

Perspectives

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Helping your not-for-profit & government organization achieve its mission

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Intermediate sanctions require vigilance

by Tim Snavely, St. Louis,
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Fiduciaries of tax-exempt entities should review the organization's transactions for any problem areas, such as private inurement and excess benefits provided to insiders.

Otherwise, an organization may risk severe penalties, negative publicity and potential damage to its reputation.

...the IRS has instructed its agents to closely review responses to the questions on Form 990. . .

Overview

The *Jobs and Growth Tax Relief Reconciliation Act of 2003* (the Act) imposes a personal liability on any organization insider (disqualified person) who receives excess compensation or sells property at an inflated price to an exempt organization.

A disqualified person is an individual, such as an officer, director, trustee or key employee, in a position to exercise substantial influence over the affairs of an exempt organization.

A 25% penalty is assessed on the excess benefit, with an additional 200% penalty if the excess benefit is not corrected, *i.e.*, repaid to the organization, within a reasonable amount of time.

There also is a 10% penalty imposed on any organization manager (potentially including board members) who knowingly

participates in the excess benefit transaction.

IRS enforcement

A tax-exempt organization's tax return (Form 990) now

requires an organization to indicate whether any excess benefit transactions have occurred during the tax year.

This, of course, assumes the organization has a process in place

to identify these transactions.

To ensure compliance, the IRS has instructed its agents to closely review responses to the questions on Form 990 and has hinted addi-

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IAs can help protect & improve operations

by Tracy Neumeier, Fort Wayne,
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Business risks may lurk around the corner at your organization, and it's important to know what and where they are. Resources are available to help you reveal and remedy risk areas.

IAs can help bring improvement

An internal audit (IA) is an independent, objective assurance and consulting activity designed to help protect an organization and improve its operations.

An IA can help an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

A professionally competent IA staff can provide services critical to an organization's effective and efficient control structure.

An internal auditor's competence should be apparent, supported by professional certifications, *i.e.*, certified internal auditor and certified government auditing professional; both are administered by the Institute of Internal Auditors.

IA methods vary

IA services are available in a variety of methods and degrees, including specialized consulting, cosourced and/or outsourced services.

Specialized IA services include the consulting approach; it works best when a particular need or opportunity exists, such as:

- ✓ Business process reviews
- ✓ Cost-saving analysis
- ✓ Efficiency reviews
- ✓ Internal control evaluations
- ✓ Compliance reviews
- ✓ Regulatory
- ✓ Contractual
- ✓ NCAA
- ✓ Student financial aid

IA consulting services help newly established IA departments:

- ✓ Document existing internal controls
- ✓ Assess existing internal controls
- ✓ Establish an IA charter
- ✓ Establish an entity-wide risk model

Cosourcing, an IA function shared between in-house staff and service providers, is beneficial if your organization needs to:

- ✓ Obtain a required skill set for specific audit projects

- ✓ Manage existing IA staff
- ✓ Obtain geographic coverage
- ✓ Complete the IA plan

IA outsourcing involves obtaining a full range of audit services from an outside provider, including:

- ✓ Risk assessment
- ✓ Internal control system documentation and assessment
- ✓ Annual planning
- ✓ Long-term planning
- ✓ Plan execution
- ✓ Communicate—both orally and in writing—results to management and the audit committee



Because they focus on risk management, control and governance processes, IA services will help your management team protect and improve your organization's operations. □



Out & About



by Wally Wetherill, Fort Wayne, wwetherill@bkd.com

The Association of Business Administrators of Christian Colleges (ABACC) recently held its 45th annual conference in Orlando, Florida. Chief financial officers of Christian colleges and universities from all over the country met to hone their skills and learn new ones.

The Accrediting Association of Bible Colleges meets concurrently with ABACC to discuss the development of Christian curriculum and related college administrative policies.

ABACC's Executive Director Bruce Hoeker says, "The conference offers a wide variety of information and resources. It covers just about everything a CFO in higher education needs to know.

"Our break-out sessions feature topics like 'Financial Ratios and Benchmarks,' 'Strategic Budget Planning and Control' and 'Financial Reporting Techniques.'"

The next ABACC conference is scheduled for February 16-19, 2005, in Orlando, Florida. Visit <http://www.ABACC.com> for more information. □

Sarbanes-Oxley: Help your board respond

by Travis Webb, Indianapolis, twebb@bkd.com

In last month's *Perspectives*, Debi Ladyman's "How Will Sarbanes-Oxley Affect Your Organization?" highlighted some of the "best practices" opportunities arising from the *Sarbanes-Oxley Act of 2002* (the Act).

The most often-referenced opportunities for improvement or change have been audit committee charters, whistle-blower programs and code-of-ethics statements.

Board members of many not-for-profits are learning about the Act through unrelated corporate interests and are returning to their volunteer positions with a heightened focus on their fiduciary responsibilities.

This is a positive reflection of the Act; some boards are even directing their organizations to become "fully compliant."

Your organization should help

the board identify the components of the Act where the benefits will outweigh the costs of adoption.

Without that evaluation, becoming fully compliant can be expensive, time consuming and ultimately may not be in the best interests of your organization.

For guidance in developing or revising your code-of-ethics, refer to the **Statement of Values and Code of Ethics for Nonprofit and Philanthropic Organizations**.

This document, recently drafted by a special task force of the Independent Sector (IS), is available at the IS web site: independentsector.org/members/code_ethics.html

Contact your BKD Not-for-Profit & Government Group advisor for more information about BKD's Sarbanes-Oxley compliance team and how it can help your organization. □

IRS targets exempt organizations in 2004

by Rich Royster, Springfield, rroyster@bkd.com

Recently, the Exempt Organization Division of the Internal Revenue Service (IRS) stated it will focus significant resources in 2004 on tax-avoidance schemes, as well as the political activities of exempt organizations.

Although the IRS is not targeting specific types of organizations, it is trying to identify areas where tax-shelter promoters are taking advantage of select tax structures to obtain abusive results.

The IRS is also studying a number of donor-advised funds that appear abusive. Although legitimate funds of that type exist, other promoters have established funds to:

- ✓ Generate questionable charitable deductions
- ✓ Provide impermissible economic benefits to the donors and their families (including tax-sheltered investment income for the donors)
- ✓ Provide management fees to the promoters

In addition, the IRS is studying potentially abusive transactions involving:

- ✓ IRC §509(a)(3) supporting organizations
- ✓ Organizations enrolled in Department of Housing and Urban Development Programs
- ✓ VEBAs (a medical tax-free reimbursement plan for many governmental employers, their employees and retirees)
- ✓ Use of certain corporate organizations to shelter assets and income from taxation and personal liability
- ✓ Charitable family limited partnerships

- ✓ Transactions involving the use of certain exempt and nonexempt trusts

The IRS will likewise continue its examination of other noncompliance trends in the exempt-entity world, including issues involving inurement, fundraising activities, donated property, consumer credit services and organizations formed to assist relief efforts after September 11, 2001.

With respect to inurement, the IRS is principally focused on compensation, including significant loan activity and whether excess benefit transactions are appropriately reported.

The IRS is reviewing consumer credit services because some entities appear to have the characteristics of for-profit companies.

The post-September 11 relief organizations are receiving attention simply because of the amount of money that flowed to such organizations.

Most recently, the IRS has focused on the accuracy of the fund-raising expenses reported on the annual information returns.

Not-for-profits that reported substantial contribution revenue and little or no fund-raising expenses received notices from the IRS alerting them to potential misrepresentation and advising them of its concerns.

The IRS wants to be sure exempt organizations are not under-reporting their fund-raising costs to donors and the general public.

Exempt organizations should revisit their functional expense allocation for financial and tax reporting purposes. □

Communicate risk information

Deposits and investments are often one of the largest assets on a government's balance sheet, but they also expose governments to risks that have the potential to result in losses.

GASB 40 requires state and local governments to communicate key information about deposits and investments related to:

- ✓ Credit risk
- ✓ Custodial credit risk
- ✓ Concentration of credit risk
- ✓ Interest rates risk
- ✓ Foreign currency risk

GASB 40 makes changes

The most significant changes and additions GASB 40 requires are:

- ✓ The previous requirement of GASB 3 to disclose deposits and investments by custodial credit risk category is deleted and replaced by expanded disclosures of those previously included in Category 3
- ✓ Disclosures are added for credit risk, concentrations of credit risk, interest rate risk and foreign currency risk
- ✓ The government's policy for addressing each of the five types of risk to which the government is exposed, or the fact that the policy does not address the particular risk, must be disclosed
- ✓ Investment disclosures ordinarily should be organized by investment type
- ✓ Disclosures should be made for the primary government, including blended component units, and should also be made for particular reporting units or funds when the risk exposure is significantly greater than that of the primary government □

GASB 40: Early adoption encouraged

by Mike Wolfe, Springfield
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Deposits and investments represent significant resources for many state and local governments, resources necessary for delivering services and programs and for carrying out fiduciary responsibilities.

Yet, these same resources can expose governmental entities to risks that have the potential to cause losses and compromise the very services they help provide. This is why disclosure of key information about such transactions is necessary.

To improve disclosure of common deposit and investment risks, the Governmental Accounting Standards Board (GASB) issued

Statement No. 40 (GASB 40) in June 2003.

GASB 40 amends GASB 3's custodial credit risk disclosure provisions, makes conforming amendments to GASB 25 and 28 and adds numerous additional required disclosures about deposit and investment risks.

Implement early

The provisions of GASB 40 are effective for financial statements for periods beginning after June 15, 2004. Restatement of disclosures for periods before the period of initial adoption is optional.

As a step toward greater public accountability, GASB 40 was designed to provide disclosures to help the public and other users of governmental financial statements

better assess the risks inherent in a government's deposit and investment activities.

This information is particularly relevant in today's prevailing economic, interest rate and equity and debt market environments.

Accordingly, early adoption of GASB 40 by all governmental entities is highly encouraged. Early implementation is a sound way to address the needs of users and identify the risks your governmental entity is exposed to.

Disclosure required

GASB 40 modifies the custodial credit risk disclosures of GASB 3 to focus on areas of highest risk. In addition, GASB 40 requires state and local governments to disclose

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Intermediate sanctions. . .

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tional questions will be developed to force organizations to review their compliance with the intermediate sanctions rules.

IRS audit examinations now include steps to identify transactions that would impose penalties.

Risk management essential

To address the risks of intermediate sanctions, exempt organizations should:

- ✓ Educate board members and key employees
- ✓ Use the Act's definitions to identify insiders in the organization
- ✓ Review specific transactions and compensation arrangements
- ✓ Implement a structure to com-

ply with the rebuttable presumption of reasonableness

The rebuttable presumption of reasonableness is met if an independent board or a committee approved by the board has approved the compensation or other payment to an insider before the organization makes payment.

The board or committee also must use appropriate and comparable data and adequately document its determination of reasonableness.

The key advantage to obtaining the presumption is that penalty taxes can be imposed only if the IRS develops "sufficient contrary evidence" to rebut the presumption.

Therefore, as a practical mat-

ter, the IRS would likely have to invest considerable extra effort to impose the taxes.

Take action

Tax-exempt organizations should implement and monitor an intermediate sanctions risk-management program.

At the very least, such a program would include annual education of board members, officers, key employees and managers affected by intermediate sanctions.

It also would include a process to take full advantage of the rebuttable presumption of reasonableness.

Contact your BKD Not-for-Profit & Government Group advisor if you have questions or need assistance with your own program. □



CPS provides FAA new access

by Todd Morriss, Springfield,
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The Office of Federal Student Aid (OFSA) is shedding new light into the black box known as the Central Processing System (CPS).

Beginning with the 2004-2005 processing year, financial aid administrators (FAA) will have

online access to many new functions in the CPS database.

The new functionality will allow FAA to:

- ✓ Check on the status of a student's application
- ✓ View a student's Student Aid Report (SAR) information, even before the Institutional Student Information Record (ISIR) is sent to the school

- ✓ Receive a list of student records held by CPS for missing signatures

- ✓ Enter verification information from the student's tax return to learn if new information changes the Expected Family Contribution (EFC)

- ✓ Save either a partially entered application or correction record for completion at a later time

- ✓ Request ISIR data in specific batches from the ISIR Datamart (see below)

In the past, administrators were unable to help students who visited an FAA office and said, "I sent my financial aid application in weeks ago, but I have not heard anything. Can you help me?"

Contacting CPS by telephone can be cumbersome and time consuming, but the new process, FAA Access to CPS Online, will provide students better service. It also will help FAA explain what's happening in the CPS black box.

New ISIR Datamart offers flexibility

Before the 2004-2005 school year, FAA received ISIRs as CPS received them. Requests for batches of ISIRs were based entirely on an application's CPS process dates.

OFSA now provides more flexibility to FAA. Here are just a few of the criteria FAA can use when requesting ISIRs:

Grade level - Provides priority processing for freshman applicants

Pell eligibility - Prioritizes the neediest Pell-eligible students

Verification status - Gets a jump on processing applications selected for verification

State of legal residence - Determines which students are eligible for state scholarships

EFC - Gives priority to the neediest students

Two or more criteria can be combined in the selection request. For example, FAA can request a search of all applicants who were residents of their state and who also had an EFC under 2000.

This flexibility will provide FAA more control over which ISIRs are received, as well as when they are received. □

GASB 40: Early adoption. . .

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information related to:

- ✓ Concentrations of credit risk, *i.e.*, investments in individual issues that comprise more than 5% of total investments
- ✓ Investment credit risk, including credit quality information issued by rating agencies
- ✓ Interest rate risk, including investment maturity information and interest rate sensitivity for investments that are highly sensitive to changes in interest rates
- ✓ Foreign currency risk for deposits and investments denominated in foreign currency

The objective of disclosure is to provide information about the nature and extent of risks and related policies but not to provide a conclusion about the policies effectiveness or appropriateness.


Outside GASB 40's scope are disclosures about a government's practices, procedures and informal policies, as well as its investment program objectives and strategies.

* * *

For more information or for assistance in adopting the provisions of GASB 40, contact your BKD Not-for-Profit & Government Group advisor. □

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