to evaluate charities demonstrate how an organization spends its resources. Accounting standards require nonprofits to report their expenses in three categories: program, management and fundraising. The knee-jerk reaction by users of financial statements is to consider program expenses as good and management and fundraising expenses (so-called overhead) as bad. Usually data are expressed as ratios of each category of expenses to total expenses, totalling 100 percent.

Various attempts have been made over the years to define acceptable ratios, with desirable program expenses usually somewhere in the range of 60 to 80 percent, and/or acceptable fundraising ratios generally no more than 15 to 30 percent. Of course, some expenditure on overhead is necessary for any organization to operate, but too

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## NONPROFIT SUCCESS

often more attention is paid to this than is warranted. Recently, a major Internet news site published a list of what it called “The 50 Worst Charities in America.” Its sole criterion for being on the list was related to the overhead ratio. While expense ratios provide valuable information for nonprofit executives charged with making decisions about the organization’s activities, these ratios don’t serve any value as an indicator of organizational success. Although most people understand that it takes money to raise money, and money to manage an organization, sometimes one sees expressions in a fundraising appeal of an expectation that 100 percent of all contributions raised will go directly toward program expenses. That is clearly unreasonable and indicative of an attempt to mislead the public about how a charity uses contributions.

### ▶LOW OVERHEAD VS. HIGH PERFORMANCE

Some states—most recently, Oregon—have passed laws attempting to regulate how much charities that solicit contributions in that state are allowed to spend on overhead. The Internal Revenue Service (IRS) and federal law have no such requirements. The IRS, however, evaluates tax-exempt organizations on how well they appear to be fulfilling the mission for which they obtained exempt status. So an extremely low program-expense ratio would naturally raise a question as to whether that mission is likely being fulfilled. Definitions and penalties vary, but the logic behind such a law is clear: to protect innocent citizens of the state from being bilked by unscrupulous charities that try to give the impression that donating to them will result in wonderful benefits to society, when in fact most of the money raised will go for overhead. Unfortunately, there are some so-called charities out there that spend little, if anything, on programs while paying exorbitant amounts to professional fundraisers and to their own managers. The problem for donors and regulators is to distinguish the bad actors from the well-intentioned charities. There can be various legitimate reasons why a charity’s overhead ratio may be on the high side. For example, the organization espouses a cause that is relatively unpopular with the public, so it naturally has to expend more effort to raise the money it needs; the organization’s

constituency is largely in an economically depressed area, so is less able to contribute or pay for services; the organization is new and still building its infrastructure; or the organization has experienced some problems recently, but is now getting back on its feet.

Several years ago, *The Wall Street Journal* published a single-panel cartoon showing a homeless individual with his hat held out. Around his neck was a sign saying, “No portion of your contribution will be used for administration.” Would you contribute to this nonprofit “organization?” The sign is presumably telling the truth, and the “charity” likely would not end up on the 50-worst list, but what is the program here? What beneficial outcomes are to be expected? If the program is aimed at providing him with food, clothing, job training and a job, then maybe this is a cause worth donating to. But if the “program” consists of enjoying the offerings of the nearest tavern, donors would probably give this one a pass.

Earlier this year, the presidents of three well known nonprofit organizations—the BBB Wise Giving Alliance, GuideStar and Charity Navigator, whose missions include evaluating charities and making their evaluations available as guidance to donors—issued a joint letter titled, “The Overhead Myth.” In this call to action, the three organizations urged donors and the public to place less reliance on expense ratios when making giving decisions. They correctly point out that *how* money is spent is often not a very reliable indicator of the outcomes achieved by the nonprofit. In fact, they suggest that many nonprofits should probably be spending *more* on overhead to improve the quality of management, strengthen internal control, gain operating efficiency, provide for long-term stability and the like.

The last sentence of that letter reads, “The people and communities served by charities don’t need low overhead, they need high performance.” This author could not agree more.

For more information, contact Dick Larkin, director, BDO Institute for Nonprofit Excellence<sup>SM</sup>, at [dlarkin@bdo.com](mailto:dlarkin@bdo.com).

## BDO PROFESSIONALS IN THE NEWS

BDO professionals are requested to speak on a regular basis at various conferences due to their recognized experience in the industry. The following is a list of some of the upcoming events where you can hear BDO professionals speak . . .

### OCTOBER

**Jeffrey Schragg** will be presenting a session entitled “State and Local Tax Obligations for Higher Education Institutions” at the National Association of College and University Business Officers Tax Forum on Oct. 22 in St. Louis, Mo.

**Mike Sorrells** will be presenting an all day course entitled “Form 990: A Comprehensive Approach” for the AICPA on Oct. 26 in Randolph, Mass.

### NOVEMBER

**Rebekuh Eley** will be conducting a session entitled “The Life Cycle of an IRS Exam” at the AICPA Not-for-Profit Financial Executive Forum on Nov. 4 in San Francisco, Calif.

**Lee Klumpp** will be conducting a session entitled “Nonprofit Financial Statement Presentation – What is on the Horizon?” at the Virginia Society of CPAs 43rd Annual Virginia Accounting and Auditing Conference on Nov. 22 in Virginia Beach, Va.

### DECEMBER

**Dick Larkin** will be presenting a session entitled “Accounting and Auditing Update for Nonprofits” at the Greater Washington Society of CPAs (GWSCPA) Nonprofit Symposium on Dec. 16 in Washington, D.C.

**Klumpp** will also be presenting a session entitled “FASB Update” at the GWSCPA Nonprofit Symposium on Dec 16.

**Schragg** is also presenting a session at the GWSCPA Nonprofit Symposium entitled “If I Had Only Known: The Good, The Bad and The Ugly of Alternative Investments” on Dec. 17.

**Sorrells** will also be presenting a course entitled “Tax Red Flags for Auditors and Financial Managers: Know When to Call in the Tax Pros” at the GWSCPA Nonprofit Symposium on Dec. 17.

# ISSUES WITH IMPLEMENTATION OF THE NEW GASB PENSION STANDARDS

By Patricia Duperron, CPA

The Government Accounting Standards Board (GASB) Statement No. 67, *Financial Reporting for Pension Plans*, revises current guidance for financial reporting of most governmental pension plans. GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, establishes new financial reporting requirements for most governments that provide their employees with pension benefits. GASB Statement No. 67 is effective for years ending June 30, 2014, and GASB Statement No. 68 is effective for years ending June 30, 2015. The following discusses some implementation issues with cost-sharing multiple employer pension plans as well as agent multiple employer plans.

Cost-sharing multiple employer pension plans allow participating employers to pool their assets and obligations. Assets can be used to pay benefits for any retiree of a participating employer. Currently, the plan assets and liabilities are not allocated to individual employers and the plan financial statements report only total assets and total liabilities of the plan as a whole. Under current standards, individual employers have limited footnote disclosure requirements and each employer only records a liability if they don't make their annual required contribution. The liability is based on the funding requirements of the plan. Once GASB Statement No. 68 is implemented, employers will have to record their proportionate share of the net pension liability, deferred outflows/inflows and pension expense. For the first time, these employers will be required to record pension expense as employees earn the benefits. The expense will no longer be based on the annual required contribution.

Cost-sharing plans are required to implement GASB Statement No. 67 a year earlier than employers have to implement GASB Statement No. 68. As mentioned above, cost-sharing plans currently do not allocate the assets, liabilities and deferred inflows/outflows to the individual employers. As a result of these new standards, the plans will need to determine an allocation method and allocate the pension amounts to individual



employers going forward. Some plans have thousands of participating employers and it will be a significant amount of work to allocate all of the pension amounts to each employer.

The main issue employers will face when implementing GASB Statement No. 68 is how to obtain their share of the cost-sharing plan's pension amounts. Also, because these amounts will most likely be material for each employer, the allocation will need to be audited to avoid a modified opinion for the employer's financial statements. Currently audited financial statements of cost-sharing multiple employer plans do not provide this information, nor do they provide the amounts of deferred inflows/outflows. The employer will not have access to the census data held by the plan so they will need the plan to provide audited data. It's not feasible for each employer to try to calculate their own allocations as they won't have enough information. Also, if each employer estimated its share of the liability, it could result in different allocation bases and total more or less than the 100 percent allocated amount when you add up all the individual calculations.

The American Institute of Certified Public Accountants (AICPA) has suggested that plans include a schedule of employer allocations and a schedule of collective pension amounts and that both be audited by the plan's auditors.

Agent multiple employer plans pool assets of individual employers for investment purposes but maintain separate accounts for each individual employer. Like cost-sharing plans, employers currently recognize annual pension expense equal to the annual required contribution and liabilities to the extent the annual required contribution is not made. Once GASB Statement No. 68 is implemented, employers will be required to recognize a liability as employees earn their pension benefits. Like employers participating in cost-sharing plans, they will be required for the first time to recognize their specific pension amounts in their financial statements. GAAP-based financial statements of agent plans do not include the elements required to be reported by GASB Statement No. 68. Therefore, employers will have the same challenge as those participating in cost-sharing plans to obtain audited pension amounts from the plan to avoid a modified opinion.

Employers need to start working with their plan's administrators now to ensure these details are being addressed to avoid any implications to the opinion on the employer's financial statements upon adoption of GASB Statement No. 68.

For more information, contact Patricia Duperron, director, at [pduperron@bdo.com](mailto:pduperron@bdo.com).

## HIGHER EDUCATION FACTS

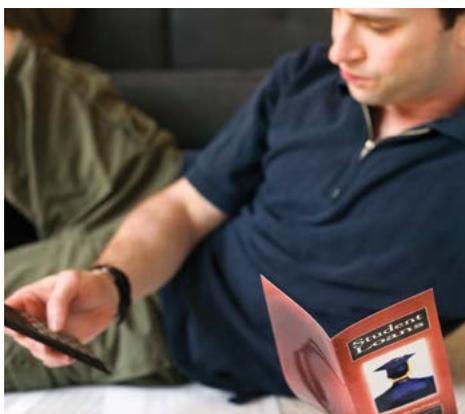
*Did you know...*

1. Massachusetts recently approved a [\\$34 billion state budget](#) that freezes tuition rates at state colleges.
2. [More than 7 million](#) Americans are expected to take out student loans during the fall of 2013.
3. While U.S. citizens have held total consumer debt to a respectable 9 percent increase since 2004, student debt has [more than tripled](#) to approximately \$1 trillion during the same period.
4. Oregon has developed a [college affordability program](#) that would allow students to attend in-state public universities at no immediate cost in exchange for 3 percent of their annual earnings for 25 years after they graduate.
5. A new study by HSBC found that Australia is the most expensive country for overseas students to study in, with the USA and the UK coming in close behind at second and third.
6. The cost of higher education, as measured by private and public tuition, has risen at rates higher than inflation, roughly 4 percent per year for nonprofit private tuition.
7. In the Pennsylvania State System of Higher Education, despite a 3 percent tuition increase, eight of the universities have issued warnings that they may lay off faculty in order to stop their budgets from going into the red due to falling enrollment and lower state funding.
8. [New research](#) has found that 57 percent of students are now working part-time to pay for the record costs of higher education.
9. The U.S. federal government spends [over \\$150 billion every year](#) on student aid, mostly in the form of loans.
10. The [MOOC industry is booming](#), and one company, Coursera, has already partnered with 83 higher education institutions worldwide.

## OBAMA PROPOSES NEW COLLEGE RATING SYSTEM

By Tom Gorman, CPA

### IN A SPEECH DELIVERED ON AUG. 22, 2013, PRESIDENT OBAMA OUTLINED A SET OF BROAD PROPOSALS AIMED AT CONTROLLING COLLEGE COSTS WITH A GOAL OF MAKING COLLEGE MORE AFFORDABLE.



Other elements of his plan will seek to promote innovations in the delivery of education and deal with the rising student debt burden.

#### ► COLLEGE RATING SYSTEM

The proposal calls for the U.S. Department of Education (ED) to develop a college rating system that would take into consideration factors such as:

- **Affordability** – including the average tuition charged, availability of scholarships, and level of loan debt
- **Access** – measure of how well the institution provides access to education to students from disadvantaged backgrounds
- **Outcomes** – includes graduation rates, graduate earning potential, and number of advanced degrees pursued by graduates

While these are laudable goals, there is some degree of skepticism about how effective ED can be in developing this rating system. Critics point to many of the shortcomings in the

College Scorecard developed by ED in recent years. There is also a concern about the second aspect of the proposed college rating system – tying future student financial aid funding to a college's rating and performance. Students that attend higher performing colleges would be eligible for potentially larger financial aid awards. While these proposals are just that – proposals with implementation dates of 2015 for the development of the new rating system and 2018 for legislation to change how aid is awarded based on performance – they do signal continuing pressure on the industry to do a better job of controlling costs and reining in the rate of tuition increases.

#### ► INNOVATION AND COMPETITION

The president laid out his vision for promoting innovation in the delivery of education and measures to enhance competition among colleges and universities as they compete for a proposed \$260 million innovation fund. This would be in addition to an additional \$500 million the Department of Labor would make available to support accelerated degree programs and credentials for adult students.

In his speech, the president highlighted the steps some institutions have made to leverage massive open online courses (MOOCs) to deliver content, shorten the length of degree programs by granting credit for prior learning or using competency-based assessment models, and the use of technology to improve student retention. He also called on states and private donors to be partners in supporting these initiatives.

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## COLLEGE RATING SYSTEM

While this sounds well and good, and many institutions are already engaged in many of these activities, significant regulatory barriers need to be removed to make these initiatives more widespread and readily accepted. It is yet to be seen how quickly ED will move to revise regulations that restrict the use of federal financial aid dollars to support these initiatives.

## ►DEALING WITH STUDENT DEBT

The plan also includes proposals to help the 37 million student loan borrowers deal with what many are calling “a mountain of debt” that has the potential to restrict future economic growth.

The major component of the proposal is to expand the existing “pay as you earn” program. This program, only available to certain borrowers, caps federal student loan repayment at 10 percent of the borrower’s income. The proposal calls for an expansion of the program to all student borrowers. This would be combined with a massive education campaign to make students aware of this option and promote the plan.

## ►THE DEVIL IS IN THE DETAILS

As with so many proposals, the final product will likely look very different from the plan outlined by the president. However, as noted in my industry outlook in the Summer 2013 edition of the *Nonprofit Standard*, the higher education industry will continue to face increasing regulatory attention as the disconnect between cost and value remains firmly in place.

# INTERMEDIATE SANCTIONS AND THE RISKS OF NONPROFIT EXECUTIVE COMPENSATION: WHAT YOU NEED TO KNOW

By Laura Kalick, JD, LLM

## IF YOU'RE A HIGHLY COMPENSATED EXECUTIVE AT A NONPROFIT AND IN A POSITION TO INFLUENCE HOW MUCH YOU EARN, YOU MAY BE AT RISK.

**N**onprofit executives who are paid what might be considered excess benefits in their compensation packages could be subject to a substantial penalty tax. What could these penalty taxes mean for your organization and what do they mean for you? How can you avoid them?

The penalty taxes, called [Intermediate Sanctions](#), were enacted into law in 1996 to address situations in which influential “insiders” were unjustly enriched from charities. Previously, the only action the IRS could take for this excessive compensation was to threaten revocation of exemption, which only hurt the organization and its community—not the wrongdoer. But now, Intermediate Sanctions provide the Internal Revenue Code (IRC) an additional, powerful tool to deal with this.

For so-called “excess benefit transactions,” or compensation earned by key persons that is in excess of fair market value, the Internal Revenue Code imposes a 25 percent tax. If the arrangement is not corrected—which usually means paying back the excess with interest—a 200 percent tax can apply. But here’s the kicker: the tax is levied on the *executive* who is considered able to substantially influence the organization—not on his/her organization. Additionally, board members who approve of such compensation while knowing that it is excessive can also be at risk for a penalty tax.

The taxes are imposed on a Disqualified Person (DP)—someone who can substantially influence an organization—when he/she enters into an excess benefit transaction with either a 501(c)(3), 501(c)(4) organization or

an entity that the organization controls. By definition, officers and board members are DPs and, depending on the organization’s leadership structure, other positions can also be categorized as such. Just because a person is highly compensated does not necessarily make the individual a DP, however. For instance, if the person does not participate in any management decisions affecting the organization as a whole, and if he/she does not control a discrete segment of the organization that represents a substantial portion of the activities, assets, income or expenses of the organization, the person may not qualify as a DP.

An excess benefit transaction could be unreasonable compensation or a transaction between a DP and an organization, such as a loan, lease or sale. And, if an executive receives an economic benefit that is not documented as compensation, then it could be classified as an automatic excess benefit. For example, if an executive takes her entire family of five on a 10-day trip to Hawaii so that she can attend a two-day educational conference and none of the personal expenses are reported as compensation, those expenses may constitute an automatic excess benefit, even though her overall compensation may be considered reasonable.

Given these substantial risks, what can nonprofits and their leaders do to guarantee that they are in compliance? When the IRS examines nonprofits, the organization under scrutiny has to prove that compensation is reasonable. The only exception is if the organization has previously established the “Rebuttable Presumption of Reasonableness,”

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## INTERMEDIATE SANCTIONS

which shifts the burden to the IRS to prove that compensation is unreasonable. There are three simple steps to establish the Rebuttable Presumption: (1) have an authorized independent board or committee make compensation decisions; (2) have the authorized body use comparable data; and (3) have the decision and its process contemporaneously documented.

Actually establishing the Rebuttable Presumption can be tricky. In the recently released IRS College and University Compliance Project Report, the IRS indicated that approximately 20 percent of the institutions examined failed to establish it. Oftentimes, comparability data fell short because the surveyed schools were not similarly situated. For example, the report indicated that the institutions were not similar to the comparables on factors such as location, endowment size, revenues, total net assets or number of students. Also, compensation studies did not document the selection criteria for the schools compared, or they failed to specify whether the compensation amounts included benefits other than salaries, which must be taken into account for purposes of IRC 4958. The total compensation package must be compared and includes salary, deferred compensation, car and housing allowances, etc.

Moving forward, states such as New York appear to be adopting rules regarding how nonprofit organizations should set compensation levels for executives. (See the article on page 13 for more on this issue.) Hopefully, this will be an incentive for more organizations to use a process that will minimize their risk of sanctions.

Nonprofits can even use for-profit comparables as long as they can show how they are relevant. If the comparables include the Forms 990 of other organizations, make sure that the relevancy of the institution and the comparability of the executive's duties are being documented *and* that the Forms 990 are in the files. The IRS is looking for a process. What metrics does your organization use to establish compensation packages?

*For more information, contact Laura Kalick, national director, Nonprofit Tax Consulting, at [lkalick@bdo.com](mailto:lkalick@bdo.com).*

## COMPENSATION CONSULTANT – DO WE NEED ONE?... REALLY?

By Michael Conover

**IN THE WEEKS PRECEDING THIS ISSUE OF THE *NONPROFIT STANDARD*, I'VE BEEN WRACKING MY BRAIN FOR A TOPIC.**



**P**revious articles have covered many aspects of executive compensation, but then it occurred to me that one aspect had not been covered: the role of the compensation consultant. I suspect that partly out of a lack of objectivity (more than 25 years as one of “them”) and excessive familiarity (doesn’t everyone know what we do?), I never thought about exploring this particular topic. However, I believe it is well worth examining the consultant’s role in the overall governance and administration of executive compensation. And so, having revealed my total lack of objectivity, I hope that some of my observations may be helpful in better understanding the role of a compensation consultant.

At the start of my career, my mentor advised me never to waste my time telling people what I did. “They’ll never understand it. Tell them you’re a dentist. People always clam up about what you do then,” he advised. My youngest daughter once told her friend, “My dad doesn’t have a real job. He just flies in airplanes and tells people how much money they should make.” Finally, on one of my

earliest client interviews, a particularly caustic executive quipped, “You and people like you aren’t consultants, you’re ‘insult-ants!’ People that need outsiders to run their business shouldn’t be in business!”

Thankfully, times have changed and I believe most people have a clearer idea of what compensation consultants do. The consultant’s work of analyzing and interpreting competitive information, as well as providing advice and assistance with development of pay plans and processes, is pretty familiar to most businesspeople today. There are, however, some ongoing discussions about the role that consultants play in the executive compensation arena. Who should the consultant represent, the board or management? Are consultants to blame for the spiraling levels of executive pay?

Clarity around the consultant’s role is essential for executive compensation to be properly governed and administered. I believe that sharing a few “anonymous” situations I’ve encountered over the years may help illustrate this.

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## COMPENSATION CONSULTANT

### • Independence

Just prior to a presentation to the board's Compensation Committee of the results of a consulting project for a nonprofit financial services organization, the CEO asked me to recommend that he receive a \$100,000 bonus. He explained the organization had a "good year" and he'd located a boat he wanted to buy. It was soon apparent that he was not joking. I explained that neither the competitive data nor business results for his organization for the year in question could support that recommendation. When he pressed the point and made it clear I would not meet the board if I did not make the recommendation, I refused and was shown the door.

There have not been many instances as dramatic as this one over the years, but there certainly have been times when it has been necessary to remind executives and boards that the facts and recommendations presented are not intended to serve the interest of one party or group over another.

It is very important that all parties understand that the board and management have related, but distinctly different, roles to play with regard to executive compensation. Executives have a strong stake in the compensation program as a critical component of the organization's management systems. Board members provide oversight and necessary authority and/or approvals to ensure the propriety of the compensation program. The board and executives should find common ground in supporting findings and recommendations that are in the best interest of the organization and its mission. They are jointly accountable for the overall success of the organization's executive pay practices. The consultant is a resource and provides support to both parties in fulfilling their respective roles.

### • Advisor – Not a "Decider"

On more than one occasion, perhaps a day crowded with busy board and committee meetings, I've found myself sitting with some board members obviously not interested in discussing the data provided to them in advance of the meeting, but eagerly pressing me

to "just tell us what we should do." The decisions at hand have ranged from salary increases to bonus awards, even unusual perquisites. I suspect the individuals in question are either pressed for time, have not taken the time to understand the topic in question or might want to explain an unexpected or unwelcomed decision to an executive with "the consultant made us do it."

The consultant's advisor role, in my opinion, is to help the organization understand the compensation topic under review as well as any competitive information presented that is related to the topic, but not to make the decision. The objective is to prepare the board and executives to make an informed decision about what is best for their organization. Frequently, this is accomplished with a review of the pros and cons of several alternative courses of action and/or identification of other areas impacted by a decision on this topic. The result should be a decision in which the organization has full ownership.

### • Resource

**An organization seeking a compensation consultant for the first time once asked us to dispense with the typical "proposal," but instead prepare a sample report of what we could offer the board about competitive pay practices. After securing some basic background from the organization's human resources department, we prepared a competitive analysis of the top three or four executives. Board members were stunned when they saw the analysis and the significant gap between their pay and competitors.' They had never seen the total compensation for the executives, but had instead dealt with each pay program component separately. Salary, bonus, incentive and benefit matters were addressed on an "as-needed basis" and were never presented in the aggregate. Competitive information had similarly been distributed on a piecemeal basis. Many directors had no information about the criteria used to identify competitors or the organizations viewed as "peers."**

The consultant's resource role is to know where to obtain, how to analyze and

effectively present information or advice that is pertinent to the organization and issue at hand. In many instances, individuals associated with nonprofit organizations have very limited experience with compensation matters or the sources of data about it. For this reason, the resource offered by the consultant is both educational and informational, providing background and explanatory information to ensure the information is understood and useful. The IRS also stresses the role that access to reasonable and relevant information plays in good governance of executive pay. It is one of the factors outlined in the Intermediate Sanctions' presumption of reasonableness.

With another acknowledgement of my bias/lack of total objectivity on this topic, I'll conclude with my answer to the question posed in the title of this short article. Yes, many organizations do need a compensation consultant, particularly nonprofits. Board members and executives who are often those unfamiliar with the subject of compensation or are more in tune with the for-profit compensation realm often benefit from the involvement of a consultant who can fulfill the roles highlighted here. A consultant can help by explaining unfamiliar terms and regulations, dispelling mistaken assumptions and assisting with the formulation of policies and guiding principles that will guide the organization's pay practices in the future.

Ideally, an organization should cultivate a relationship with a trusted advisor that can get to know the organization and keep abreast of pertinent marketplace trends and regulatory developments. The need for the consultant's services might vary over time. It might range from a significant introductory engagement to periodic updates and/or in specific as-needed situations. It need not always be an extensive and expensive involvement. However, the role as an independent advisor and resource to the organization must always be maintained.

*For more information, contact Michael Conover, senior director, Specialized Tax Services – Global Employer Services, at [wconover@bdo.com](mailto:wconover@bdo.com).*

# UPDATE ON THE FASB NOT-FOR-PROFIT FINANCIAL REPORTING PROJECT

By Laurie Arena De Armond, CPA

**A**s noted in the Winter 2011 issue of the *Nonprofit Standard*, the Financial Accounting Standards Board (FASB or the Board) added a standard-setting project to its agenda entitled "Not-for-Profit Financial Reporting: Financial Statements." This project is focused on examining the financial statements and related disclosures that are unique to nonprofit organizations. The main focus points of the project include the reexamination of the existing standards related to net asset classification and other topics such as how nonprofit organizations show their liquidity, financial performance and cash flows.

To date, the Board has deliberated on the net asset and intermediate operating measure project components and has made certain tentative decisions that are discussed below.

## ► NET ASSETS

Currently, the Board has made the tentative decision to replace the current requirement to show three classes of net assets: unrestricted, temporarily restricted and permanently restricted and to replace this with two classes of net assets. The net asset classes would be presented as net assets with donor-imposed restrictions and without donor-imposed restrictions. The two classes of net assets would still be presented on the face of the statement of financial position in total and for changes in each of those classes on the face of a statement of activities and would be subject to similar requirements.

The current requirement to provide information about the nature and amounts of different types of donor-imposed restrictions would be maintained. However, the current distinction between temporarily and permanently restricted would be removed and the current focus would be on providing information regarding how and when net assets could be used. So, for example, in the footnote detailing the net assets, the components would potentially be described as (a) endowments, (b) purpose restricted and (c) time restricted.

The footnote disclosures would still need to provide information about the nature and amounts of net assets designated by the governing board.

## ► OPERATING MEASURE

The Board tentatively decided to define an intermediate operating measure that is based on two dimensions. The first is a mission dimension and would be based on whether resources are from or directed at conducting the nonprofit's purpose for existence. The second is an availability dimension and would be based on whether resources are available for current period activities, and would reflect both external limitations and internal limitations set by the nonprofit's governing board.

The Board has directed staff to discuss whether the availability dimension should be limited to resources that are liquid.

The Board considered three options for the presentation of the intermediate measure in the statement of activities and tentatively decided to adopt the following option. All legally available mission-related revenues would be presented and, then, any reductions for amounts designated by the governing board for use in future periods would be shown as a transfer out of the intermediate operating measure. In this presentation, amounts that were previously designated by the governing board that became available in the current period would be shown as transfers into the intermediate operating measure.

The Board will address whether the intermediate operating measure will be required, permitted or encouraged at a future meeting.

On Sept. 9, 2013, the Board and FASB staff met with the FASB's Not-for-Profit Advisory Committee (NAC) to discuss the tentative decisions outlined above. The NAC was established in 2009 to serve as a standing resource for the Board in obtaining input from

the nonprofit sector on existing guidance, current and proposed technical agenda projects and longer-term issues affecting nonprofits.

NAC members generally agreed with the Board's tentative decision to show two classes of net assets; however, some members raised questions about whether this would preclude entities from presenting additional information. The FASB staff clarified that the Board has not finalized the required disclosure related to this issue at this point but noted there is no intent to preclude organizations from disclosing more than the minimum information.

NAC members had mixed views on the tentative decision regarding the presentation of the operating measures specifically with regard to the analysis of liquidity versus availability included therein. NAC members felt there was confusion in the industry regarding these terms and that it would add additional difficulties and cost to the financial statement presentation process.

The feedback received from the NAC will be considered by the FASB as it continues to work through this project.

The staff expects to discuss the liquidity and statement of cash flows presentation aspects of this project with the Board in October.

These tentative decisions allow the project to continue to move forward. The Board projects that an exposure draft related to this project will be issued in the first quarter of 2014. We will continue to keep you apprised of the Board's tentative decisions and the overall project status.

For more information, contact Laurie Arena De Armond, partner, at [ldearmond@bdo.com](mailto:ldearmond@bdo.com).

# NEW YORK LEGISLATURE PASSED THE NONPROFIT REVITALIZATION ACT PROVIDING COMPREHENSIVE AND SIGNIFICANT CHANGES TO NEW YORK NONPROFIT CORPORATION LAW

By Christina K. Patten

New York Attorney General Eric T. Schneiderman set out to make New York a model for nonprofit governance and oversight through the recently passed [Nonprofit Revitalization Act](#) (the Act). The Act involves updates to New York Nonprofit Corporation Law which aims to improve corporate governance and oversight while cutting red tape. The Act was passed unanimously in both the Senate and Assembly on June 21, 2013, and is currently awaiting delivery to Governor Cuomo's office, at which time Governor Cuomo would have 10 days to take action or the bill would automatically become law, provided it is delivered before the end of the legislative session on Dec. 31, 2013. This would be the first major revision to New York's nonprofit laws in over 40 years.

Most of the Act applies to nonprofits incorporated in New York but one significant provision, relating to financial audits and reporting to New York State (NYS), applies to **all** nonprofits which are registered with New York for charitable solicitation, regardless of state of incorporation. Some of these provisions will require many nonprofits to amend their governance documents, policies and procedures; and, in some cases, significantly rebuild their governance structure in order to comply with some of the detailed requirements of the Act. Most provisions summarized below would be effective July 1, 2014, with a few provisions taking effect in 2015, 2017 and 2021.

## Elimination of Letter Types

The Act involves the elimination of classification as Type A, B, C and D and now classifying nonprofit corporations as either "charitable" or "non-charitable." There would be no need for existing nonprofits to amend their governing documents as the Act provides that Type B and C entities, as well as Type D entities formed for a charitable purpose, will be deemed "charitable." Type A and all other Type D entities will be regarded as "non-charitable."

## Modernization and Streamlining of Nonprofit Governance Actions and Communication

The Act will allow new technology options for holding meetings and taking action. Notice or waiver of notice can be given via e-mail, where prior to the Act it was required to be given via mail or in person. Video conferencing, such as Skype, for board meetings will be allowed unless restricted by the organization's certificate of incorporation or by-laws.

## Enhanced Governance Procedures, Policies and Prohibitions

### Limitation on Employee Serving as Chair

Effective Jan. 1, 2015, the Act expressly prohibits an employee from serving as chair of the board or in an officer position with similar responsibilities. This prohibition would not extend to *bona fide* independent contractors. The prohibition on an employee serving as chair would presumably **not** apply to the president in a nonprofit in which different individuals serve as chair and president.

### Compensation Approval

The Act provides that compensation paid to directors, officers and key employees be "fair, reasonable and commensurate" with the services provided to the organization. The respective person may not participate in his/her own compensation deliberations or vote on it.

The Act adds a provision allowing the New York Attorney General to bring an action to enjoin, void or rescind compensation of directors, officers and key employees that is not fair, reasonable and in the best interest of the organization.

### New Definition of "Independent Director"

An "independent director" under the Act meets all of the following criteria:

1. Has not been an employee or does not have a relative who was a key employee of the organization or affiliate in the past three years
2. Has not received or does not have a relative who received \$10,000 or more in direct compensation from the organization in the past three years (expense reimbursement not considered)
3. Not a current employee and does not have substantial influence in an entity that made or received payments from the organization or affiliate of more than \$25,000 or 2 percent of the organization's gross revenue for property or services (whichever is less) in the last three years
4. Does not have a relative who is a current officer or with substantial interest in an entity making or receiving payments of a similar amount to the organization in the past three years

## Mandatory Conflict of Interest Policy

Nonprofits are required to adopt a conflict of interest policy covering directors, officers and key employees. As a result some nonprofits may need to adopt a new conflict of interest policy, or update their current policy, to meet the new requirements.

The conflict of interest policy must include:

1. What constitutes a conflict of interest
2. Procedures for disclosing a conflict of interest to the audit committee or the board
3. Requirement that person(s) with a conflict of interest cannot be present or participate in board deliberations or voting on these matters
4. Requirement that person(s) with a conflict of interest be prohibited from influencing the board
5. Documentation procedures to detail existence and resolution of a conflict of interest
6. Procedures for disclosing and addressing related-party transactions

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## NONPROFIT REVITALIZATION ACT

Additionally, a written statement identifying potential conflicts must be signed prior to initial election of any director and annually thereafter. The board or designated audit committee must oversee adoption, implementation and compliance of a conflict of interest policy if not performed by another committee of the board with solely independent directors.

### Related-Party Transaction Approval Process

The Act redefines what constitutes a “related party” and requires that transactions with a nonprofit be fair, reasonable and in the best interest of the nonprofit. Additional requirements include that the board consider alternative transactions to the extent available and approve any related party transaction by not less than a majority vote.

The Act grants the New York Attorney General authority to bring action to enjoin, void or rescind any related-party transaction that violates any law or is otherwise not fair, reasonable and in the best interest of the nonprofit.

### Mandatory Whistleblower Protection Policy

The Act mandates that nonprofits with 20 or more employees *and* annual revenue in the prior fiscal year in excess of \$1 million institute a whistleblower protection policy. The policy must be distributed to all directors, officers, employees and volunteers and must protect from retaliation any one of them who, in good faith, reports an action or suspected action that is potentially illegal, fraudulent or in violation of any adopted policy of the nonprofit. Additionally, the policy must include procedures for reporting violations, identification of person responsible for administering the policy and reporting to the audit committee or other committee of independent directors.

### Required Audit Procedures and Financial Reporting

This provision of the Act also applies to nonprofits registered in New York for charitable solicitation that are incorporated both inside and outside of New York.

### Audit Committee and New Audit Procedures

A designated audit committee is required and must be comprised of “independent directors” responsible for retaining an independent auditor and reviewing the results of the audit.

Audit committees of nonprofits subject to NYS charitable solicitation with greater than \$1 million gross revenues have additional duties relating to the audit including:

- Review the scope and planning of the audit with the auditor prior to commencement of the audit
- Discuss significant disagreements between auditor and management after audit
- Annually consider performance and independence of auditor

### Raised Thresholds for Financial Reports

The Act provides that threshold levels increase on July 1, 2014:

Gross Revenues	Financial Statement (FS)
< \$250,000 (previously \$100,000)	Unaudited F/S signed by CFO and President
> \$250,000; < \$500,000 (previously \$100,000; \$250,000 respectively)	F/S with CPA's review report
> \$500,000 (previously \$250,000)	Audited F/S with CPA's audit report

The Act further increases the threshold for the audit requirement for all organizations subject to registration for charitable solicitation in New York to \$750,000 in 2017 and \$1 million in 2021. The threshold for a review report is scheduled to increase up to the audit requirement thresholds.

### Streamlining Procedures for Nonprofit Mergers, Property Sales and Corporate Dissolutions

#### Ability to Seek Consent of Attorney General as Opposed to New York Supreme Court for Certain Corporate Transactions

The Act provides for a simplified process for “charitable” entities, in which the organization can seek the approval of the Attorney General instead of initiating a court proceeding for

transactions such as dissolution (sale, lease, exchange or other disposition of substantially all assets); merger or consolidation; and change of purposes.

### Notification Instead of Consent to New York Commissioner of Education

The Act eliminates the requirement to obtain consent of the New York Commissioner of Education (now notification) prior to incorporation for some nonprofits with an educational purpose.

### Lowered Approval Requirements for Real Property Transactions

The Act lowers the approval requirements for real property transactions. It requires a simple majority of the board to authorize the purchase, sale, lease, exchange or disposal of real property to be acquired or disposed of unless it constitutes all or substantially all of the assets of the nonprofit. If property constitutes all or substantially all of the assets of the nonprofit, approval of two-thirds of the entire board is required (unless 21-plus board members, then a simple majority is required).

### Other Provisions

- New definition for the term “entire board” that clears up an ambiguity in the previous definition
- Removal of requirement to provide residential address of board members

The Nonprofit Revitalization Act, assuming it will be signed into law, is set to go into effect on July 1, 2014. In short, nonprofit organizations will now be able to operate, dissolve and merge more easily; communicate and hold meetings using modern technology; and enter into certain transactions without having to go to court. At the same time, the Act includes critical oversight, and governance restructuring is aimed at preventing fraud and improving public trust.

For more information, contact *Christina K. Patten*, associate, at [cpatten@bdo.com](mailto:cpatten@bdo.com).

## OTHER ITEMS TO NOTE....

### Data Collection Form Update

Currently the Federal Audit Clearinghouse (Clearinghouse) has not released the revised 2013 Data Collection Form. As a result, although a single audit for a fiscal period ending in 2013 may have been released by the auditors, the data collection form cannot be prepared at this point. Therefore, auditees will not be able to meet the 30-day deadline for submission of the data collection form as required by Office of Management and Budget (OMB) Circular A-133, section .320(a). To address this issue, OMB has granted an extension until Dec. 31, 2013, for reporting packages due to the Clearinghouse before that date. The extension is automatic and no approval is required. The extension applies only to single audits for the fiscal periods ending in 2013.

The Clearinghouse is also planning system changes that will include new log-in procedures, including requiring individual accounts and passwords. The Clearinghouse is also planning other updates to the submission requirements. The Clearinghouse plans to roll out the new system changes effective Oct. 7, 2013. In light of the government shutdown this launch will most likely be delayed. Currently, the FAC website is unavailable. One of the proposed updates to be effective in 2014 is that the reporting package uploads need to be unlocked and unencrypted to allow them to be searchable.

### New Charity Navigator Ratings

Charity Navigator (CN), a charity-ratings group, is introducing a new approach in rating charities. The new approach, referred to as "CN 3.0," will focus on "results-oriented" and "evidence-based" information provided by charities. This new approach will focus on whether a charity's programs are successful and whether they are achieving programmatic results.

CN has said this new results-reporting evaluation method will not affect a charity's rating on the group's website until at least 2016, but they have started to perform reviews of charities using the new assessments and have begun to post the results of these assessments online. These initial evaluations do not tell donors whether a charity is effective, just whether the charity is trying to find out if they are. The initial evaluations consist of 14 questions. The charity is awarded a blue X for those questions that can be answered positively, and a red X for those that cannot. CN has noted that these initial evaluations have shown many red Xs.

Charities should consider these proposed changes and the effect this new evaluation methodology may have on their organization and what changes they may need to make internally to measure the success of their programs and the rating they may receive from CN in the future based on this new criteria.

### FASB to Prioritize Disclosure Framework, Financial Instruments Aim for Simplification of Codification

The Financial Accounting Standards Advisory Council (FASAC), the main advisory group for the Financial Accounting Standards Board (FASB), recently released the results of a survey it performed to solicit views about FASB's future agenda. The purpose of the FASAC's role is to advise the FASB on future project priorities and other possible new agenda items.

The FASAC's annual survey of constituents' views helps the FASB develop its agenda of what its upcoming priorities for the next three to five years, and most urgent priorities for the next two years, should be. A high-level summary of the results of the survey revealed a strong desire by many constituents for the following to be addressed: financial disclosures, hedging and simplification of FASB's codification of U.S. GAAP.

The top projects survey participants thought the FASB's agenda should address were the disclosure framework, accounting for financial instruments - hedging, financial instruments with the characteristics of equity and pension accounting. With the completion of several major FASB projects on the current agenda expected in the next year or so, the survey was timely in providing the FASB's constituents an opportunity to share their views on projects and areas that they believe are the most important for FASB to address.

Other priorities mentioned in the survey included overhauling the conceptual framework that the FASB uses as a foundation for developing new standards, financial statement presentation, liquidity and interest rate disclosures, and accounting for intangible assets. While many of the constituents polled had similar priorities, some who answered the survey gave greater priority to accounting for intangible assets, such as intellectual property, than other groups.

While some of these projects, most notably disclosure framework, accounting for financial instruments and pension accounting, may affect nonprofit organizations, there are a few that might not. It is also key to note that the FASB's current agenda for this year will include the continuing contributions of the Private Company Council (PCC) (three projects that could affect nonprofits) and the Not-for-Profit Advisory Committee (NAC) (one standard-setting and two research projects). These groups are providing advice that could help simplify both private and public company and nonprofit accounting and financial reporting, which has already resulted from some PCC recommendations finding their way into proposed Accounting Standards Updates (ASU), which would apply to both public and private companies.

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With more than 2,000 clients in the nonprofit sector, BDO's team of professionals offers the hands-on experience and technical skill to serve the distinctive needs of our nonprofit clients – and help them fulfill their missions. We supplement our technical approach by analyzing and advising our clients on the many elements of running a successful nonprofit organization.

In addition, BDO's Institute for Nonprofit Excellence<sup>SM</sup> (the Institute) has the skills and knowledge to provide high quality services and address the needs of the nation's nonprofit sector. Based in our Greater Washington, DC Metro office, the Institute supports and collaborates with BDO offices around the country and the BDO International network to develop innovative and practical accounting and operational strategies for the tax-exempt organizations they serve. The Institute also serves as a resource, studying and disseminating information pertaining to nonprofit accounting and business management.

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