

Profitable **Solutions** *for* **Nonprofits**

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Prudent is the word

Accounting rule, federal law wield impact on endowments

You're likely to be managing endowment funds somewhat differently in 2009 — with more disclosures about how you invest and spend those funds — due to a new accounting pronouncement.

The Financial Accounting Standards Board's (FASB's) Staff Position No. 117-1 (FAS 117-1) shakes up the world of endowment management for nonprofits. Subtitled "Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA), and Enhanced Disclosures for All Endowment Funds," the pronouncement affects:

- * How you classify the net assets (equity) associated with endowment funds, and
- * What you must disclose about the management of your endowment funds on financial statements.

The pronouncement — and the federal act that prompted it — represent the most significant changes in the handling of endowments in 35 years.

THE UPMIFA UMBRELLA

UPMIFA was passed by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in 2006. It replaces the 1972 Uniform Management of Institutional Funds Act, with the fitting addition of "prudent" in its title.

NCCUSL sees UPMIFA as a needed upgrade that: 1) responds to the tremendous growth in endowment funds held by nonprofits, 2) reflects advances in asset management theory and practice, and 3) establishes "an even sounder and more unified basis" for fund management.



So far, UPMIFA legislation has been introduced — or enacted into law — in about two-thirds of the states, and it's likely the momentum will continue. You can find information about UPMIFA legislation in the states where you operate at www.upmifa.org.

PROVISIONS OF THE FEDERAL ACT

UPMIFA approaches the management of endowment funds from many angles, including accounting, portfolio investment and spending. Its underlying thesis: The management of a nonprofit's financial assets is one of the most important obligations of a governing board. And boards must be prudent when placing assets into the highly complex, dynamic — and sometimes volatile — financial markets that have evolved in recent years.

The act has implications for everything from spending rates and financial statement presentation to interactions with creditors and donors. For example:

- * Portfolio managers are permitted to invest in a broad range of investments. Investment decisions should consider proper diversification.
- * The historic dollar value limitation on expenditures that was in the previous act has been eliminated.
- * Under a new, comprehensive *prudence standard* spending is now focused on the organization's purposes and needs rather than on the fund's purposes and perpetual nature.
- * Investment *expenses* must be managed prudently in relation to the assets, the purposes of the nonprofit and the investment skills available to the organization.
- * States may adopt an optional rule that presumes annual expenditures *exceeding 7% of fair market value of a fund* are imprudent.
- * A procedure exists for releasing restrictions on small institutional funds (less than \$25,000) if they were held for a long period of time (20 years), and the organization uses the property in a manner consistent with the charitable purposes expressed in the gift agreement. Notice must be given to the State Attorney General 60 days in advance of the release.

OPEN TO THE PUBLIC

Under FAS 117-1, you must disclose the following information about the management of your endowment funds on your financial statements:

- * Your governing board's interpretation of the law that underlies your organization's net asset classification of donor-restricted funds, such as the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA),
- * Your policy for the appropriation of endowment assets for expenditure (endowment spending policies),
- * Your endowment investment policies including:
 - ✓ Return objectives,
 - ✓ Risk parameters,
 - ✓ The relationship of return objectives and risk parameters to spending policies, and
 - ✓ Strategies employed to achieve objectives.
- * The composition of the net asset class at the end of the period, in total and by type of endowment fund, showing donor-restricted funds separately from board-designated funds, and
- * A reconciliation of beginning and ending balances of the endowment in total and by net asset class including:
 - ✓ Investment income,
 - ✓ Net appreciation or depreciation,
 - ✓ Contributions, and
 - ✓ Amounts allotted for expenditure changes and reclassifications.

UPMIFA applies to endowment funds held in any form, including nonprofit corporate form, except charitable trusts with a commercial or individual trustee.

IMPLEMENTATION VIA FAS 117-1

FAS 117-1, effective for fiscal years ending on or after Dec. 15, 2008, applies to all states, including those that haven't passed UPMIFA laws. Said FASB project manager Jeffrey Mechanick when the rule was released: "The adoption of UPMIFA has raised significant questions about the reporting of donor-restricted endowment funds. Organizations around the country now find themselves subject to increased public scrutiny on how they manage and use their endowments ..."

The pronouncement provides guidance on classifying the net assets of endowment funds and also requires additional disclosures about endowments (both donor-restricted funds and board-designated funds) for all organizations. (See "Open to the public" above.)

According to FAS 117-1, you should continue to classify a portion of a donor-restricted endowment fund as a permanently restricted net asset, as determined by your governing board's interpretation of relevant law. This is anticipated to generally be consistent with the historical dollar value previously reported, according to FASB. "Historic dollar value" is defined as the aggregate fair value in dollars of:

- * An endowment fund at the time it became an endowment fund,
- * Each subsequent donation to the fund at the time it is made, and
- * Each accumulation "made pursuant to a [provision] in the applicable gift instrument at the time the accumulation is added to the fund."

FAS 117-1 also states that organizations should continue to account for "underwater" funds as a reduction of unrestricted or temporarily restricted net assets (rather than as a reduction of permanently restricted net assets). Additionally, the portion of an endowment fund that is not classified as permanently restricted net assets should be classified as temporarily restricted net assets, even in the absence of purposeful restrictions.

MOVING FORWARD

UPMIFA and implementation regs like FAS 117-1 are expected to change the pronouncement of care required of nonprofits that manage endowments. And with greater scrutiny of the organizations that manage these funds, increased public confidence should follow. Evaluation of the impact of FAS 117-1 and UPMIFA on your nonprofit — and of implementing these requirements — is essential. Contact your professional advisors if you haven't done so already. *

6 ways to make the new Form 990 less taxing

Are you ready to fill out the new IRS Form 990 for 2008 — all 11 pages of it? Do you know which of 16 possible schedules that go with it apply to you? Must you use the new form or is Form 990-EZ acceptable?

UNDERSTANDING IS ELEMENTARY

It's important to understand what's required on the new form so that you can generate the additional information required. Here are six ways to get in the zone to fill it out properly:

1. Determine if Form 990-EZ is an option. Revenue Procedure 2008-13 significantly raises the filing thresholds that allow filing this simpler form. For the 2008 tax year, nonprofits with gross receipts of less than \$1 million and total assets under \$2.5 million may use the 990-EZ form. To determine gross receipts for this threshold, an organization also must include proceeds from the sale of assets such as securities, gross special event revenue before deducting expenses and gross sales of inventory before deducting the cost of goods sold. Even if you fit the bill, the shortened form doesn't get you off the hook completely; you're still required to fill out many of the 16 companion schedules that will likely apply to you.

If you do all your homework and take the necessary steps, your nonprofit can produce a completed Form 990 that speaks well of your organization.

2. Develop the required reporting systems. First, review the form and schedules to pinpoint the new information that needs to be reported. A copy of the new form, the supporting schedules and background information on the changes can be found on the IRS Web site at <http://www.irs.gov/charities/index.html>. Next, determine whether that information currently exists in your various databases or if modifications must be made to capture it. Be aware that different time



frames may enter the picture. For example, even if you operate on a fiscal year, compensation data must be reported on a calendar-year basis.

3. Determine which policies and procedures your organization may need to modify or implement. The new Form 990 has an increased focus on governance and other management policies. If you aren't eligible to complete the simplified Form 990-EZ, review Part VI — "Governance, Management and Disclosure" — of the core 990 form and determine if any policies or procedures need to be changed or implemented before the end of your fiscal year. This will enable your organization to respond appropriately to these new questions.

4. Put on the hats of the funders, donors and media. Form 990 and any needed schedules need to be filled out accurately and truthfully. That said, make sure that you give complete thought to the information included in your return, including your explanations. Remember, a lot is at stake. Funders, donors and everyone else in your community will be able to view the form on places like GuideStar and Network for Good and will be making decisions about you accordingly. If your responses seem

out of line with those of other nonprofits, you could not only risk losing donations and funding, but also receive a request from the IRS for more information.

5. Educate your board. You need to explain the new process — remember, it's more than just a form — and what is required of your organization's board. They need that information to decide if they want to develop any new policies or procedures that relate to the form.

6. Get help from tax and accounting advisors. Use your advisors as a resource to provide materials and guidance on acceptable answers. Estimates



are acceptable as answers to certain questions. "Please explain" may not require more than one paragraph, and a "No" answer is not necessarily wrong but may require elaboration.

MAKING IT A JOB WELL DONE

If you do all your homework and take the necessary steps, your nonprofit can produce a completed Form 990 that speaks well of your organization. And the public's access to more information about you could pay off in terms of what donors, funders and your community think of you. *

New 403(b) plan requirements kick in

If you're offering a 403(b) plan to your employees, you'll have more responsibility for plan years that start on or after Jan. 1, 2009.

PUT IT IN WRITING

IRS Revenue Procedure 2007-71 requires that 403(b) plan sponsors provide a written plan document for participants. It should outline the responsibilities of the plan's sponsor, annuity contract issuers and anyone else involved with the plan.

Eligibility rules as well as distribution and loan requirements must be listed in the plan document. And various benefits, such as employer funding, must be explained.

Under the new rules — the first since 1964 — the employer may be held responsible for monitoring excess contributions, eligibility, loan repayment and documentation for hardship withdrawals. These are areas where the agency has said it has found common errors in plan operations. The IRS has published a checklist for 403(b) plans at <http://www.irs.gov/pub/irs-tege/pub4546.pdf> that incorporates the new requirements.



LARGE PLANS NOW SUBJECT TO AUDITS

Under U.S. Department of Labor (DOL) regulations issued in November 2007 amending the filing requirements for Form 5500, "Annual Return/Report of Employee Benefit Plan," ERISA-covered 403(b) plans with 100 or more participants generally will be required to file audited financial statements beginning with their 2009 Form 5500 filing.

Those that have 403(b) plans with fewer than 100 participants may be eligible to use abbreviated reporting forms without audited financial statements. The DOL estimates that approximately 7,000 403(b) plans will be subject to the new audit requirements and another 9,000 403(b) plans may be eligible to use abbreviated reporting forms.

ALLOW ACROSS-THE-BOARD CONTRIBUTIONS

Under the new rules, almost all of a participating non-profit's employees must be allowed to make salary deferral contributions. And employees must be notified of their "effective opportunity" to make or change their elective salary deferrals, as well as the conditions required to make them.

One exception to inclusion is an employee who normally works less than 20 hours per week. This creates problems for some school districts, since many exclude substitute teachers from retirement plans. If substitutes work 20 hours or more per week, their exclusion from a plan would violate the "universal availability" requirement that ensures the plan is available to a variety of employees. So it's important to include substitute teachers if they meet the hours requirement.

Bus drivers also are often excluded from 403(b) plans, even though they may work 20 hours or more per week. Again, it will be important to consider the hours these employees work — and not merely exclude them based on their job status.

Rev. Proc. 2007-71 also creates stricter rules about the transfer of 403(b) account assets from one annuity product to another, limiting the participants' selection of annuity products and giving plan sponsors more control. Previously, participants could pick and choose where to invest their contracts. Now sponsors may limit the number of providers.

NOTE EXCEPTIONS TO THE RULE

One notable exception to the deadline is for 403(b)s that are part of collective bargaining agreements in effect on July 26, 2007. For these plans, the regulations don't apply until the earlier of:

- * The date the collective bargaining agreement terminates, or
- * July 26, 2010.

Another exception involves church-related organizations whose church convention holds the authority to amend the plan. In these cases, the regulations apply to plan years starting Jan. 1, 2010 and later.

WORK TOWARD COMPLIANCE

The IRS is expected to monitor for compliance more heavily than in the past. For example, the agency has launched a compliance project to examine school districts' adherence to the universal availability rule. A school district targeted by the IRS for the project could have a costly surprise if the agency were to impose sanctions. School districts and other nonprofits with 403(b) plans should consult with their professional advisors about compliance concerns. *



Newsbits

DON'T GET LOST IN TRANSLATION

For many nonprofits, marketing to ethnic groups in the community is important. Ethnic audiences may benefit from your services or be natural tie-ins to your organization's mission. The problem can be reaching them — they may not be proficient in English.

Finding a translator is the obvious answer, but certain factors should be considered, whether you seek out an individual or a professional language company for help.

Above all else, don't underestimate the complexity of the project, says Robert E. McLean of the Association of Language Companies. For example, idioms and other expressions — even something as important as your organization's motto, if you have one — could be lost in translation. Also, think of the details involved. For instance, the material eventually will need to be proofed, down to every accent mark, umlaut or other characters not used in English.



Besides finding a company or individual with knowledge of the language you require, look for those experienced with the types of documents you need. After all, translating a radio show script into Hindi takes a different skill set than translating poster advertising into Polish.

Finally, examine how companies charge for their work. Is it by the word or the page? Some vendors might discount for volume. So if you're translating pages of Web site text into Spanish, you might consider translating all of your print brochures at the same time. *

IRS SCRAPS ADVANCE RULING PROCESS

New IRS regulations eliminate the advance ruling process for a Section 501(c)(3) organization. Under the regulations, issued Sept. 9, 2008, the IRS now automatically classifies a new 501(c)(3) organization as a public charity for its first five years if it can show that it can reasonably expect to be publicly supported.

Previously, an organization that wanted to be recognized by the IRS as a publicly supported charity instead of a private foundation had to go through an extended two-step process. First, the organization had to declare that it expected to be publicly supported on an ongoing basis. Then, after five years, it had to file Form 8734, "Support Schedule for Advance Ruling Period," showing that it actually met the public support test. If not, it was designated a tax-exempt private foundation and would be subject to stricter rules.



The new rules no longer require the organization to file Form 8734 after five tax years. The IRS now will monitor the organization's public charity status using the public support information it reports annually on Schedule A of its Form 990. Its public support test is based on a five-year computation period that consists of the current year and the four years that immediately precede it.

The new rules won't affect a nonprofit's tax-exempt status — only its classification as a public charity or private foundation. If the charity fails the public support test, it will be classified as a private foundation. Private foundations pay excise taxes on their net investment income, have required minimum distributions based on the average fair market value of their assets, and could be slapped with severe penalties for failing to make their required minimum distributions. *

