

THE NEWSLETTER OF THE BDO NONPROFIT & EDUCATION PRACTICE

NONPROFIT **STANDARD**



HIGHER EDUCATION UPDATE: THREE TOP TRENDS IMPACTING THE SECTOR

By Terri Albertson, CPA and Tom Gorman, CPA

After attending the Eastern Association of College and University Business Officers (EACUBO) 2014 Annual Meeting, we've been reflecting on the most pressing trends currently challenging the higher education community. Overall, what remains constant in this rapidly transforming landscape is the mission of higher education institutions: preparing students with the right tools, knowledge and problem-solving capabilities to make productive and beneficial contributions to society.

In a slowly-recovering economy, however, the business and policy pressures that colleges and universities now face are both evolving and intensifying. From demographic shifts to peaking enrollment, as well as the growing

influence of alternative methods of education delivery, the competition to attract and retain top students and faculty from a shrinking pool of candidates is at an all-time high, and will likely continue to grow. At the same time, cost pressures are compounded by federal funding challenges and an increased focus on measuring and reporting outcomes.

As institutions respond to this difficult environment, here are three trends to keep on your radar in the coming months:

▶VALUE METRICS

As tuition prices continue to rise, there are growing demands from the public and government alike for colleges and universities

CONTENTS

- Higher Education Update: Three Top Trends Impacting the Sector 1
- Institute Professional Profile..... 2
- Bitcoin in the Charitable Sector: What Nonprofits Need to Know 3
- Establishing the Groundwork for Joint Ventures Between Nonprofit and For-Profit Organizations..... 5
- Nonprofit Facts: Did you know..... 6
- Awkward Board Conversations About Pay – Can We Talk?..... 7
- What Goes In Must Come Out 9
- Takeaways from the NACD Conference: Nonprofits' Need for More Strategic Dialogue 10
- New Form 1023-EZ 11
- AICPA to Launch New Not-For-Profit Member Section 11
- Other Items to Note..... 12
- BDO Professionals in the News..... 12

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►CONTINUED FROM PAGE 1

HIGHER EDUCATION UPDATE

to demonstrate the value and return on investment (ROI) of their offerings. To measure this value in the most consistent and accurate manner—both within and across different institutions—conventional metrics that look primarily at completion rates no longer suffice. While the White House looks to advance a performance-based single rating system focused on access, affordability and outcomes, efforts are underway across the industry to develop techniques that more accurately measure knowledge acquired during college, as well as the success and quality of job placement after graduation. As more states gradually adopt performance-based funding systems, metrics and ratings may also become more than a tool for consumer use; they are likely to transform into an impactful measuring stick that can compel compliance and enhancements from underperforming institutions.

►RESOURCE SHARING AND CONSOLIDATION

Colleges and universities face demands to stabilize tuition rates while also improving their recruitment processes, and as a result, are increasingly looking for innovative ways to revamp their business models and cut costs. In the year ahead, we expect to see more institutions considering resource sharing and consolidation — including mergers — as potential options to accomplish these goals. These partnership arrangements can enhance operational efficiencies, allowing organizations to broaden their outreach, offer more diverse programs and more effectively compete for top students. They are also often difficult to execute, however, as they require considerable financial and operational engineering, as well as alignment across and within two or more organizations around a shared vision, governance structure and goals.

►INCREASINGLY COMPLEX REGULATORY ENVIRONMENT

The scope of rules, regulations and compliance considerations to which colleges and universities must adhere continues to grow more complex. Amid the White

INSTITUTE PROFESSIONAL PROFILE

TERRI ALBERTSON



Terri is an assurance partner and the leader for BDO USA, LLP's nonprofit and education industry practice in Philadelphia. She serves on BDO's national Nonprofit and Education strategy team. Terri has over 25 years of professional experience serving all sub-segments within the nonprofit and education sector, including colleges and universities, health and human service organizations, religious organizations, associations, foundations, arts and cultural organizations and hospitals. In addition to performing high-quality audits, she strives to help her clients thrive as they face mission, business and governance challenges.

Terri is a frequent speaker on a variety of nonprofit issues and has been published in various industry publications. Throughout her career she has been recognized for her impact, including being named by the *Philadelphia Business Journal* as a Top 25 Women of Distinction. She was recognized as a 'SmartCPA' by SmartCEO Magazine's Readers' Pick of the Region's Top Accountants.

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House's proposed single rating system, Clery Act compliance and the OMB's Uniform Guidance, it's critical that institutions and their leadership understand the ramifications of new and potential regulations in order to avoid the penalties and costly reputational harm that can result from non-compliance.

Which higher education issues and trends are on your radar?

Article reprinted from the Nonprofit Standard blog.

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BITCOIN IN THE CHARITABLE SECTOR: WHAT NONPROFITS NEED TO KNOW

By Laurie De Armond, CPA, Laura Kalick, JD, LLM, and Sandra Feinsmith, CPA

“SHOULD WE ACCEPT DONATIONS OF BITCOIN?”

It's a question many nonprofit executives and their boards may be asking as they encounter potential donors wishing to make their contributions with Bitcoin. Within the nonprofit sector, organizations such as Greenpeace and The Water Project have recently announced that they are accepting Bitcoin donations. However, the digital currency's use is still very much in early adoption phase. Organizations that currently accept Bitcoin donations tend to do so in order to outwardly support innovation, appeal to their tech-savvy donor bases and give their donors a low cost option for making donations.

For background, Bitcoin is a digital currency—also known as “cryptocurrency.” Essentially, those who buy Bitcoins assume that the currency is worth something, and its value subsequently fluctuates based on supply and demand. That being the case, Bitcoin is not controlled or backed by any central authority or sovereign government. The supply of Bitcoins and all transactions are instead controlled on the currency's peer-to-peer network. Still, Bitcoin exchanges exist, which can easily convert the digital currency into most national currencies.

The process for accepting Bitcoin donations is reasonably simple. An organization creates an account with a third-party processing company (e.g., Bitpay or Coinbase), and then incorporates the payment option into its online donation portal. With this system in place, organizations can accept incoming Bitcoin donations and then exchange them at the time of a transaction, if desired, for legal tender via third-party processors.

One benefit of accepting Bitcoin donations—as opposed to credit card transactions—is that Bitcoin transaction fees are notably lower. For example, some third-party processors will process and convert donations for eligible



U.S. 501(c)(3) organizations listed in the Internal Revenue Service (IRS) Publication 78 at no charge. Also, there are no exchange rate complications with which overseas donors must contend when contributing to a cause.

Still, there are notable risks and uncertainties around virtual currency, especially when it comes to tax and accounting issues. As nonprofits contemplate whether or not to accept Bitcoin donations, they should first understand the following financial accounting and reporting risks, as well as unique tax issues, that come with this nascent technology. Failure to do so could result in serious financial consequences down the road.

► FINANCIAL ACCOUNTING AND REPORTING RISKS

When it comes to managing the financial risks associated with virtual currencies and ensuring that all donations are accurately reported, management teams and Boards should be keenly aware of the following areas of concern:

1. The value of virtual currencies is highly volatile;
2. These currencies are not backed or regulated by any sovereign government, including the U.S. federal government; and
3. There are widely-publicized reports of asset losses at exchanges.

One way to mitigate the risk of market volatility currently associated with Bitcoin is to have donations converted to cash immediately through an agreement with the third-party processing vendor of your choosing. If an organization decides to accept Bitcoin for charitable donations, a best practice is to modify its gift acceptance policy accordingly, and if appropriate, include its intention to immediately convert these donations to cash.

For financial reporting purposes, Bitcoins should be treated as a financial asset, and if held, should be reported at fair value in an organization's statement of financial position and in the notes to the financial statements.

▶CONTINUED FROM PAGE 3

BITCOIN IN THE CHARITABLE SECTOR

It is reasonable to expect that the fair value would be determined based upon the trading price of the Bitcoin on the applicable exchange on the date of the transaction.

Along with deciding whether or not to hold Bitcoin donations or convert them to cash immediately, it's also critical that management and the Board understand how Bitcoins are valued, and how the third-party vendor safeguards them. The controls in place at exchanges and other locations that house Bitcoins for customers are important to ensuring that Bitcoins continue to exist. Once Bitcoins are lost, they are not recoverable, and unlike deposits held at a bank, they are not insured against loss by the government.

A sound understanding of the valuation and existence of Bitcoins is essential to accounting for the transactions and reporting Bitcoin for financial reporting purposes. Of course, Bitcoin is, for the most part, unregulated, and changes in laws or regulations could significantly impact its value, which could cause changes in market sentiment and liquidity.

▶TAX ISSUES

There are also notable tax considerations that nonprofits should understand prior to accepting virtual currency donations. Bitcoin doesn't have legal tender status anywhere in the U.S. or with any other sovereign government at this time, and the IRS has classified the currency as property for federal income tax purposes. See [IRS Notice 2014-21](#). With that in mind, whether a nonprofit is accepting Bitcoin donations or allowing services or goods to be purchased with Bitcoin, they should be aware of the following tax reporting requirements:

Rules regarding donations of property: The Internal Revenue Code makes a distinction between how gifts of property to a charity are treated versus gifts of cash. Various factors come into play, such as whether the gift is to a public charity or a private foundation, the use of the property, whether the donor held the property for more than 12 months, the type of property or whether the property is a publicly traded security, and the fair market value of the property on the date of donation.

In the case of gifts of property to a public charity, the donor may be eligible for a full fair market value deduction for appreciated long-term capital gain property. Gifts of property to most private foundations other than securities, where quotations are readily available on an established securities market, do not receive such generous tax treatment.

A charity must sign a donor's [Form 8283](#) in order for the donor to receive a charitable deduction if the property is valued at \$500 or more. For gifts over \$5,000 that are not publicly-traded securities, fair market value must be substantiated. It is our understanding that, at this time, Bitcoin is not considered a publicly-traded security, and therefore the question arises whether an appraisal is needed, or if there are market quotations readily available (see [Regulations section 1.170A-13\(c\)\(7\)\(xi\)\(B\)](#)) that would make an appraisal unnecessary. Although the IRS notice does point to the fact that virtual currencies are listed on exchanges, this point may need clarification.

Also, as part of signing the Form 8283, the charity is promising that it will file [Form 8282](#) if the property is sold within three years. The reason for the follow-up Form 8282 is to catch situations where the donor's deduction was significantly higher than the amount for which the property was subsequently sold. In that case, the IRS might follow up to see why there was such a large discrepancy. It is the donor's responsibility to value the property — not the charity's — and as a best practice, the nonprofit should refrain from doing so.

Don't forget that if a nonprofit accepts Bitcoin for the purchase of a ticket to one of their fundraising events, such as a gala, the same rules would apply as if the patron had used cash or credit. The charity is required to provide a written disclosure of the goods or services that have been received [if the payment is in excess of \\$75](#).

So, what does this mean for a charitable gift of Bitcoin, especially in the event that the charity immediately translates the Bitcoin donation into cash? Would the donor making a Bitcoin gift of over \$500 still be required to have the charity sign the Form 8283? Would the charity

have to file Form 8282, even if it immediately converts the Bitcoin to cash? These are all questions that the IRS still has yet to answer.

Other tax rules for goods or services: The IRS Notice provides that "a taxpayer who receives virtual currency as payment for goods or services must, in computing gross income, include the fair market value of the virtual currency, measured in U.S. dollars, as of the date that the virtual currency was received." It is, therefore, important that transactions be reflected at fair value, especially if the goods being sold or the services being provided would create unrelated business income (UBI). In addition, these transactions are subject to all of the normal tax rules regarding sales tax, information reporting and withholding.

Selling Bitcoin that a nonprofit holds: The good news is that if an organization holds Bitcoin and sells it at a gain, there should not be any taxable income, since the IRS treats Bitcoin as property, and sales of property that are not inventory or stock in trade are excluded from UBI, regardless of how long the charity holds the property.

As the use of Bitcoin continues to grow, it's critical that organizations understand best practices of accepting donations in virtual currency. If your organization is considering whether or not to accept such donations, we encourage you to consult an experienced advisor to navigate these complex and evolving rules, and to help you make the best possible decision.

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ESTABLISHING THE GROUNDWORK FOR JOINT VENTURES BETWEEN NONPROFIT AND FOR-PROFIT ORGANIZATIONS

By Laura Kalick, JD, LLM and David Friend, MD



Joint ventures between nonprofit and for-profit entities are very popular these days, especially in the healthcare arena, where nonprofits are hungry for access to new sources of capital to fund efforts that will give them a competitive advantage in a rapidly changing environment.

While joint ventures between nonprofit and for-profit entities aren't a new concept, the rules have changed over the years. Initially, the Internal Revenue Service (IRS) opposed arrangements in which the exempt organization acted as the general partner of the arrangement, since it subjected the assets of the organization to the claims and creditors of the partnership. As the industry has evolved, so has the IRS' position: Now, the exempt organization can be a general partner, so long as the partnership furthers its purpose

and there are effective controls to protect its assets.

Whether the joint arrangement is through a partnership, limited liability company or management contract, the general financial considerations remain the same. The key issues to consider with joint venture arrangements include:

Economic justification

Does the transaction make sense from a business and economic perspective? Simply seeking to perform a tax arbitrage will not yield a satisfactory result.

Proper income treatment

Joint ventures taxed as partnerships are "pass-through" entities. This means the venture is taxed as if the exempt organization entered into the venture directly. Securing favorable tax status for the venture weighs heavily on not only "what" the venture is doing, but "how" it is being done. The key question to ask: Would the venture be considered an unrelated trade or business if the exempt organization operated it directly? If so, it would create unrelated business income if operated through a joint venture.

In order to avoid unrelated business income taxes, there must be documents and evidence to suggest that the venture is operated in a manner that is consistent with the nonprofit's purposes. Thus, the exempt organization must maintain sufficient control over the venture to ensure it is run in a manner that prioritizes the exempt organization's purposes over profit-making objectives. If the exempt organization does not have an interest large enough to exercise control, other safeguards should be implemented, such as super majorities required for certain actions or veto powers.

If one of the exempt partners happens to be a hospital, the hospital must be able to ensure that the venture's activity will be conducted to further the community's benefit.

Otherwise, the income stream could create unrelated business income. Furthermore, if the joint venture partner is involved in a hospital department's operation, the hospital's section 501(r) financial assistance policy and billing and collection policies must still cover the department to avoid creating tax issues that would cause revenue to be treated as unrelated business income.

Quid pro quo funding

The exempt organization's share of profits and losses from the venture must be proportionate to its contribution to avoid tax issues, such as private inurement.

Buying, leasing and lending

In some cases, the exempt organization may lease or sell property to the joint venture, or buy or lease property from the for-profit entity. In either case, the transaction must be transparent and for fair market value. This also holds true for loans and guarantees.

Intermediate Sanctions rules could apply if transactions are not at fair market value and if the for-profit entity is one that can exercise substantial influence over the organization. Whether a party can exercise substantial influence over an exempt organization must be determined through a facts and circumstances analysis. For cases in which the joint venture is with physicians, their previous relationships with a hospital, including how many patients their practices admitted, may factor into the analysis.

Organizations can proactively work to prevent the levying of Intermediate Sanctions by establishing the rebuttable presumption of reasonableness when negotiating lease or sales arrangements. This shifts the burden of proof to the IRS to show that the amount involved is excessive. An independent governing body can establish the presumption by approving the transaction based on comparable data and then documenting its

►CONTINUED FROM PAGE 5 GROUNDWORK FOR JOINT VENTURES

decision contemporaneously. Appraisals are always useful in establishing fair market value.

Reasonable compensation

New ventures usually present an opportunity to enter into new compensation arrangements that appropriately reward the players.

Again, the fair market value standard reigns supreme here. A more in-depth discussion on the constraints of executive pay for nonprofit healthcare providers can be found in the [Fall 2014 Nonprofit Standard newsletter](#) and the [Fall 2014 BDO Knows Healthcare newsletter](#).

Asset protection

The IRS is highly concerned about protecting the assets and activities of nonprofit organizations in these arrangements, so the venture's business terms should provide details of the protective measures in place. For example, if the business venture is liquidated, will the exempt organization still be able to serve its population? Is a non-compete clause too onerous? The assets contributed by the exempt organization should be adequately insured by the new venture.

Use of tax-exempt bonds

If a venture leases property from an exempt organization whose property is financed with tax-exempt bonds it may be considered a "private business use," creating taxable interest on the bonds if certain thresholds are met. For Accountable Care Organizations (ACOs), the IRS [expanded its 1997 safe harbor](#), which states that ACOs using property financed with tax-exempt bonds will *not* be considered a private business use. Paramount in the criteria is that the economic benefits participants receive are proportional to their contributions, and all arrangements with the parties are at fair market value.

Management contracts

New combinations of tax-exempt organizations and for-profit entities often involve a management contract. These contracts should be structured carefully for bond-financed facilities, paying special attention to "qualified use," which can affect the tax-exempt status of the bonds. The IRS also [expanded its 1997 safe harbor](#) as to what

NONPROFIT FACTS: *Did you know...*

Healthcare spending is now projected to grow at a rate of 6 percent per year from 2015 to 2023, or 1.1 percentage points faster than the economy, according to findings published in the trade journal *Health Affairs*.

The Center for Responsive Politics (CRP) projects that spending in the current election cycle by 501(c)(4) groups that do not disclose donors will break all previous records. Spending by these groups rose from \$1.3 million in 2006 to \$256.3 million in 2012, according to the CRP.

According to the Chronicle of Philanthropy's annual nonprofit executive compensation survey, the median change in CEO salary among 82 organizations between 2011 and 2012 was 4.9 percent.

From 2007 to 2012, the number of jobs at organizations registered as charities with the Internal Revenue Service increased 8.6 percent, climbing from 10.5 million to 11.4 million, according to new research from the Bureau of Labor Statistics.

The tax-exempt sector in the U.S. contributed 5.4 percent — or \$887.3 billion — of the nation's gross domestic product (GDP) during 2012, according to

the most recent Nonprofit Sector in Brief report by the Urban Institute's Center on Nonprofits and Philanthropy.

According to new data by the Council on Foundations in a study of more than 1,000 U.S. grant makers, more than one in five grant makers pays board members.

The median loss among frauds committed by nonprofit executives is \$600,000, according to information from the Association of Certified Fraud Examiners (ACFE).

Giving to the nation's biggest and most popular charities grew by nearly 11 percent last year and was fueled largely by affluent donors, according to The Chronicle of Philanthropy's annual rankings of the 400 charities that collect the most from private sources.

According to a new report from UBS Wealth Management Americas, nine in 10 affluent Americans say they donate to charity, yet only 20 percent consider their giving to be effective.

Fifty-seven percent of internships at nonprofit organizations are unpaid, compared to 48 percent at government offices and 34 percent at for-profit businesses, according to a 2010 Intern Bridge study.

provisions of a management contract will allow it to be considered qualified use. The new provision allows the manager to be paid an annual productivity reward, in addition to other compensation, if the reward is based upon the quality of services provided under the contract, rather than increases in revenues or decreases in expenses of the facility. The amount of the productivity award must also meet certain criteria.

It is likely that in the not-too-distant future, there will be increasing combinations of for-profit and nonprofit corporate structures as organizations look to access capital and

management talent. In order for these arrangements to be successful, organizations must lay considerable tax, business and governance groundwork to ensure efficiency and tax effectiveness.

Article adapted from the Nonprofit Standard blog.

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AWKWARD BOARD CONVERSATIONS ABOUT PAY – CAN WE TALK?

By Mike Conover

“HOW MUCH DO YOU GET PAID, DAD?”

I'm not sure if you ever asked this question growing up, but I have a very vivid recollection of the time I floated it. Sitting around the supper table one evening, I guess the subject of pay had come up in a conversation between Mom and Dad. I boldly joined the conversation with the question, “How much do you get paid, Dad?”

All conversation came to an abrupt halt, eating stopped, and for what seemed like an eternity and all I could hear were crickets. All I could see was the stern glare of my parents and a warning, “Don't you ever ask anyone how much they get paid!”

The meal was completed in near silence with more than a couple of follow-up glares. Mission accomplished, life lesson learned: pay is not a polite subject of conversation, not even among family members.

After spending more than half of my adult life advising all sorts of organizations on matters related to pay, I've concluded that nearly everyone has had similar parental or societal ‘guidance’ on the subject of pay. It's right up there, perhaps even more sacrosanct, than the discussion of religion or politics. It is just not discussed. Employees squirm before those periodic ‘pay discussions’ with their supervisors. Frankly, many supervisors squirm more than the employees with whom they are having these discussions. Even Chief Executive Officers (CEO) and board members will confide that this ‘pay discussion’ is always a bit different than any other that will arise in the course of business.

Given this general attitude about discussing pay, it is somewhat easier to understand some of the struggles that take place in the boardroom when the topic is on the agenda. Whether in conference rooms, large or small, the faceless conference call or a hastily-called gathering at some other event



for the organization, directors are often uncomfortable with pay discussions. Board briefing materials, consultant reports and presentations can ‘set the table’ by forestalling the topic, but eventually it must be discussed and a decision made.

Working with boards over the years, I've observed several different patterns of avoidance behavior in the boardroom as these pay discussions arise. Of course, the importance of these discussions and the decisions produced in them require effective communication. This reticence to discuss the topic poses a threat to good decision making.

It might be helpful to describe some of the more common avoidance behaviors in order to better understand the dynamics (or lack thereof) of pay discussions, and to offer some

suggestions that might engage directors and make pay discussions more effective.

My list of classic ‘avoidance’ strategies used for boardroom discussions of pay includes the following:

“What are we doing for everyone else?”

This question is often asked after a prolonged pause in the discussion when the subject of a pay recommendation for the CEO or other senior staff members is raised. To break the uncomfortable silence, some brave soul asks this question. It is certainly ‘safe.’ The rationale implied is if it is okay for the staff, it should be fine for the top executive(s). It also requires no additional research specific to the executive(s)

►CONTINUED FROM PAGE 7

CONVERSATIONS ABOUT PAY

in question. It might also require no further discussion than “All those in favor...?”

“Let (fill in board member name) handle it”

In this situation, the entire matter is delegated to a single member of the governing body. That person is believed to be more knowledgeable on the subject or is the individual who historically has been tasked with this chore or the poor soul now ‘taking his/her turn’ with this duty. Whether the individual is formally or informally charged with the responsibility and authority to address this matter with the CEO, the other board members may have no further involvement in the process other than hearing the percentage or dollar amount of the change made in pay.

“Ask the consultant”

At a loss for an answer or a volunteer, the board turns to the consultant to break the silence. The board seeks ‘expert’ advice and feels absolved of any disappointment or problems that might arise from the answer provided. “What should we do?” the consultant is asked. After offering whatever information the consultant can provide, with a unanimous vote, the issue is considered closed.

“The CEO will tell us what to do...”

In some cases, the CEO will be willingly obliged or bold enough to provide the information to substantiate a specific recommendation to the board or simply answer the board’s “What should we do?” question. Having received the CEO’s information, the board is then strangely left to simply approve it or awkwardly question or change it, if they dare.

It is not my intention to portray all boards or compensation committees as dysfunctional when addressing this important duty assigned to the governing body. However, it is not unusual for some of the behaviors described above to appear in the course of board discussions and decision making regarding pay. Often these behaviors appear in some otherwise very effective boards. A lack of

familiarity with the nonprofit executive compensation matters coupled with the previously mentioned ‘sensitivity’ of this topic periodically interferes with the best of boards.

The critical success factor for effective governance/oversight of executive pay is engagement of the board in the process. One of the best signs of engagement is the level and extent of dialog among board members as the process is carried out. Quite simply, the subject of executive pay is a subject for discussion among the board members, not simply a well-orchestrated chorus of “I move the motions,” “seconds” and “ayes.”

In order for engagement to occur, there are a number of necessary conditions:

- **Board members/compensation committee members must understand the role/responsibility they are expected to play in the process.** Clear statements of decision making authority (e.g. input, recommend/propose, approve) for each step in the process need to be defined. Some organizations prepare charters for the committees engaged in compensation decisions similar to ones used by other committees (e.g. audit, finance, etc.).
- **A specific process should be defined for use in the governance and administration of executive compensation.** Organizations sometimes prepare a calendar describing two or three meetings per year that are devoted to executive compensation. The calendar lays out a schedule for the year as well as the activities, objectives and decisions associated with each meeting. Establishing a calendar is particularly effective for engaging board members. It provides clarity on the purpose of each meeting and will focus directors on the matter(s) at hand.
- **Organizations often establish formal pay policies/guiding principles that articulate the organization’s beliefs about pay and the particular factors that will be considered when pay decisions are made.** Developing these points of view on a formal basis rather than on a case-by-case basis goes a long way toward establishing a sound business rationale for pay and promoting consistency from one decision

to another. A formal policy can also support consistency from the standpoint of turnover on the board, committee assignments and management. The arrival of a new individual involved in the process will not necessitate development of a ‘new’ policy, if one has not been developed. New members can also review documentation pertaining to the compensation program and quickly begin to participate in the process without the need for lengthy ‘oral histories’ to prepare them to engage.

With these necessary conditions satisfied, board members are well-positioned to substantively engage in the governance/administration of executive compensation. With the benefit of clarity on key aspects of the process, questions for more information and comments offered on various topics should come more freely and more often. Those questions and comments are exactly what engagement implies. When engaged, all parties involved in the process, especially board members, demonstrate that they are involved in the issue and not simply performing the ‘review and concur’ role so often associated with board membership. Good questions and thoughtful opinions are essential for effective management of executive pay.

The key point I’m making is that in the boardroom, pay is a topic of conversation and a very important one. The behavior we are seeking is characterized by thorough discussions, participation by all parties and broad ‘ownership’ of decisions made.

A final thought – it is still inadvisable to ask anyone at the dinner table how much they get paid!

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WHAT GOES IN MUST COME OUT

Does Your Financial Reporting Support Your Strategic Plan?

By Michael G. Hogan, CPA, CGMA



STRATEGIC PLANNING IS THE FOUNDATION FOR SUCCESS IN ANY ORGANIZATION.

But the decision-making that flows from that planning is only as good as the information upon which it is based. Managers work hard to develop systems for accounting and financial reporting that are compared to the key performance indicators of their organizations. For entities in the for-profit realm, it may be simple: Are the resources used to make the items adding up to the number of items produced? For entities in the nonprofit sector, this consideration may not be quite as black-and-white: Are our efforts contributing toward our mission? However, regardless of the sector your entity occupies, the goal is the same: you want to utilize information to help management make better decisions.

Accounting systems are notorious for being able to generate... accounting data. After all, that's what they're designed to do. When inputs and outputs can be condensed down to quantifiable units, be they raw materials, labor hours, or something else, costs can be assessed and compared against industry and/or historical benchmarks to determine if

operations are being conducted in as efficient or effective manner as planned. But when the output of your organization is an intangible, like better research, higher literacy or a cleaner environment, how do you gauge your effectiveness with the financial statements? At first blush, my answer is YOU DON'T.

That's not to say that the product generated by your accounting department is for naught; it simply needs to be utilized in a somewhat different manner. As noted, accounting systems generate accounting data. This is of great benefit to accountants. But there are legions of managers out there who need something other than accounting data; they need **management information**.

Accounting data and management information are not that disparate in their composition. The two largely stem from the same source, the results of operations as recorded in the general ledger of the organization. The difference results in their application. Keep the debits and credits to themselves and (hopefully) they will behave quite nicely in your books of record. Take the data away from the summarizations that are inherent in the financial statements – the totals used in the statement of financial position (balance sheet) may not be what you need. Strip the data down to its component pieces, choose the appropriate items to couple

with your performance indicators or business drivers, and then you can see their utility to the management process.

While there may be no direct correlation to the intangibles inherent in your mission, there are doubtless steps that your entity has taken in heading toward your goal. Comparison of the details in your payroll postings to the results of your membership drives may reveal inefficiencies in your association's outreach initiative. Tracking sponsorship costs by a particular demographic may highlight disparities in your efforts. Identifying those steps and determining which financial parameter is the appropriate monitor is often a joint effort between managers and the accounting professional – either inside your organization or from a qualified external consultant. That accounting professional can then work within the confines of your systems to generate a **management** reporting structure to augment the accounting reports and provide decision makers with the information needed to plan, assess, and evaluate the forward momentum of your nonprofit.

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TAKEAWAYS FROM THE NACD CONFERENCE: NONPROFITS' NEED FOR MORE STRATEGIC DIALOGUE

By Michael Ward



I was fortunate to attend the National Association of Corporate Directors (NACD) 2014 Board Leadership Conference because of my position as a board member for a nonprofit entity. The conference was attended by over 1,200 leaders — with broad representation from both for-profit and nonprofit boards of directors — who gathered to share experiences over three days of presentations and working sessions that revealed the shifting focus and increased engagement of today's boards.

During the conference, the NACD presented its latest Blue Ribbon Commission Report, "The Board's Role in Strategy," a thought-provoking state of the union address on board governance that provided an in-depth explanation on why boards should reassess their role in strategy development and execution. While the report and its findings are noteworthy on their own, what I found most impressive was the NACD's ability to pointedly address a topic that was brought up again and again in discussions throughout the conference: the need for more dialogue and coordination around strategy between boards and management teams.

How do most boards and management teams actually engage one another around strategy? The answer used to depend heavily on whether you were talking about a for-profit

or a nonprofit organization. Historically, for-profit boards have tended to be more engaged in regular dialogue with management teams around strategy development and execution, whereas nonprofit boards have lagged in this respect. That divergence is now disappearing.

With greater competition for financial resources, greater technical innovation and heightened operational and reputational risks, nonprofit management and boards are breaking down walls and reconsidering how they engage one another. Here are three of the biggest advantages that this more collaborative approach to strategy can bring about:

1. Regular dialogue creates nimbleness:

The old adage of "review and concur," in which a management team develops strategy on its own and then presents it to the board on an annual basis, no longer suffices. As was apparent from conference discussions, nonprofit boards are increasingly engaging in collaborative relationships with management teams to monitor the environment in which they operate and evaluate the need for strategy adjustments. This point was reinforced during a presentation by Save the Children CEO Carolyn Miles and Director Dona Davis Young, as they described how more consistent strategy discussions recently

provided them the ability to more rapidly and effectively respond to the Ebola threat in countries impacted by the disease.

2. Enhanced resource management:

Allocating resources is one of a board's most important responsibilities, and it's a lynchpin for effectively mitigating the many risks that nonprofits face. Organizations need to secure the best forward-thinking leaders, secure digital platforms that house hundreds of millions of beneficiary and donor records, and safeguard their reputations in order to attract and retain donors. Funding is a critical component of achieving these ends, and transparent, collaborative dialogue between boards and management teams is the oil that keeps the engine running.

3. Executive compensation and succession planning:

Nonprofit boards play an instrumental role in the selection and compensation of their organization's executives. Long term sustainability relies on the board's ability to select and retain the right leaders, and a poorly-planned or ill-timed transition can undermine a nonprofit's momentum. It can also threaten the organization's financial stability and employee job security. To establish the right process to identify and compensate the right leaders at the right time, boards must coordinate and communicate their strategy with the right stakeholders across the entire organization.

For ideas and recommendations for nonprofit directors on how to enhance the dialogue between their boards and management teams, we encourage you to read the full [NACD Blue Ribbon Commission Report on Strategy Development](#). As your nonprofit organization addresses its future challenges, how is the relationship between its board and the management team evolving to keep pace?

Article reprinted from the Nonprofit Standard blog.

For more information, contact Michael Ward, director, Outsourced Financial Services, at mward@bdo.com.

NEW FORM 1023-EZ

Can Private Foundations Rely on Determination Letters?

By Jeffrey Schragg, CPA

THE INTERNAL REVENUE SERVICE (IRS) ROLLED OUT THE NEW FORM 1023-EZ ON JULY 1, 2014 FOR USE BY SMALL ORGANIZATIONS TO ACHIEVE TAX-EXEMPT STATUS UNDER INTERNAL REVENUE CODE (IRC) SECTION 501(c)(3).

As with any change, questions can arise. For example, may a private foundation and other grantors rely on a determination letter issued to an organization that submitted a Form 1023-EZ in the same manner and to the same extent as a determination letter issued to an organization that submitted a Form 1023?

Typically, a private foundation need not exercise expenditure responsibility when making a grant to certain organizations, including those eligible for Form 1023-EZ use. Revenue Procedure 2014-40, provides that a determination letter “issued to an organization that submitted a Form 1023-EZ . . . may not be relied upon if it was based on any inaccurate material information.” For this purpose, “inaccurate material information includes an incorrect attestation as to the organization’s organizational documents, the organization’s exempt purposes, the organization’s conduct of prohibited and restricted activities, or the organization’s eligibility to file Form 1023-EZ.”

As such, there may be concerns whether a private foundation can rely on the Form 1023-EZ determination letter or whether they must exercise expenditure responsibility. A private foundation does not have the ability to determine whether the organization made an “incorrect attestation” on its tax-exemption application without undertaking the in-depth review that once would have been done by the IRS via the Form 1023 application review process, nor should they have to.

And although the instructions for Form 1023-EZ say, “donors and contributors may rely on an organization’s favorable Determination

Letter under section 501(c)(3) until the IRS publishes notice of a change in status, unless the donor or contributor was responsible for or aware of the act or failure to act that results in the revocation of the organization’s Determination Letter,” the instructions do not reference grantors. However, the instructions cite Revenue Procedure 2011-33, which actually references “grantors.” Therefore, the question becomes whether it is safe to assume the grantors may also rely on the Form 1023-EZ determination letter.

It is easy to differentiate determination letters issued to Form 1023 filers vs. Form 1023-EZ filers. Determination letters issued to Form 1023-EZ filers are issued on “Letter 5436,” which opens with: “We’re pleased to tell you we determined you’re exempt from federal income tax . . .”. Currently, determination letters issued to Form 1023 filers, on the other hand, are issued on “Letter 947,” which opens with: “We are pleased to inform you that upon review of your application for tax exempt status we have determined that you are exempt from Federal income tax . . .”.

Hopefully, the IRS or the Treasury Department will issue guidance or revise the instructions clarifying that a determination letter issued to an organization that submitted a Form 1023-EZ may be relied on by private foundations and other grantors in the same manner and to the same extent as a determination letter issued to an organization that submitted a Form 1023.

For more information, contact Jeffrey Schragg, partner, Core Tax Services, at jschragg@bdo.com.

AICPA TO LAUNCH NEW NOT-FOR-PROFIT MEMBER SECTION

By R. Michael Sorrells, CPA

As president of the Greater Washington Society of CPAs, I am fortunate to also be a member of the AICPA Council (the Council). I attended the Fall Council meeting in Boston the week of Oct. 20, where we discussed and voted on a number of new initiatives, including the AICPA’s new Not-For-Profit Member Section (the Section), which received unanimous approval.

This exciting development is a positive acknowledgement by the AICPA that the nonprofit sector is both a significant part of the U.S. economy and a unique practice for the accounting profession. Although the AICPA has incorporated sections for specific practice areas such as tax, this marks the first section devoted to an industry, and we expect that it will set a precedent for the inclusion of other industry-specific sections in the future.

The mission of the new program focuses on delivering impactful, integrated resources, fostering a community of professionals and enhancing the knowledge of its members in and around nonprofit tax, governance, financial reporting and assurance. There will be both a premium and basic membership option for the Section, with additional publications and offerings available to premium members. The provision approved by the Council also creates a new category for non-CPA associate members, i.e. individuals who hold a management or governance position at an organization served by an AICPA industry-specific member section.

Much of the initiative is still in development, however we are genuinely looking forward to this new program and the many benefits that it will bring to the nonprofit community. Jeffrey Schragg, BDO tax partner, will be a member of the initial leadership group. The first meeting of the group was held in early December. As the Section continues to evolve, we will be sure to keep you informed of the latest news and opportunities as soon as they become available.

Article adapted from the Nonprofit Standard blog.

For more information, contact Michael Sorrells, national director, Nonprofit Tax Services, at msorrells@bdo.com.

OTHER ITEMS TO NOTE

New Mortality Tables

The Society of Actuaries (SOA) issued two final reports in Oct. 2014 that update the mortality assumptions that private defined benefit retirement plans in the U.S. use in their actuarial valuations to determine a plan sponsor's pension obligations. The new tables are a result of a comprehensive review of recent mortality experience of uninsured private retirement plans in the U.S. Plans that use these new tables should expect the value of the actuarial obligations to increase. In addition, the new tables will likely result in higher contribution requirements, a lower funded status, an increase in lump-sum payments and larger Pension Benefit Guaranty Corporation (PBG) variable rate premiums. The rate of the increases will depend on the type of plan, specific demographics of the plan participants, and the types of benefits the plan provides.

The RP-2014 Mortality Tables Report (RP-2014) replaces the RP-2000 Mortality Tables Report (RP-2000). The SOA's companion Mortality Improvement Scale MP-2014 Report (MP-2014) adds a second, complex variable to the RP-2014 tables for "future mortality improvements." Improvement in this context refers to the concept that mortality rates have generally decreased from year to year and this pattern is expected to continue in the future. The new MP-2014 improvement scale varies by age and year.

The SOA committee that developed the tables recommends consideration of their immediate use for measuring private pension plan obligations. Their use should also be considered for private employer postretirement health and life insurance plans. The adoption of the new tables will be at the plan sponsor's discretion. Tables chosen should provide for the most accurate estimate of the plan's obligations. Public and multiemployer pension plans are not required to adopt these new tables. However, these plans may review these tables and determine whether the information presented in these new tables should be considered in their assumptions.

Calculations to comply with the 2006 Pension Protection Act will not be affected until the Internal Revenue Service formally adopts a replacement for the current statutory tables which are now based on the RP-2000. Minimum required cash contributions

will likely increase upon the adoption of a replacement mortality table.

Services Received from Personnel of an Affiliate

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-06 entitled "Services Received from Personnel of an Affiliate" in April 2013. This ASU applies to all nonprofit entities, including not-for-profit, business oriented healthcare entities, that receive services from the personnel of an affiliate that directly benefit the recipient nonprofit and for which the affiliate does not charge the recipient nonprofit. Charging the recipient nonprofit means requiring payment from the recipient for at least an approximate amount of the direct personnel costs incurred by the affiliate or the approximate fair value of that service. This ASU does not address transactions between affiliates for which the affiliate charges the recipient nonprofit at least the approximate amount of direct personnel costs.

Nonprofit entities should record the contributed services at fair value if employees of the separately governed affiliated entities regularly perform these services for and under the direction of the recipient nonprofit (other than those received in an advisory capacity). These contributed services should only be recognized if they (1) create or enhance nonfinancial assets or (2) require specialized skills, are provided by individuals possessing those skills, and typically would need to be purchased if not provided by donation. The

presentation of these contributed services should be reported in the same manner the entity reports other such expenses or assets.

A recipient nonprofit entity within the scope of Accounting Standards Codification Topic 854, Health Care Entities, that is required to provide a performance indicator should report as an equity transfer the increase in net assets associated with services received from personnel of an affiliate that directly benefits the recipient nonprofit and for which the affiliate does not charge the recipient nonprofit, regardless of whether those services are received from personnel of a nonprofit affiliate or any other affiliate.

A recipient entity is permitted to use fair value of the services received if it is deemed that the cost recognized by the affiliate for the personnel providing the services would overstate or understate the value of the services received.

The provisions of this ASU are effective prospectively for fiscal years beginning after June 15, 2014 and may be adopted early. A recipient nonprofit may apply the provisions of the ASU using a modified retrospective approach under which all prior periods presented upon the date of adoption should be adjusted, but no adjustment should be made to the opening net assets of the earliest period presented.

Entities affected by this ASU should begin to identify services provided by affiliates and develop systems to capture this information.

BDO PROFESSIONALS IN THE NEWS

BDO professionals are regularly asked to speak at various conferences due to their recognized experience in the industry. You can hear BDO professionals speak at these upcoming events:

JANUARY

Michael Sorrells will be presenting a session entitled "Public Support Test on the 990 and Unusual Grants" at the Greater Washington Society of CPAs Non Profit Section Meeting on Jan. 27 in Washington, D.C.

Sorrells will also be part of a roundtable discussion entitled "Tax and Legal Update" at the 2015 Statewide Summit on Philanthropy sponsored by the Florida Philanthropic Network on Jan. 29 in Orlando, Fla.

MARCH

Dick Larkin and **Lee Klumpp** will be presenting a session entitled "Not-for-Profit Accounting Update and New FASB Rules" at the 51st Annual Washington Non-Profit Legal & Tax Conference on Mar. 20 in Washington, D.C.

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BDO NONPROFIT & EDUCATION PRACTICE

For 100 years, BDO has provided services to the nonprofit community. Through decades of working in this sector, we have developed a significant capability and fluency in the general and specific business issues that may face these organizations.

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 ExcellenceSM (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.

The Institute offers both live and local seminars, as well as webinars, on a variety of topics of interest to nonprofit organizations and educational institutions. Please check BDO's web site at www.bdo.com for upcoming local events and webinars.

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