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News for Nonprofits

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NONPROFIT AGENDAS

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Working remotely: Don't neglect internal controls

The pandemic has forced many nonprofits to change to work-at-home mode for extended periods, and some may remain there even as COVID-19 recedes. This shift in operations offers potential advantages, but it's critical that organizations institute new, or adapt existing, internal controls to protect their finances and accounting-related data. Here are some of the most important areas to survey.

Conduct a risk assessment

Ideally, you should perform a new risk assessment every time your organization undergoes significant changes in operations. The tumult created by the pandemic and recession certainly qualify.

A comprehensive assessment likely will reveal new risks, as well as different twists on more standard risks related to, for example, fraud or human error. This assessment is a fundamental first step toward mitigating your nonprofit's vulnerabilities.

Segregate duties

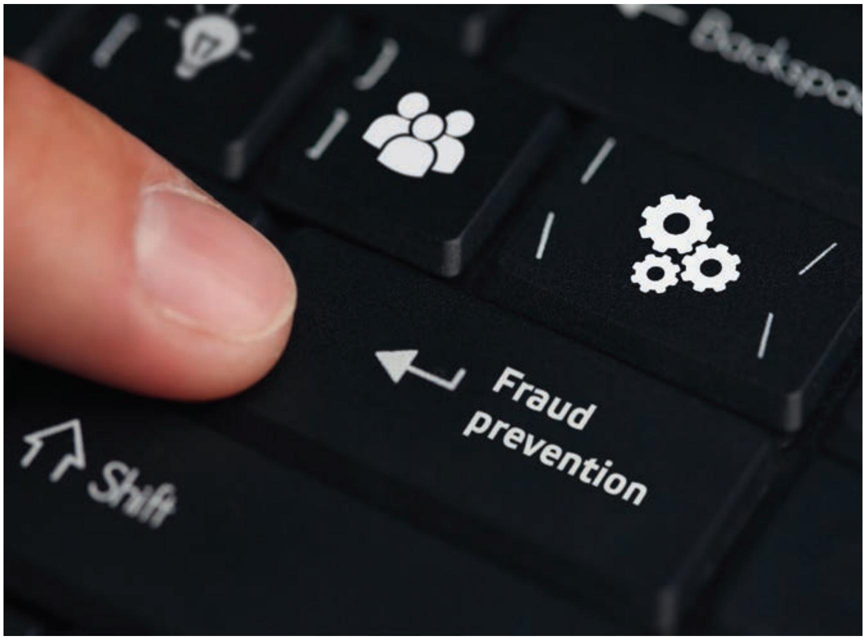
One employee should never be responsible for collecting, recording, reconciling and depositing cash receipts — those duties should be split up, or segregated, among multiple employees. Different employees should be assigned to approve, record and report transactions. And, if applicable, the employee who handles incoming payments shouldn't also handle outgoing invoices.

Smaller organizations find segregating duties difficult in "normal" times. But when accounting and finance employees are working remotely and independently, the challenge is compounded. For example, you'll need to adjust procedures for approving and making payments and for processing receivables.

Make payments safely

If your organizational policy (as opposed to bank policy) requires two signatures on outgoing checks, you might be able to document the second signer's approval virtually. Your accounting software may include features for building a digital trail of the necessary reviews and approvals. If it doesn't have such capabilities, other technological tools (for example, Slack, Google Documents or Microsoft Teams) can help.

Alternatively, you could reach out to your vendors and arrange paying via a different method. You may be able to pay online, with automated



clearinghouse (ACH) payments or by credit card over the phone. For the longer term, consider adopting an automated software solution, such as those offered by MineralTree or Bill.com.

For incoming cash flow, you can establish similar electronic alternatives for members, customers, donors and grantmakers, thereby eliminating the risks associated with the receipt of payments by mail. One option to avoid at all costs? Having payments forwarded to employees' homes for processing. The opportunity for fraud is too great. In these trying economic times, even the most trusted employee might be tempted to go astray.

Don't forget reconciliation

You're no doubt attempting to keep a lot of plates spinning right now, but don't let vital controls lapse. In the current environment, regular reconciliations are perhaps more important than ever. In fact, they're one of the most effective methods for detecting discrepancies.

What should you reconcile? First and foremost, an employee who doesn't have check-signing authority should perform a monthly reconciliation of bank statements. A trusted staffer also should reconcile accounts payable and accounts receivable. This includes reconciling the donor database against contributions revenue and donations against deposits. Additional reconciliations may be advisable depending on your circumstances, and don't forget the important step of management review to ensure that all discrepancies are resolved.

Protect your culture

Take care to maintain a culture that prioritizes ethical behavior as well as anti-fraud policies and practices. But, as many organizations have learned over the last year, culture can suffer when employees are scattered.

Proactive measures are essential. As always, the tone at the top matters. Organizational leaders should regularly communicate with staff to reinforce the need for adherence to internal controls. Don't rely solely on emails or texts for this messaging — incorporate phone or video conferencing to emphasize the point.

Tailored plan

Your CPA can provide specific, tailored recommendations for tweaking or implementing internal controls to reflect your changed circumstances while maintaining necessary safeguards. Your advisor also can help you use the lessons learned during the pandemic — what worked and what didn't — to safely continue remote working arrangements and prepare for any future crises.

ADAPT CYBERSECURITY TO HOMES

An ongoing reliance on remote workers calls for greater cybercrime vigilance. Hackers and other malicious actors have had a field day penetrating employees' poorly secured home networks to access their employers' confidential information.

Talk to your IT staff to ensure that the necessary firewalls, multi-factor authentication and other protective measures have been adapted for work at home. You may need new policies to alert employees to which practices are secure and permissible and which are prohibited. For example, you might forbid employees to use unsecured networks.

Employees also may need training to prevent cyberattacks and data theft. For example, the prevalence of phishing has risen during the pandemic, targeting victims on both work and personal devices. An employee who clicks on a predatory link in an email sent to a personal account can unleash malware that collects both personal and professional information.

IRS clarifies royalty exception to UBIT

Provisions in the Tax Cuts and Jobs Act have brought renewed attention to nonprofits' potential liability for unrelated business income tax (UBIT). Organizations generally are subject to a 21% tax on unrelated income, but exceptions apply — including one for royalties.

Although "royalties" aren't defined in the U.S tax code or regulations, a recent IRS Technical Advice Memorandum shot down one nonprofit's claim that some of its income qualified for an exception. The memo applies only to the situation it considered. However, it can shed light on the factors the IRS weighs when evaluating whether income qualifies for the royalty exception.

Failure to report

The income in question was received by an unidentified association, which publishes academic journals and earns revenues from advertising sales. The organization also has offered a job placement program — charging employers and job seekers fees — for more than 40 years. It developed a web application for the program, but, after encountering technical problems, contracted with a for-profit vendor to manage it.

On audit, the IRS found that the association failed to report income from the online program on its Forms 990-T. The association conceded that its online placement service is an unrelated trade or business but argued that it doesn't conduct the connected services. Rather, it asserted, the vendor conducts the service and any income received by the association constitutes royalties.

IRS's stand

The IRS memo finds the online placement services to be a trade or business of the association. It rejects the nonprofit's argument that the income stems from the licensing of its website, trademarks and members list.

The memo identifies several factors that support this conclusion, including:

Lack of licensing language. The agreement between the association and the vendor includes no reference to the association's tangible or intangible property — such as its name or trademarks. And it doesn't mention the transfer or use of such property to the vendor. The memo further points out that the online program isn't a vendor web page with the association's name, but part of the association's website.

Income share. The association receives almost all of the income from users of the service, less a nominal credit card transaction fee. The IRS contrasted this arrangement with the situation where a nonprofit receives as little as 50% of the income from a member's use of an affinity credit card. The latter is much more likely a royalty.

Service agreement. The agreement is titled "Website Operator Service Agreement," suggesting it outlines the terms of services provided by the vendor, not a licensing agreement. In

addition, it refers to the vendor as "provider" and the association as "customer," meaning the vendor provides the services for the benefit of the taxpayer. A licensing agreement would establish that the association's intangible assets are provided for the benefit of the vendor.

Overall operations. The association operated the service on its own for decades. It also provides significant services for the job placement activity. For example, it sets the prices and determines the content, type and timing of any advertising for the service. Moreover, it maintains a small team that provides career and resume advice as part of the placement services.

Proceed with caution

The IRS memo (https://www.irs.gov/pub/irs-wd/202039018.pdf) highlights some facts and circumstances that might lead to taxation of the income a nonprofit considers exempt royalties. Your financial advisor can help you review your vendor arrangements to see if you're potentially at risk for unexpected taxes.

IRS rules

Restructuring in today's regulatory climate

Some nonprofits have been forced to restructure their organizations due to the economic challenges of the COVID-19 pandemic. Fortunately, IRS rule changes from a couple of years ago make the restructuring process far easier than it once was. If you're considering such a change, here's what you need to know.

How have the rules changed?

Under previous IRS rules, a tax-exempt organization was required to file a new exemption application when it made certain changes to its structure. Each of these circumstances was seen as creating a new legal entity that must file an exemption application. An unincorporated association that incorporated was generally considered a new legal entity required to file an application, as well.

To apply for new exempt status, a restructuring organization would need to file a final Form 990 under its initial Employer Identification Number (EIN), obtain a new EIN and apply for exemption for the new entity. In addition to being a time-consuming and often expensive process, the new organization risked failing to receive the desired tax-exempt status. This also required changing the EIN on all bank and investment accounts, which is part of the administrative burden of a restructuring.

Then change arrived under IRS Revenue Procedure 2018-15. Restructuring nonprofits are now only required to report significant organizational changes on their Forms 990. However, the restructuring must satisfy certain conditions.

What are the requirements?

To avoid the application process, the original organization must be 1) a U.S. corporation or an unincorporated association, and 2) tax exempt as a 501(c) organization. It also must be in good standing in the jurisdiction where it was incorporated or, in the case of an unincorporated association, formed.

The reorganization must involve one of the following:

- Changing from an unincorporated association to a corporation,
- Reincorporating a corporation under the laws of another state after dissolving in the original state,
- Filing articles of domestication to transfer a corporation to a new state without dissolving in the original state, or
- Merging a corporation with or into another corporation.

The resulting, or "surviving," organization must carry out the same exempt purpose that the original organization had. If it's a 501(c)(3) organization, the new articles of incorporation must continue to satisfy the IRS's organizational test for such nonprofits. The test requires that the nonprofit's organizing documents (for example, its articles of incorporation) limit its purposes and use of its assets to exempt purposes.

Any exceptions or caveats?

The new rules don't apply if the surviving organization is a "disregarded entity" (an entity the IRS doesn't consider to be separate from its owner for tax purposes), limited liability company (LLC), partnership or foreign business entity. They also don't cover the incorporation of exempt trusts, or mergers of organizations into LLCs. Nor do the new rules include reorganizations in which the surviving organization obtains a new EIN. Surviving organizations that aren't covered by the new rules must submit a new exemption application to be recognized as exempt.

Covered surviving organizations don't escape without any reporting obligations, of course. The IRS still requires survivors to report the restructuring on any required Form 990 for the applicable tax year. In the case of a domestication or reincorporation in a different state, the surviving organization also must report its change of address on Forms 8822-B and 990.

Restructuring nonprofits are now only required to report significant organizational changes on their Forms 990.

Note, too, that the surviving organization will need to reapply for exemption *if* there's been a material change to the exempt purpose or type of exemption from the original organization. An example would be switching from providing outreach services to having an advocacy mission.

The new rules apply only to federal income tax exemptions. Your state's laws could require you to file a new exemption application.

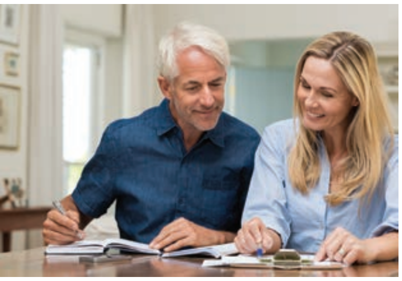
Seek assistance

If you're considering restructuring, contact your CPA. He or she can guide you through the process and help position your organization for future success.

News for Nonprofits

COVID-19 relief benefits donors

The COVID-19 relief legislation signed into law in December 2020 includes some provisions that could be a boost to donors and the nonprofits they support. For example, it extends the temporary "universal charitable deduction" for taxpayers who don't itemize their deductions through 2021.

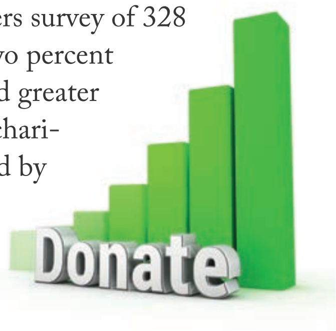


The deduction was limited to $300 for cash contributions to qualified charities for both individuals and married couples filing jointly in 2020. But couples can deduct up to $600 for 2021. Many taxpayers are unaware of this opportunity, so nonprofits should highlight it in appeals throughout the year.

The relief package also includes another round of funding for first-time or so-called "second-draw" forgivable loans under the Paycheck Protection Program — including for qualifying 501(c)(6) organizations, which weren't eligible for the first round. In addition, borrowers can use the funds for a wider array of expenses than previously allowed. These include certain operating expenses, property damage costs and worker protection costs.

How the pandemic has changed planned giving

Gift planning programs are experiencing higher interest since the emergence of COVID-19, according to a National Association of Charitable Gift Planners survey of 328 organizations. Sixty-two percent of respondents reported greater donor enthusiasm for charitable bequests, followed by donor-advised funds (54%) and retirement plan beneficiary designations (52%).



Forty-five percent saw more interest in qualified charitable distributions. Charitable gift annuities also attracted greater attention for 30% of respondents. Charitable remainder trusts and charitable lead trusts drew the least amount of new interest (15% and 4%, respectively).

The findings reinforce the value of gift planning programs, even in a challenging environment. The researchers encourage organizations to continue marketing their programs. Despite early concerns that such efforts might seem insensitive during a pandemic, they say that donors have been receptive.

Volunteerism suffers in the face of COVID-19

Two-thirds of volunteers reduced or stopped their contributions of time due to the pandemic. That's one finding from a recent study conducted by Fidelity Charitable, an independent public charity and grantmaker. (By contrast, in a March 2020 Fidelity survey performed before social distancing guidelines were issued, 30% of respondents said they'd increased their volunteering time in the previous two years.)

Among those who continued to volunteer, 65% turned to virtual or remote opportunities. Pre-pandemic, only 19% of volunteer activity was performed remotely.

Notably, 64% of those who hadn't tried virtual or remote volunteer activities didn't know how to find such opportunities, and 73% said they planned to return to volunteering when it's safe. These figures suggest nonprofits should take steps to educate supporters about how they can continue to help safely.

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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