

Keeping Current! - GAAP and Other Financial and Tax Updates Applicable to Not-for-Profit Organizations

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September 13, 2011

2011 NAVREF Annual Conference
Seattle, WA

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Vincent Stevens, CPA is a shareholder in the Not-for-Profit Services Group of Clark Nuber P.S. Vincent helps serve the firm's 650 not-for-profits clients by providing high level expertise in the areas of accounting and auditing, A-133 audit, federal compliance consulting, indirect cost negotiations, risk assessments, grants management and information system solutions. Vincent has specialized in not-for-profit entities for over 20 years. Vincent's primary focus is on serving healthcare, social service, and life science not-for-profit entities. Vincent is a regular featured speaker at the AICPA National Not-for-Profit Conference in Washington D.C. Vincent received a Bachelor of Science degree in accounting from Arizona State University, graduating with honors.

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Jane is a tax shareholder with Clark Nuber in Bellevue, Washington. She leads the firm's public charity and private foundation tax practice. Jane is the immediate past chair of the AICPA Exempt Organizations Technical Resources Panel which addresses tax issues facing exempt organizations at a national level. She specializes in issues of public disclosure, income and excise tax planning for exempt organizations and their taxable subsidiaries, international financial transactions and compliance, as well as complex social venture structures and charitable giving strategies. She has extensive experience with IRS examinations, appeals, exemption applications, and ruling requests. She was listed in the April/May 2008 issue of *CPA Magazine* as one of the Top 50 IRS Practitioners and April/May 2009 issue of *CPA Magazine* as one of the Top 40 Practitioners to Know In A Recession. Jane is a regular presenter with a wide variety of organizations including the Washington Not-For-Profit Conference, Philanthropy Northwest, Robert Wood Johnson Foundation, CCH Annual Users Conference, and the AICPA national Non-Profit Conference in Washington D.C. Writing credits include co-author and editor of the CCH *Earm 990 Compliance Guide*, by Clark Nuber, and *A Guide to Estate Planning For Parent of Children with Special Needs*, as well as various articles on tax issues surrounding tax exempt organizations, private foundations, and charitable gift and estate planning. She is a graduate of the University of Washington and holds a master's degree in Taxation from Golden Gate University.

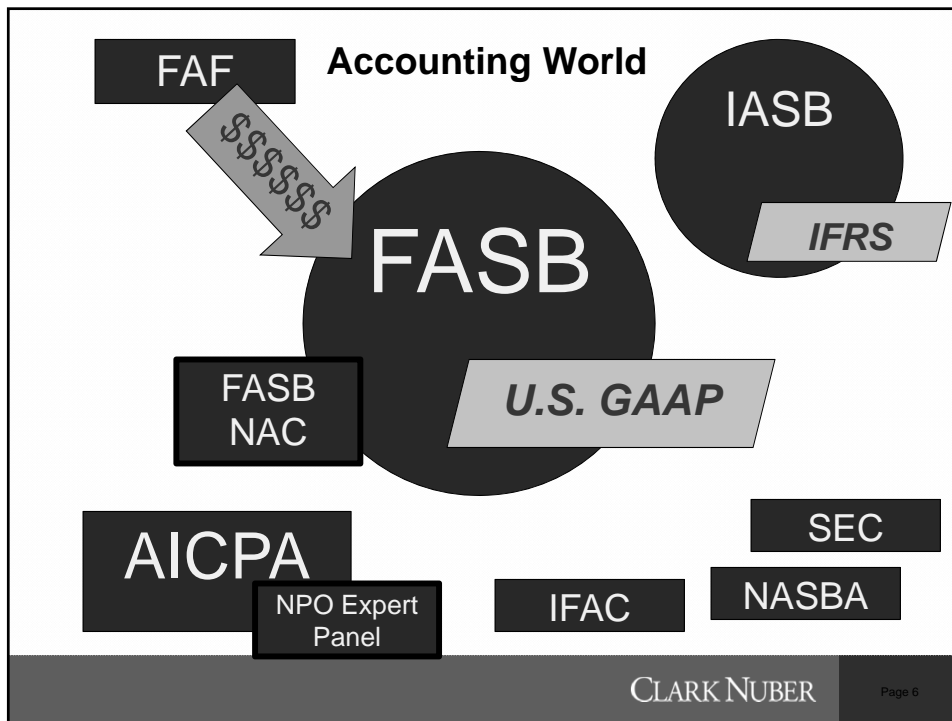
Jane is a member of Washington Women's Foundation Education Grants Committee, Trustee of World Neighbors in Oklahoma City, on the board of Seattle Philanthropic Advisors Network, Membership Committee for Independent Sector, and is a Special Olympics Alpine Ski Racing Coach for the Skihawks.

Agenda for next 90 Minutes

- Perspective on the tax exempt sector and who is making the rules
- Perspective on organizations impacting financial reporting in the sector
- Update from Washington (DC)
- Revenue Recognition
- Accounting Regulatory Trends
- Form 990 Reporting Issues
- When Things Go Wrong

Tax World

1894	<ul style="list-style-type: none"> • Wilson Gorman Tariff Act • 2% flat tax except charitable, religious, & Education
1917	<ul style="list-style-type: none"> • Funding driving legislation • Allowed tax deduction for contributions
1943	<ul style="list-style-type: none"> • First Form 990
1950	<ul style="list-style-type: none"> • Concept of Unrelated Business Income
1969	<ul style="list-style-type: none"> • Private Foundations Codified
1996	<ul style="list-style-type: none"> • Intermediate Sanction Legislation
2006	<ul style="list-style-type: none"> • Pension Protection Act
2008	<ul style="list-style-type: none"> • Redesign of the Form 990



Organizations Impacting Financial Reporting

- **FASB** – Financial Accounting Standards Board
 - *Issues U.S. Generally Accepted Accounting Principles (GAAP)*
- **IASB** – International Accounting Standards Board
 - *Issues International Financial Reporting Standards (IFRS)*
- **FASB NAC** – FASB Not-for-Profit Advisory Committee
- **FAF** – Financial Accounting Foundation
- **AICPA** – American Institute of CPAs
- **IFAC** – Global org. of Nat'l Assoc.s of Accountancy
- **NASBA** – Nat'l Assoc. of State Boards of Accountancy
- **SEC** – Securities and Exchange Commission

Regulatory Trends – Potential for Private US GAAP

- Blue Ribbon Panel recommended a separate Board (2/11).
 - Under the oversight of the Financial Accounting Foundation (FAF), using a new standard-setting model that follows U.S. GAAP with exceptions for private companies.
- Financial Accounting Foundation (FAF) group is now working to obtain input and issue an action plan in six to eight months on whether or how to devise rules that differ from those of public companies.
- The need for private company GAAP likely to become even more acute if SEC mandates IFRS for public companies.
 - Canada, UK, others keeping national GAAP for private companies.

“Big GAAP vs. Little GAAP”

- Question –
 - Would a “Little GAAP” apply to NFPs?

FASB Not-for-Profit Advisory Committee

- Started in September 2010
- Advise FASB on NFP issues
- Current projects to improve the financial reporting model
 - Reporting financial performance
 - “Telling the story”
 - Liquidity / financial health measures

FASB/IASB Top 5 Convergence Projects

- Top 5 Projects –
 - Revenue recognition
 - Financial instruments
 - Fair value measurements
 - Statement of comprehensive income
 - Leases
- Commitment to completing projects in 2011
- Effective dates unknown, but likely several years out

You have Congress's Attention

- Both state and federal legislators are looking for money
- IRS and State tax boards are the collectors
- Which non-profits “deserve” to be tax exempt?
- What income should be tax exempt?
- What portion of the “tax gap” is associated with underpayment of taxes by tax exempt organizations?

The BIG Question

- Why are some organizations tax exempt?
- It is a policy decision
- In the theory the benefit to society is greater than the cost of the forgone taxes
- Who is under the microscope?
 - Hospitals
 - Colleges and Universities
 - Non-(c)(3) Organizations

What is “exempt income”

- Contributions (1917)
- Income integrally related to the conduct of the organization’s exempt purpose.
- Income that is statutorily exempt (interest, dividends, royalties, capital gains, certain rents, BINGO, etc.)
- Income which is not UBI (1950)
 - Trade or Business
 - Regularly carried on
 - Unrelated to exempt purpose

Closing the Tax Gap

- IRS has hired over 200 new revenue agents trained to examine exempt organizations
- Audits are clearly on the rise
- Understand all sources of income
- Do not fall into the “below market” trap
- Avoid commercial type behavior
- Most states respect federal exempt status for income tax purposes but other taxes are an issue (property, gross receipts, etc.)

Research Revenue Issues

- Grants: Gift or Program Revenue
 - General support of research activities vs. Quid Pro Quo element
 - Fundamental/basic research & results made publicly available vs. Results restricted to funder who paid for research
 - Research vs. Testing
 - Undertaken for the government (federal, state or political subdivisions of a state)
 - Undertaken by a hospital, college or university

Revenue Timing/Public Support

- Redesign of Form 990 (2008) called for changes in the Treasury Regulations
- Public support is now computed on the basis of accounting on which the organization normally keeps its books and records
- For most = Accrual Based Accounting
- Revenue recognition based upon “all events”
 - Timing & amount known
 - No “substantial conditions” (condition is not a restriction)

Revenue Recognition

- Project seeks to create a single revenue recognition standard for contracts with customers
 - Contributions and rents out of scope
- Proposes revenue recognition using a performance obligation approach
 - Performance obligation = enforceable promise, whether explicit or implicit, in a contract with a customer that transfers goods or services to the customer
 - Recognize revenue when the performance obligation is delivered (e.g. when the customer obtains control of the goods)
 - Accrue loss immediately for “onerous contracts”

Revenue Recognition

- FASB is still working on implementation guidance, specific issues include:
 - How to apply this guidance when the performance obligation is delivered continuously over multiple periods (example, R&D grant or contract)?
 - How to apply the “onerous contract” guidance to contracts that only fund part of the activity (example, grant or contract to partially fund an R&D project)?

Revenue Recognition

- Questions related to NFPs
 - Are grants contributions or customer contracts?
 - How would revenue on a R&D grant be recognized?
 - What about the related expenses?

Leases

- Goal of project is to recognize leases as assets and liabilities on the balance sheet and do away with the “bright-line” distinction between capital leases and operation leases.

Regulatory Trends – Sustainability Reporting

- Sustainability Reporting Gaining Momentum Worldwide
 - Sustainability Spending to Double by 2014
 - Driven by utilities, automakers, engineering, banking, retail . . . with supply chain implications (so could affect many small businesses).
 - Economic (financial), environmental, and social accountability.

Reporting Trends

- Inclusion of a Management Discussion and Analysis (MD&A) and/or management assurance on internal control has been seen on occasion.
- Some organizations are starting to disclose the amount of government and certain nongovernment grants and contracts that have been awarded but has not yet been recognized as revenue. (A further breakdown by year would give the reader of the financial statements a sense of the secured pipeline over the next three to five years)
- PCAOB proposed changing auditor's report to include a supplemental Auditor's Discussion and Analysis (AD&A) and required emphasis paragraphs.

A-133 Reminders

- Indicate findings relate to ARRA-funded programs, if applicable
- Label ARRA-funded programs as "ARRA" in the Data Collection Form
- Programs included in the Research & Development Cluster
- SAS 119 impact on reporting on Schedule of Expenditure of Federal Awards

“FFATA”

- Federal Funding Accountability and Transparency Act
 - New required federal award reporting process (similar to Recovery Act 1512 reporting)
 - Extends to all non-ARRA federal awards and federal contracts
 - Beginning 10/1/2010 prime grant awardees of federal grants of \$25K or more must report “first-tier subgrants of \$25K or more by end of month following the month subaward or obligation made”
 - Visit www.USASpending.gov
 - 2011 A-133 Compliance Supplement
 - FFATA procedures added to Part 3, L “Reporting”

Form 990 Reporting Issues

- Who is an officer?
 - Organizational documents and state law
 - Top management and top financial official
 - Who signed last year’s tax return...only an authorized officer of the organization may sign a tax return
 - Officers listed on Part VII will include compensation from reporting, related and some unrelated organizations

Form 990 Reporting Issues

- What is a related organization?
 - Controlled and controlling organization
 - Parent, subsidiary or brother/sister
 - Named Supporting/Supported Organizations
 - Overlapping Boards
 - Ability to appoint the board
 - Employees, officers or agents of one organization > the board of another organization
 - Votes, capital, income or beneficial interest

Form 990 Reporting Issues

- Exercising “reasonable efforts” (Parts VI, VII and Schedule L)
 - Questionnaire –sent annually, individualized (name, title, date, signature), contains definitions
 - Governance and Transactions with Interested Persons - Independence disclosures
 - Reporting compensation from related or unrelated organizations
 - Organization has to ask, but....
 - Only lack of related organization compensation requires any type of disclosure
 - Disclosure is merely how you met the reasonable efforts standard

When Things Go Wrong

- Embezzlement (opportunity, motivation and rationalization)
- Excess benefit transactions
- Noncompliance with laws and regulations
- Business Failure
- Reputational Damage

Management Oversight Failures

- Expense report completed, but ...
- Net payroll was just fine, but ...
- Cash reconciled, but ...
- Payroll taxes accrued, but ...
- Management comment letter issued, but ...
- The timesheets are certified, but ...

Board Oversight Failures

- We get regular reports, but ...
- We had an audit, but ...
- We have cash, but ...
- We have unrestricted net assets, but ...
- We approved the budget, but ...
- We all get along great, but ...
- We got a great deal, but ...
- Why doesn't our tax return match the financial statements?

Reputational Damage

- Use of professional fundraiser
- Small fraud BIG impact
- Charitable spending ratio
- Lack of transparency
- Lack of communication
- Failure to manage their message
- What does your most publicly available document say about you?

Additional Resources

- FASB Not-for-Profit Advisory Committee
<http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176156543050>
- FASB's Lease Project
http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=900000011123www.stayexempt.org
- FASB's Revenue Recognition Project
http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=900000011146
- AICPA A&A NFP Guide available for purchase at
<http://www.cpa2biz.com/>

Additional Resources

- www.irs.gov/charities sign up for EO Updates
- www.stayexempt.org - Helpful training on preserving tax exempt status
- *CCH Form 990 Compliance Guide* by Clark Nuber also available electronically through Intelliconnect.
- www.clarknuber.com Electronic Organizer and 990 Questionnaire Tool (meets reasonable efforts standard)

Questions?

Thank you!