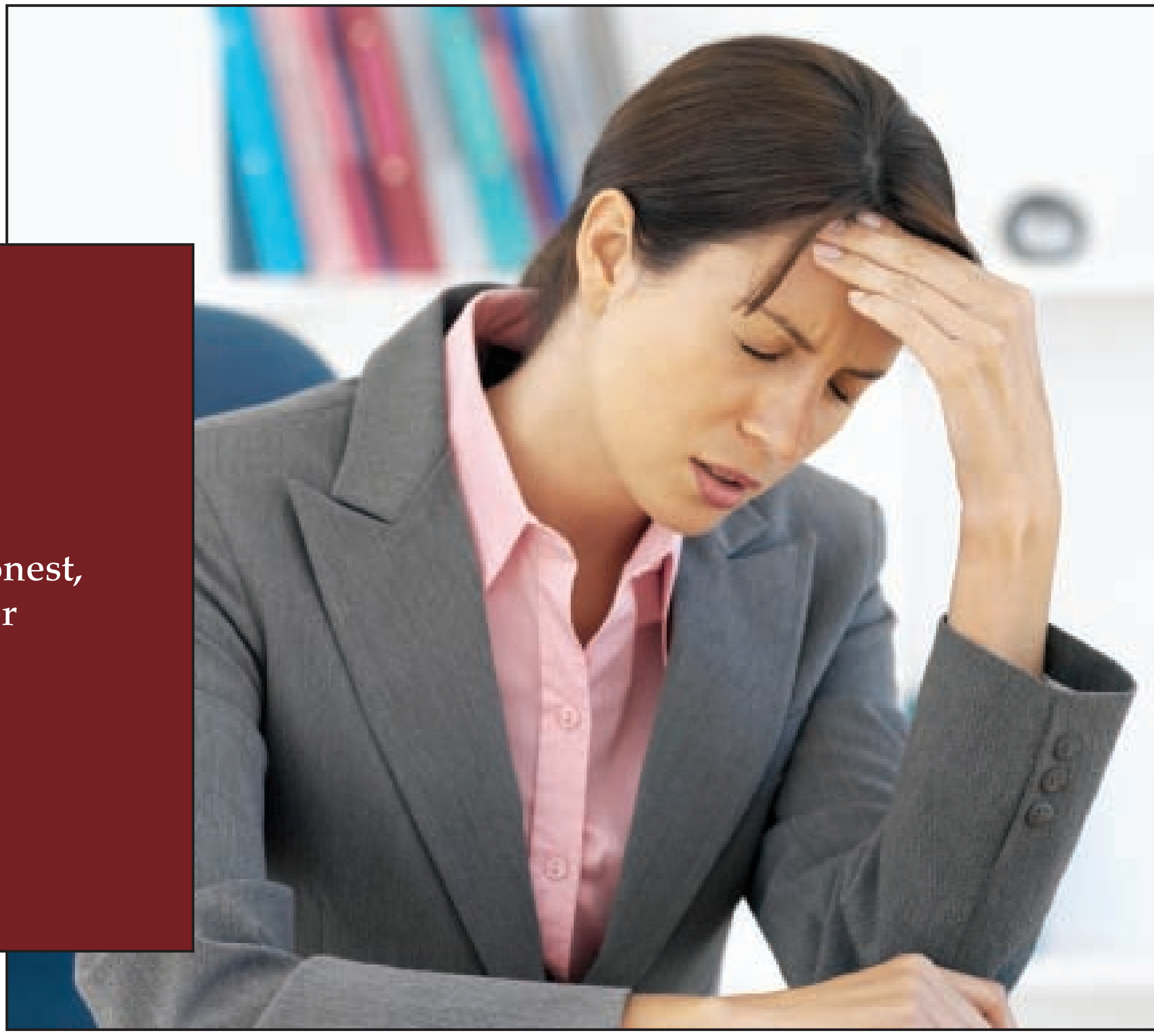
# Profitable Solutions *for* Nonprofits



Spring 2008

**FIN 48: Your newest accounting headache?**

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# FIN 48: Your newest accounting headache?

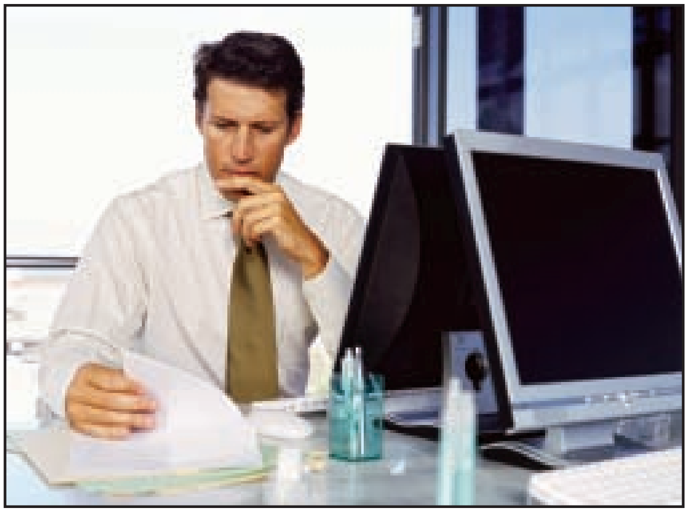
## *FASB ruling can impact nonprofits with unrelated business income*

**Even if your nonprofit is considered tax-exempt, it still may need to comply with a new accounting rule on uncertainty in income taxes.**

The Financial Accounting Standards Board's (FASB's) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) — effective for calendar-year 2008 and later financial statements — could impact your nonprofit, depending on your activities.

### THE REQUIREMENTS

FIN 48 requires organizations that prepare their financial statements according to Generally Accepted Accounting Principles (GAAP) to review their federal and state tax positions and determine whether they would "more likely than not" withstand a challenge by the IRS or a state taxing body.



If a position fails the more-likely-than-not test, the corresponding tax liability isn't recognized in the organization's financial statements. For positions that meet the test, FIN 48 outlines a complex process for determining the portion of the benefit that should be recognized. (See "Doing the two-step" at left.)

In either case, the organization must establish reserves for any tax liabilities not recognized and make financial statement disclosures about uncertain tax positions.

### UBI UNCERTAINTY

Let's say you're a hospital with a gift shop. Selling flowers, greeting cards and calendars is unrelated to your tax-exempt purpose of treating patients. So, your gift shop revenue might be unrelated business income (UBI) and fair game for federal and state taxing bodies. And you'll likely need to apply FIN 48 to your financial statement.

Also, if the IRS is investigating your tax-exempt status for any reason, you may be required to apply FIN 48.

### EXEMPTIONS TO UBI

Whether UBI is subject to unrelated business income tax (UBIT) is another potential area of uncertainty. UBI may be exempt from UBIT if 1) your gross UBI is less than $1,000;

### DOING THE TWO-STEP

**How to determine income tax uncertainty**

Are you unsure whether some of your nonprofit's income is taxable? The Financial Accounting Standards Board's (FASB's) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), requires nonprofits to address such uncertainty by applying this two-step process:

1. **Determine how sure you are that a particular tax position will be upheld by the taxing authority. Use a "more likely than not" standard.** For example, determine whether you're more than 50% sure that income you receive from a particular activity will be deemed tax-exempt by the IRS.
2. **Determine the largest tax benefit that is more likely than not to ultimately be realized.** This means the amount that's more than 50% likely to be allowed after settlement with the taxing authority. If, for example, you're more than 50% certain that 75% of income from a particular activity is exempt, on your financial statements you should recognize unrelated business income tax (UBIT) liability on 25% of the income.

Keep in mind that this is only a brief summary of a complex accounting matter. You'll want to work with your tax expert on this FIN 48 process.

2) only volunteers run the money-making activity; 3) most of the merchandise you're selling is donated; *or* 4) your organization's "members" are primarily the people who benefit from the business — for example, outpatients who use the hospital's heated swimming pool for physical therapy.

Here is where uncertainty enters the picture. If that hospital with a pool, besides providing outpatient physical therapy, offers a water aerobics class to the community, that income may be viewed as subject to UBIT — *or* it may not. That's because the rules aren't clear about how many patients vs. nonpatients may use the swimming pool. If you're unsure whether UBI is taxable, you'll need to show that you've thought about FIN 48 on your financial statements.

*FIN 48 requires organizations that prepare their financial statements according to GAAP to review their federal and state tax positions.*

### YOUR DUCKS IN A ROW

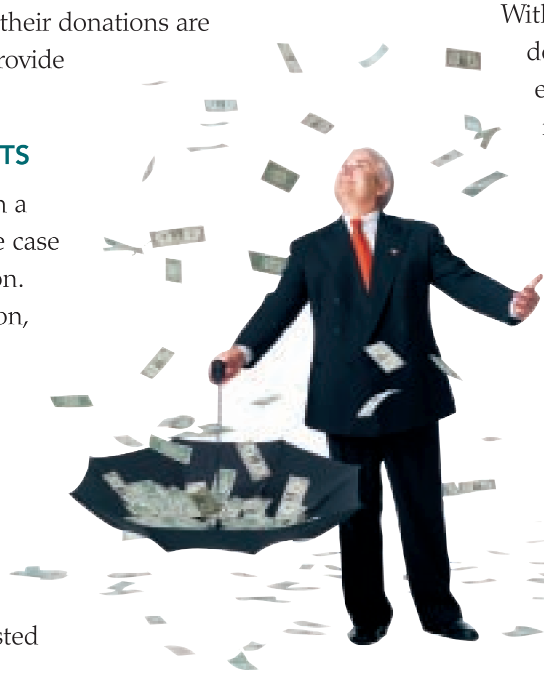
Like other FASB rulings, FIN 48 is a complex accounting issue. Your tax expert can help you determine whether it applies to you. Don't leave this complicated matter until the 11th hour. ❋

# You can count on it

## *Planned giving vehicles provide reliable income streams*

**You know the importance of charitable contributions to your nonprofit. But do you know the value of *planned* giving and the vehicles that donors can use to help both you and them?**

Planned giving lets your organization do just that: *plan*. You'll know *who* is giving *what when*. But just as important is being able to communicate to contributors the many ways they can give. By choosing the right vehicle, donors can get the optimum tax benefit and have as little or as much say-so as they desire about how their donations are used. Planned giving can even provide donors with monthly income.



### DIRECT GIFTS AND BEQUESTS

These donations go directly from a donor (or a donor's estate, in the case of a bequest) to your organization. Generally, the bigger the donation, the bigger the tax benefit.

Lifetime gifts of cash, property or other assets are usually fully deductible for income tax purposes as long as the donor's itemized deductions exceed the standard deduction and his or her donations don't exceed adjusted gross income (AGI) limits. Direct bequests, typically made via a will, are generally 100% deductible for estate tax purposes.

### CHARITABLE GIFT ANNUITIES

These vehicles, available in most states, can be a good fit for people who want to donate substantial assets during their lifetimes and are concerned about keeping a consistent income flow for themselves while minimizing taxes.

With this legal agreement between you and the donor, you receive money, securities or real estate and in return agree to pay the donor a fixed income for life. That amount is based on the contributor's age at the time of the gift, and the rate of return your organization expects to earn and agrees to pay to the donor. The payments could begin right away or be deferred to a later time.

The contributor can defer any capital gains on appreciated property given to you, recognizing gains only as he or she receives annual payments. Meanwhile, a portion of each payment is defined as a tax-free return on principal. Also, the donor can claim an income tax deduction equal to the present value of

## TAKE STOCK OF THESE GIFTS

When it comes to gifts, nothing beats a bird in hand, right? Not necessarily. While your nonprofit isn't likely to turn down a check, your donor can miss out on significant tax savings by giving cash.

For contributors, giving appreciated stock they want to sell anyway, rather than cash, can mean big tax savings — additional money they give to you or keep themselves. But the wrong move can cause them to miss out on tax savings. So remind prospective stock-giving benefactors that:

- They may be able to receive an income tax deduction equal to the appreciated stock's fair market value (FMV), but should check with their tax advisor on this,
- It can be easier to give publicly traded stock rather than closely held stock, whose FMV is more difficult to determine and may be more costly to substantiate, and
- Depreciated stock is a different matter — when FMV is less than the stock's purchase cost, donors can deduct only the FMV and will lose the capital loss deduction that could be taken if they sold the stock. Donors are better off selling it and then giving the cash proceeds to your organization.

In addition to stocks, your patrons can give you almost anything else they want, including property, life insurance, artworks and collectibles. They should consult with their financial and tax advisors to learn about the benefits and pitfalls of each type of donation.

the charitable interest the year the annuity is set up.

Charitable gift annuities also are subject to the registration and licensing provisions of state insurance departments.

### CHARITABLE TRUSTS

With a charitable *lead* trust (CLT), the contributor donates assets to a trust, which pays income to the charity for a number of years. Then the property reverts to the donor or a beneficiary. The donor receives a gift or estate tax deduction (depending on whether the trust is funded during life or at death) equal to the present value of the charitable interest when the CLT is set up. Depending on the CLT's structure, the donor also may receive an income tax deduction.

With a charitable *remainder* trust (CRT) the donor (or another noncharitable beneficiary) receives income from the donated assets for a specified period, or for the life of the beneficiary, and the remainder goes to the charity. As with a charitable annuity, the donor can defer capital gains on certain long-term appreciated property given to the CRT, recognizing gains only as he or she receives annual payments.

The donor receives a gift or estate tax deduction equal to the present value of the charitable interest when the CRT is set up and, if it's set up during life, will also receive an income tax deduction.

### DAFs, SUPPORTING ORGANIZATIONS AND FOUNDATIONS

Donor advised funds (DAFs) give donors a simple way to make charitable gifts when they choose, and to then participate in directing the funds to other charitable organizations. The contributor can create a DAF in his or her name to be held by a nonprofit organization that administers the funds and makes grants. DAFs are designed to broadly benefit a variety of charities and are less costly to set up than a private foundation.

Donors who want more, but not necessarily full and direct, control over how funds are used — without the headaches of foundation administration — should consider creating a supporting organization to ally with their favorite nonprofits. The charities typically handle tax-filing and administration costs. The donor also can deduct contributions up to a higher percentage of AGI than allowed for private-foundation contributions.

Private foundations are the vehicle of choice for donors who want to make significant contributions, such as $1 million or more annually, or have full control over how funds are used. Because a foundation is funded and controlled by the donor, it must file income tax returns each year and pay a 1% or 2% excise tax on net investment income. It also must bear administrative costs.

### UNDERSTANDING: AN AID TO FUNDRAISING EFFORTS

Planned giving is critical to all nonprofits. Your understanding of your donors' choices should help you in your general and one-on-one fundraising efforts. Whatever your supporters' inclinations, encourage them to talk over the options with their tax and financial advisors. ✻

# Single nonprofit seeks honest, detail-oriented self-starter

*Taking the right steps to find your dream bookkeeper*

**Looking for the perfect bookkeeper for your nonprofit is something like looking for an ideal mate. You'll want to think hard about your organization's needs before you start searching for, and commit to, the person who will handle your day-to-day accounting functions.**

### LOOKING FOR THAT SPECIAL SOMEONE

Before placing any want ads, you should define the role. Crafting a detailed job description that outlines the position's responsibilities will help you attract qualified candidates and give you a consistent yardstick with which to measure them.

Common bookkeeper responsibilities include preparing and recording accounts payable, accounts receivable and cash receipts; tracking expenses; reconciling bank statements; posting accounts to the general ledger; and preparing for year end financial audits.

If you also will be relying on the bookkeeper to send donor acknowledgments, order supplies or handle any other clerical duties, spell out those duties in the job description.

### MAKING SURE IT'S A GOOD FIT

Nonprofit experience may not be essential, but it can be helpful. Nonprofits have special bookkeeping challenges that for-profit businesses don't. Most for-profit businesses, for example, don't handle pledges, donated goods or services, or restricted donations.

### BOOKKEEPER VS. ACCOUNTANT

The terms "bookkeeper" and "accountant" sometimes are used interchangeably, but there are differences. In general, a bookkeeper enters income and expense data into your accounting system. An accountant uses that data to generate financial reports and prepare tax documents.

Bookkeeper candidates should have a basic understanding of accounting terms and principles to do the job well. But, in most cases, the individual doesn't need the specialized knowledge of a CPA.

At the very least, you want someone who understands there are differences between for-profit and nonprofit accounting methods and is willing to learn your organization's accounting specifics.

Other skills are nonnegotiable. Candidates should be knowledgeable about accounting basics; attentive to details; deadline-oriented; and computer-literate — that is, familiar with the accounting system you use.

Finally, because your bookkeeper will handle cash, financial records and proprietary information, potential hires must be trustworthy and above reproach. Conduct thorough background and credit checks on anyone you're seriously considering, including following up on any references.

Many organizations hire a bookkeeper because other staff members don't have the necessary accounting skills. If you're in that situation, you may wonder how you can judge the accounting acumen of bookkeeper candidates.

The American Institute of Professional Bookkeepers (AIPB) can help. The AIPB has created a short test and test administration guidelines you can use with candidates to gauge their knowledge of accrual-basis bookkeeping. If you require special skills, the tests can be customized to your needs. For more information on this free resource, go to http://www.aipb.org.

### TYING THE KNOT

A bookkeeper is instrumental in maintaining your organization's financial health. So focus on finding the best candidate with the right skills and experience to handle this special job. ✻

## FOLLOW THE YELLOW BOOK ROAD

*Changes impact how you act on deficiencies in controls*

A number of federal rule changes are likely to affect your next audit — including the way an auditor evaluates and reports on deficiencies in a nonprofit's internal controls.

Among revisions to the General Accounting Office's (GAO's) Government Auditing Standards, often referred to as the Yellow Book, is a requirement that the head of internal audit communicate audit results to the board of directors (via the audit committee).

The revised standards, issued in July, "encourage" internal auditors to use Institute of Internal Auditors (IIA) standards along with Generally Accepted Government Auditing Standards (GAGAS).

The revised standards apply to financial audits, attestation engagements and performance audits beginning after Jan. 1, 2008.

Here are just a few of the other significant changes. They relate to:

**Ethics and independence.** There will be greater emphasis on ethical principles as the foundation, discipline and structure behind the implementation of the standards, including a description of five key ethical principles to guide auditors' work. Chapter 2 is now completely devoted to ethical principles.

**Performance audits.** The GAO has "enhanced" performance auditing standards to elaborate on the overall framework for "high-quality performance audits." The office also has added a section on information systems controls to be used to assess audit risk and plan the audit. Additionally, it has added requirements and guidance for auditors to follow in situations when they discover they didn't have sufficient, appropriate evidence to support the reported findings.

For a full description of the Yellow Book changes, go to www.gao.gov.

The Yellow Book, last revised in 2003, is used for guidance in following GAGAS. The standards apply to organizations that spend $500,000 or more of federal funds in a year and are required to have an OMB Circular A-133 audit.

The standards also may apply to nonprofits that receive state and local funds, depending on the audit requirements of those government funding sources.

To make sure you're in compliance with the new standards, discuss them with your independent auditors.

# Newsbits

## 2008 SEEING A BUMPER CROP OF "DO-NOT-MAIL" LEGISLATION

Proponents of direct mail, which includes much of the correspondence your nonprofit generates, are busy fighting battles this year in several states where "do-not-mail" initiatives have been added to legislative agendas.

Hawaii, Michigan, New York, North Carolina, Rhode Island, Vermont and Washington all have proposed bills that would establish state-run do-not-mail registries, similar to do-not-call registries. ❋

## COMBATING THE CERTAINTY OF HIGHER POSTAL RATES

The only sure things in life, they say, are death and taxes — but some would add higher postage costs to that list.

If you're sending anything larger than a standard letter (annual reports, conference brochures, membership appeals, donation solicitations, and so on) via the U.S. Postal Service, you now pay between 20% and 40% more for postage than you did before the new rates took effect last year, according to the Alliance of Nonprofit Mailers.

So, here are some strategies nonprofits can employ to cut postage costs between last year's hikes and the next (inevitable) increases:

- Because it now costs more for "flats," or oversized materials, consider using a different format or vehicle instead: a standard letter, a postcard, or even e-mail solicitations or a telephone campaign.
- Remember, the Postal Service offers a lower rate if the mail (over a certain quantity) is delivered to the post office presorted and grouped by ZIP code.
- Think about working with a reputable mail house to handle mailing tasks, like the one mentioned above; it might be well worth the cost.
- Clean up your mailing lists regularly — donors move. ❋

## SOX INTERPRETED FOR NONPROFITS

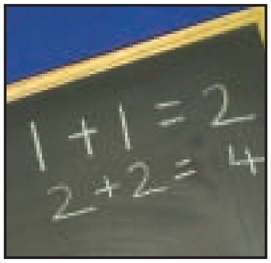
You should run a nonprofit like any business — with meaningful strategic planning, sound risk management and a carefully crafted leadership team. That's the theme of *Nonprofit Strategic Planning: Leveraging Sarbanes-Oxley Best Practices* by Peggy M. Jackson, released in September by John Wiley & Sons. And as with any business, those in leadership spots need to direct the organization with focus, clarity and purpose, Jackson says.

The hardcover book discusses establishing important control mechanisms, learning how the legal and legislative environments have changed over the last few years, and discovering the direction your nonprofit needs to go.

Jackson also is co-author of *Sarbanes-Oxley and Nonprofit Management: Skills, Techniques, and Methods* (John Wiley, 2006, paperback), which addresses the portions of the 2002 act that directly affect nonprofits, such as document retention and whistleblower protection, as well as those parts that aim for greater accountability and transparency — qualities that benefit any organization.

These books are useful references, but they're no substitute for professional advice personalized to the specific issues facing your nonprofit. So if your organization has questions about SOX, be sure to consult your CPA. ❋

## FUNDRAISING BY MULTIPLICATION TABLES NOT ADDING UP




One common mistake among those new to nonprofits is trying to reach a fundraising goal by dividing it by the number of likely donors and then asking everyone to contribute the same amount.

So says the nonprofit resource, GuideStar, which asserts that you can't, for example, raise $1 million by asking 1,000 people to give $1,000 each.

For one thing, some people won't donate anything. Also, if you're asking everyone to donate the same amount, some people — who see themselves as less wealthy than others in the drive — will think it's unfair. Plus, asking everyone to make a $1,000 pledge sets a cap, discouraging anyone who would have been generous enough to donate more.

To read about 19 other common fundraising mistakes, go to www.guidestar.org. ❋