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How you should respond after an outside audit

News for Nonprofits

# NONPROFIT AGENDAS

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# Corporate sponsorships: Tax-free gift or taxable income?

Done right, corporate sponsorships can pay off for both the nonprofits that receive funding and the sponsors that receive valuable branding opportunities. Done wrong, though, your organization could end up on the hook for unrelated business income tax (UBIT). You need to understand how to navigate the nuances before you wade in.

## Identify qualified sponsorship payments

Under the Internal Revenue Code — Section 513(i) — "qualified sponsorship payments" aren't subject to UBIT. The term refers to payments of money, property transfers or the performance of services by a business without an expectation or arrangement that the business will receive any "substantial return benefit" in exchange.

Sponsored activities may include a single event, a series of related events, an ongoing activity or continuing support of a nonprofit's operation. A qualified sponsorship payment doesn't have to relate to the organization's exempt purpose. A "substantial return benefit" generally is any benefit other than an acknowledgment. It includes advertising; goods, facilities, services or other privileges; the rights to the nonprofit's trademark or logo; and exclusive provider arrangements.

Note that an exclusive *sponsor* arrangement isn't a problem. You can agree that a certain sponsor will be the only sponsor for your activity. But you can't, for example, agree to limit the availability of products provided by the sponsor's competitors at your event. The latter scenario usually results in a substantial return benefit.

If a sponsor will receive a substantial return benefit, only the part of the payment that exceeds the fair market value (FMV) of the benefit is a qualified sponsorship payment. If you can't establish that the payment exceeds the FMV, no portion of the payment constitutes a qualified sponsorship payment. Qualified sponsorship payments also don't include payments:

- Contingent on the degree of public exposure, such as the level of attendance at your event, broadcast ratings or similar factors,
- That entitle the sponsor to use its name or logo in your regularly scheduled and printed periodicals, such as magazines or e-newsletters (as opposed to materials published only in connection with a specific event), or
- Related to convention or trade show activities.

If part of a payment is qualified and part of it isn't, the IRS will treat the portions as separate payments.

## Nonprofit loses exempt status over sponsorship

Citing a corporate sponsorship agreement, the U.S. Tax Court recently found that a nonprofit failed the operational test for 501(c)(3) organizations and therefore wasn't tax exempt. The circumstances in *Giving Hearts, Inc. v. Commissioner* (Tax Court Memo 2019-94) were unusual — even suspicious — but the case highlights the importance of operating exclusively for exempt purposes.

The nonprofit was formed by the president of a for-profit window company, which relied heavily on telemarketing, after the implementation of the National Do Not Call (DNC) Registry. (Nonprofits, of course, aren't subject to the DNC restrictions.) The two entities entered a corporate sponsorship arrangement that allowed the business to fundraise for the nonprofit by making telemarketing calls that also generated sales leads.

The court found that, although the calls ostensibly were made on behalf of the nonprofit, the real purpose was business promotion. And business promotion isn't a qualified exempt purpose or substantially related to such a purpose. Thus, the nonprofit wasn't operated exclusively for one or more exempt purposes.

## Differentiate between advertising and acknowledgments

The IRS has pinpointed the primary issue presented by corporate sponsorships: distinguishing qualified sponsorship payments and the related acknowledgment of sponsors from the sale of advertising. Advertising is defined as any transmitted, published, displayed or distributed message or programming material that promotes or markets a business, service, facility or product.

An acknowledgment is intended only to identify the sponsor — not promote its products, services or facilities. Acknowledgments don't have to be as bare bones as you might expect, though. They can include the sponsor's logo, slogans, brand or trade names; locations and phone numbers; product service listings; and value-neutral descriptions of its product line or services. An acknowledgment also can include a sponsor's website URL. It can link to the website's home page, but not to the page for a particular product or service.

Try to avoid comparative or qualitative descriptions — for example, "the best software for nonprofits." The IRS considers a message that includes comparative or qualitative language *and* an acknowledgment to be advertising.

Finally, your acknowledgments shouldn't include price information, indications of savings or value, or an endorsement or inducement to buy, sell or use the sponsor's products or services. But mere display or distribution of a sponsor's product at a sponsored activity isn't considered to be such an inducement.

## Proceed with caution

At a time when many nonprofits face funding gaps, and some experts predict that a recession looms on the horizon, corporate sponsorship dollars can be appealing. It's critical, though, that you take care when crafting such arrangements. A seemingly small misstep could result in an unexpected tax bill.

# CFOs deliver financial know-how

But does your nonprofit really need one?

Some executive directors, board members and others in nonprofit leadership roles may look at the financial side of their organization and muse, "We could do so much better." You may think you can boost financial performance by hiring a chief financial officer to help "run the show." But there's a lot to consider before taking that step.

## Defining the CFO's role

Generally, the nonprofit CFO (also known as the director of finance) is a senior-level position charged with oversight of the organization's accounting and finances. He or she works closely with the executive director, finance committee and treasurer, and serves as a business partner to program heads. CFOs report to the executive director or board of directors on the nonprofit's finances, analyze investments, develop budgets and devise financial strategies.

The CFO's role and responsibilities will vary greatly based on the organization's size, as well as the complexity of its revenue sources. In smaller nonprofits with budgets of $1.5 million to $10 million, CFOs often have broad responsibilities — possibly overseeing accounting, human resources, facilities, legal affairs, administration and IT.

Midsize organizations, with budgets running up to $40 million and simple funding and programming, also may require their CFOs to cover such diverse areas.

In larger nonprofits, though, CFOs usually have a narrower focus. They train their attention on accounting and finance issues, including risk management, investments and financial reporting.

CFOs of midsize organizations with diverse programs (for instance, several programs generating different types of revenue) or governmental funding may have a similar focus.

Nonprofits with small budgets and straightforward operations probably assign these responsibilities to the executive director or choose a more affordable option. As organizations grow and their financial matters become more complex, though, CFOs can help steer the ship.

## Deciding to hire

Weigh the following factors when determining whether to bring a CFO on board:

- Size of your organization,
- Complexity and types of revenue sources,
- Number of programs that require funding, and
- Strategic growth plans.

Static organizations are less likely to need a CFO than not-for-profits with evolving programs and long-term plans that rely on investment growth, financing and major capital expenditures.

### Finding the right person

With CFOs playing such an essential role, your nonprofit should seek, at a minimum, a person with in-depth knowledge of the finance and accounting rules for nonprofits. A CFO who has only worked in the for-profit sector may find the differences difficult to navigate. Nonprofit CFOs also need a familiarity with funding sources, grant management and, if your nonprofit expends $750,000 or more of federal assistance, single audit requirements.

What about educational and professional credentials? The ideal candidate should have a certified public accountant (CPA) designation and, optimally, an MBA. The position also requires strong communication skills, strategic thinking, financial reporting expertise and the creativity to deal with resource restraints.

Additionally, you'd probably like the CFO (and every employee, for that matter) to have a genuine passion for your mission — nothing motivates employees like a belief in the cause. And, in the case of a CFO, this makes it easier to understand that success for a nonprofit isn't only about the bottom line.

### Considering outsourcing

But here's a different scenario. Let's say that your organization lacks the size or complexity to warrant having a full-time CFO on staff. Nonetheless, you desire the financial peace of mind that filling the position can provide. In this case, you might consider outsourcing CFO responsibilities.

Outsourcing can produce several benefits at far less cost. With outsourcing, you can obtain cost-efficient access to top-notch expertise. It will likely cost far less than hiring an executive with the appropriate background. You might even determine that your organization doesn't have enough financial "work" to keep a full-time professional on staff busily engaged.

### Make a decision

For a growing organization, a CFO may be the right choice. First talk with your department heads and board members, list the "pros" and "cons" and only then make your move. ■

## How you should respond after an outside audit

Regular outside financial audits are among the most effective tools for revealing financial risks in a timely manner. And they assure your donors and other stakeholders about your stability — so long as you respond to the results appropriately. Failing to act on issues identified in an audit isn't only a waste of money. It also may threaten your organization's long-term viability.

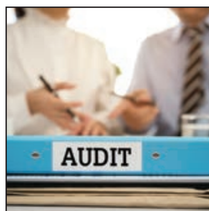
### Before the final audit report

Once the outside auditors complete their work, they typically present a draft report to the audit committee, executive director, and senior financial staffers. Those individuals should take the time to review the draft before it's presented to the board of directors.

The audit committee and management also should meet with the auditors prior to the board presentation. Often the auditors will provide a management letter (also called "communication with those charged with governance"), highlighting operational areas and controls that need improvement. The nonprofit team can respond to these comments, indicating ways they plan to improve the organization's operations and controls, to be included in the final letter.

The audit committee also can use the meeting to ensure that the audit is properly comprehensive. The auditors should report to the committee about:

- The level of staff cooperation,
- Whether they received all requested documentation,
- Any other difficulties or limitations encountered during the process,
- Any significant audit plan changes that were made and the reasons for such changes, and
- Any unresolved matters.




The audit committee should determine whether there were any conflicts of interest between the auditors and the nonprofit and how they affected the scope of the audit.

## Executive director's role

The committee should obtain the executive director's impression of the auditors and the audit process, too. Were the auditors efficient, or did they perform or require redundant work? Did they demonstrate the requisite expertise, skills and understanding? Were they disruptive to operations? The board should consider this input when deciding whether to retain the same firm for the next audit.

The audit committee and management also might want to seek feedback from the employees who worked most closely with auditors. In addition to feedback on the auditors, they may have suggestions on how to streamline the process for the next audit. For example, staff could develop a checklist of documentation the auditors requested so it can be gathered and properly formatted in advance.

## After the final audit report

The final audit report will state whether your organization's financial statements fairly present its financial position in accordance with U.S. accounting principles. The statements must be presented without any inaccuracies or "material" — meaning *significant* — misrepresentation.

The auditors also will identify, in a separate letter, specific concerns about material internal control issues. Adequate internal controls are critical for preventing, catching and remedying misstatements that could compromise the integrity of financial statements, whether due to error or fraud. The auditors' other suggestions, presented in the management letter, should include management's responses.

If the auditors find your internal controls weak, your organization must promptly shore them up. You could, for instance, implement new controls, such as segregating financial duties or implementing new accounting practices or software. Such measures can reduce the odds of fraud, improve the accuracy of your financial statements and help reduce future audit costs.

## Ignore at your own risk

Underresourced organizations can struggle to respond to audit findings. The potential costs, however, are too high to sit back and do nothing. Much can be gained by constructive follow-up. ■

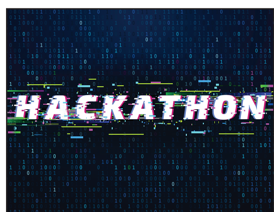
## IRS proposes regulations on donor disclosures

Until recently, most nonprofits were required to disclose to the IRS names and addresses of those who donate $5,000 or more during the tax year. However, in July 2018, the IRS released a new rule that eliminated this disclosure requirement for social welfare organizations and professional and trade associations. These organizations were still required to collect and maintain the requisite donor information, but they didn't need to report it on Schedule B of Form 990.

The states of Montana and New Jersey brought a lawsuit challenging the rule. In July 2019, a federal district court struck it down because the IRS hadn't followed proper procedures for legislative rulemaking.

In September 2019, the IRS responded by issuing proposed regulations that would allow the affected nonprofits — but not 501(c)(3) organizations — to redact the names and addresses of donors on their annual Schedules B. Organizations can rely on the proposed regulations for tax returns filed after September 6, 2019. ■

## Hackathon benefits charities




Smartsheet, a for-profit software provider, recently held a "hackathon" to help a group of leading nonprofits that focus on child welfare and enablement. Hackathons are events where computer programmers and developers work on hardware or software projects with the goal of producing a finished product within days or hours.

The daylong Hack-for-Good involved organizations such as the Special Olympics, the National Court Appointed Special Advocate/Guardian ad Litem Association for Children and the JDRF (formerly the Juvenile Diabetes Research Foundation). Each organization partnered with a Smartsheet certified user to tackle operational challenges and improve the delivery of their services.

The JDRF, for example, ended up with a dashboard it can use to provide its national board with real-time updates on hundreds of projects. The hackers also developed a tool for scheduling, planning and executing almost 1,000 training courses across the nation. ■

## Some organizations are making a dent in the gender pay gap

A new GuideStar study reveals that nonprofits with annual budgets of $25 million to $50 million are making the biggest strides toward closing the gender pay gap for CEOs. But other data shows that progress in addressing gender pay disparities has slowed or even reversed at most other organizations.

The 2019 *GuideStar Nonprofit Compensation Report* analyzes fiscal year 2017 compensation data from more than 113,000 nonprofits. It found that median compensation of female nonprofit CEOs continued to lag behind that of their male counterparts. The difference was most dramatic at the largest organizations. The gap ranged from 5% (meaning women earned 5% less than men) at organizations with budgets up to $250,000 to 20% at nonprofits with budgets exceeding $50 million. ■

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# The support you need. The service you're looking for.

**Succeeding in the not-for-profit sector today requires more than a strong commitment to your mission. It takes shrewd fiscal management, careful regulatory compliance, skillful use of technology and the assistance of advisors who know the issues nonprofit organizations face and how to address them.**

This is where Sechler Morgan CPAs, PLLC comes in. Our team of experienced professionals cherishes the opportunity to support nonprofit organizations, meet their management challenges and fulfill their missions. We offer a variety of specialized accounting, tax and consulting services including:

- Audit intermediary services
- Budget and policy design
- Outsourced accounting/bookkeeping
- Tax form preparation (990, etc.)
- Strategic and management consulting
- Speaking on financial literacy and other topics
- Technology and virtual system design

### RESPONSIVE QUALITY

We are committed to providing responsive, personalized service to the highest quality. We take time to truly understand your Organization so that we can customize our recommendations to your specific situation. Our goal is to make your processes easier, streamline your operations and ensure your success in reaching *your* goals.

We welcome the opportunity to discuss your mission and vision so that we may assist you with our expertise. Please call us at 602-230-2700 or e-mail info@azcpa.com and let us know how we may support you. Be sure to visit our website at www.azcpa.com for additional tools and information, as well as our archive of this newsletter.


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