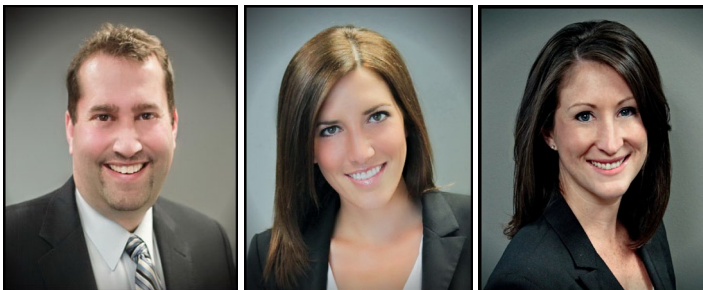




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## YH ADVISORS IS PROUD TO PUBLISH AND DISTRIBUTE THE YH EXEMPT ORG ADVISOR A QUARTERLY PUBLICATION FOCUSED EXCLUSIVELY ON THE TAX, LEGAL AND ACCOUNTING ISSUES OF ALL DIFFERENT TYPES OF EXEMPT ORGANIZATIONS.



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**YH Advisors, located in Huntington Beach, California, is solely focused on addressing the tax, legal and accounting needs and issues of exempt organizations.** The firm's Partners, Brian Yacker and Lauren Haverlock, have cumulatively consulted with exempt organizations for over 30 years.

The YH Exempt Org Advisor is electronically available on a complimentary basis to anyone who is included in our e-mail database. If you happen to be forwarded a copy of this publication and would like to receive future copies, please contact us with your e-mail address at [info@yhadvisors.com](mailto:info@yhadvisors.com).

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## Ripped from the EO Headlines

Being that there has been so much written and spoken and blogged and tweeted regarding the recent Internal Revenue Service §501(c)(4) “scandal,” we decided herein to focus on some of the other exempt organization news and developments that have taken place across the United States in the past couple of months.

### new york eo executive compensation caps

In a previous issue of the YH Exempt Org Advisor, we reported on the pending law in the state of New York, to take effect on July 1, 2013, which will limit the compensation of executives at certain charitable organizations based in New York to \$199,000 per year. To the best of our knowledge, no other state currently imposes compensation caps on the executives of exempt organizations.

According to the New York World Record, tax-exempt hospitals based in New York, which pay some of the highest executive salaries among exempt organizations in New York, will be exempt from the compensation caps being imposed in New York come July 1. Surely, that is welcome relief to some New York hospital executives whose total annual compensation packages (which includes salaries and benefits) exceed \$3 million.

### bad apple professional fundraiser

Also from the Empire State, it was recently disclosed that the New York Attorney General had shut down a professional fundraiser (essentially, a telemarketer) by the name of Campaign Center, Inc. because they had engaged in “fundraising” for breast cancer research by keeping 85% of all funds raised through their telemarketing efforts and only remitting the remainder for charitable endeavors.

According to the New York Daily News, Campaign Center, Inc. told donors that contributions to the Coalition Against Breast Cancer (whom they stated they were fundraising on behalf of) would help eradicate breast cancer

through research, mammogram screening and other programs. But the firm, which made 6,000 calls per day on behalf of the charity, kept 85 cents of every dollar it raised. Of the \$10 million raised between 2005 and 2011, only \$48,000 went toward the cause, paying for 40 women to get mammograms.

The moral of this story is that if a charitable organization is going to engage a professional fundraiser, especially a telemarketer, it is essential that the charity completely vet the professional fundraiser to ensure they are honest, up-standing and legitimate. Additionally, the charity should ensure that the professional fundraiser is registered with the state that they are operating in and that there is a written contract detailing exactly how much the professional fundraiser will be compensated.

### a level playing field?

As reported in the Topeka Capital-Journal, the owner of a series of Kansas for-profit fitness clubs invested \$45,000 in the campaigns of Kansas Senators to build support for a property tax exemption for private health facilities statewide. The owner, Rodney Steven, is a vocal critic of public funding of nonprofit YMCA and YWCA operations, and accordingly, he poured money into the campaigns of Republicans during the past two years to build support in the Kansas Legislature for tax breaks applicable to for-profit health clubs. In testimony to a Kansas Senate Committee, Mr. Steven noted that the big competitor of for-profit health clubs are tax-exempt facilities and that it is time to treat all health clubs the same. The Kansas Senate is now considering a bill which would provide property tax exemptions to for-profit health clubs in Kansas.

From the outside looking in, it appears that Kansas might find themselves on a very slippery slope if this bill is passed since there are many other instances, other than in the health club industry, of direct competition between taxable and tax-exempt entities.

Please do not hesitate to contact Brian Yacker at 310-982-2803 or at [byacker@yhadvisors.com](mailto:byacker@yhadvisors.com) if you have any questions regarding the foregoing or if you need any additional information whatsoever regarding the exempt organization tax, legal and accounting services which YH Advisors provides.

## Focus on the IRS TE/GE Division

### release of the college/university study results

In late April, before the great majority of the country had ever heard of what a §501(c)(4) organization was, the Internal Revenue Service released the results of the College and University Study which they had begun in 2008. In total, the Internal Revenue Service issued 400 questionnaires to colleges and universities located throughout the United States. Of those 400 questionnaires issued, 34 of them developed into Internal Revenue Service examinations.

Not surprisingly, the two areas where the Internal Revenue Service noticed the most non-compliance amongst the colleges and universities studied were in the executive compensation area and the unrelated business income area.

Specifically, regarding executive compensation, the Internal Revenue Service noted a good number of inadequacies related to the required reasonable compensation documentation. For example, many of the colleges and universities did not document why they considered entities to be similarly situated entities nor did they report an executive's total compensation package as required.

In the unrelated business income area, the Internal Revenue Service noted that, during their examinations, they increased the unrelated business income calculation for 90% of the colleges and universities audited. Additionally, the Internal Revenue Service disallowed \$170 million of net operating losses which were utilized to offset unrelated business income, with the biggest identified issue being the allocation of indirect expenses.

### irs self declarers questionnaire

Before the whole §501(c)(4) organization controversy had become public knowledge, the Internal Revenue Service issued an online Self-Declarers Questionnaire ("Questionnaire") to approximately 1,300 exempt organizations not considered to be charitable organizations. This Questionnaire was issued primarily as a result of the fact that non-charitable organizations are not required to file a Tax Exemption Application with the Internal Revenue Service in order to be considered tax-exempt (that is why non-

charitable exempt organizations are referred to as "self-declarers").

The Internal Revenue Service set forth that the Questionnaire is part of the IRS TE/GE division's ongoing efforts to increase voluntary compliance by studying organizations that have not applied to the IRS for recognition of exemption, but are claiming tax exemption under section 501(c)(4), (5) or (6) of the Internal Revenue Code and have filed Form 990 for either the 2010 and/or the 2011 tax year. The Internal Revenue Service further positing that responses to this Questionnaire will help them learn more about such self-declared 501(c)(4), (5) and (6) organizations and determine whether they are complying with all the applicable tax-exempt laws and regulations.

The Internal Revenue Service stated that completion of the Questionnaire by the self-declarers is optional, but certainly encouraged. We had a number of clients that received this Questionnaire, and from our perspective, we advised them that completion of the Questionnaire was "mandatory" since we did not want to increase the risk of IRS scrutiny (e.g. an audit) for the Questionnaire recipient that decided not to complete the Questionnaire. This is because the Questionnaire is part of a voluntary compliance check (and our experience has been that an ignored compliance check invariably leads to a full-scale examination).

### irs dirty dozen tax scams (2013)

As they do each and every year, the Internal Revenue Service has released their Dirty Dozen Tax Scams for the 2013 tax year. Of relevance in the exempt organization sector is the following Tax Scam which appeared on the list:

#### **Impersonation of Charitable Organizations**

Following major disasters, it's common for scam artists to impersonate charities to get money or private information from well-intentioned taxpayers. Some scammers operating bogus charities may contact people by telephone or email to solicit money or financial information. They may even directly contact disaster victims and claim to be working for or on behalf of the IRS to help the victims file casualty loss claims and get tax refunds.

Please do not hesitate to contact Brian Yacker at 310-982-2803 or at [byacker@yhadvisors.com](mailto:byacker@yhadvisors.com) if you have any questions regarding recent IRS activities in the exempt organization sector.

## Auto Revocation Scoreboard

<b>DATE</b>	March 2013
<b>REVOKED EO'S</b>	498,041
<b>ESTIMATED REINSTATED EO'S</b>	35,000

Even before the whole §501(c)(4) controversy broke, the (now infamous) Determinations Unit of the Internal Revenue Service was backed up as a result of the flood of small exempt organization Tax Exemption Applications seeking retroactive reinstatement which they received before the close of 2012.

## YH Case Study

### reporting new exempt purpose activities

One of our exempt organization clients is a religious organization not considered to be a church. They recently informed us that they were seriously considering acting as a fiscal sponsor in addition to conducting their religious operations. This organization had only undertaken religious operations since their formation in the early 2000's; all such operations conducted to date were specifically referenced in the organization's Tax Exemption Application originally filed with the Internal Revenue Service. Predictably, the organization's Tax Exemption Application did not reference the fiscal sponsor operations at all.

In situations when an exempt organization desires to conduct an exempt purpose activity which is not specifically referenced in the organization's Tax Exemption Application, there is a requirement to disclose such to the Internal Revenue Service on the Form 990 which the organization files for the year in which the new exempt purpose activity is first being conducted. Specifically, the exempt organization would respond affirmatively to Part III, Line 2 of the Form 990 and provide a detailed narrative on Schedule O of the Form 990 setting forth all of the relevant aspects of the new exempt purpose activity when such was first conducted during the past year.

In those situations where we discover a "new" exempt purpose activity that was initiated in a previous tax year, but never disclosed to the Internal Revenue Service on the Form 990, we will respond affirmatively to Part III, Line 2 on the current year's Form 990 and provide a narrative on Schedule O explaining that the "new" activity was started in a previous year and that such activity is still being conducted by the exempt organization. We do this under a "better late than never" philosophy in order to demonstrate "clean hands" to the Internal Revenue Service. Additionally, by disclosing the "new" exempt purpose activity, even if considered to be "late", this has the purpose of starting the statute of limitations for the Internal Revenue Service to claim that the activity is not considered to be a related activity.

Please do not hesitate to contact Brian Yacker at 310-982-2803 or at [byacker@yhadvisors.com](mailto:byacker@yhadvisors.com) if you have any questions regarding the reporting of new exempt purpose activities on the Form 990.

## YH Quick Tips

### calculating unrelated business income

As detailed above, one of the conclusions of the Internal Revenue Service's College and University Study was that many entities were under-reporting their unrelated business income tax. Since this is an area of intense focus by the Internal Revenue Service, we have decided to provide the following Quick Tips related to UBI.

- Similar to most areas of the tax law, contemporaneous documentation is paramount in the UBI area, especially when deducting expenses on the Form 990-T.
- If the exempt organization is receiving a K-1 from a partnership, make sure to examine the entire K-1 for any potential UBI to be reported.
- If the exempt organization is receiving a K-1 from an S-Corp, make sure to report ALL income reported on such K-1 as UBI.
- If the exempt organization is receiving a federal K-1 from either a partnership or an S-Corp, it is likely that

CONTINUED ON PAGE 5

the exempt organization will have to recognize UBI in a state(s) other than their state of residence.

- Consider allocating and deducting some portion of indirect expenses against gross unrelated business revenue if the exempt organization utilizes a reasonable allocation methodology to do so.

## accounting for net assets

While calculating the net assets for an exempt organization in and of itself may be simple (assets less liabilities), what makes tracking an exempt organization's net assets somewhat difficult is that they must be grouped into one of three separate categories according to FASB Statement No. 117:

- Unrestricted Net Assets
- Temporarily Restricted Net Assets
- Permanently Restricted Net Assets

Further complicating this accounting is that the exempt organization must be able to identify the assets and liabilities associated with each category of net assets. In order to properly do so, an exempt organization should document their methodology and procedures for tracking restrictions on net assets as well as when those restrictions are satisfied. Tracking restrictions on net assets can be done via fund accounting, subsidiary ledgers, or project accounting systems.

Please find following some quick tips to assist an exempt organization in setting up procedures of this nature:

- Only donors can impose restrictions, whether temporary or permanent. Board of Directors or other Committee designations are not donor restrictions and net assets relating to such designations should remain unrestricted.
- Temporary restrictions result from donor imposed stipulations that expire over the passage of time or upon use of the resources for the specified purpose of the contribution.
- Permanently restricted net assets are just that. Net assets that a donor has instructed an exempt organization to maintain in perpetuity. The most common form of permanently restricted net assets is an

endowment - cash or securities to be invested by the exempt organization. Income from such is typically considered either temporarily restricted or unrestricted, depending on the terms set forth by the donor.

- Net assets considered unrestricted are those that have not been temporarily or permanently restricted by a donor.

Please do not hesitate to contact Stacey Bergman at (310) 982-2805 or [sbergman@yhadvisors.com](mailto:sbergman@yhadvisors.com) if you have any questions regarding the foregoing or if you need any additional information whatsoever regarding the exempt organization accounting services which YH Advisors provides.

## YH Plain English Glossary

### §501(c)(4)

In its truest form, a §501(c)(4) organization should look and feel like a §501(c)(3) organization in that it should primarily be engaged in activities which are charitable in nature. The main difference between the two types of organizations is that the charitable services of a §501(c)(4) are generally provided to a limited group of people as opposed to the broad general public which a §501(c)(3) organization provides services to. Examples of §501(c)(4) organizations are Kiwanis, Rotary, AARP and a homeowner's association.

From a practical perspective, a §501(c)(4) organization differs from a §501(c)(3) organization in the following regards:

- Contributions made to a §501(c)(4) organization are not deductible by the donor.
- A §501(c)(4) organization does not need to apply for tax-exemption with the Internal Revenue Service (please see above regarding self-declarers).
- A §501(c)(4) organization is not as limited as a §501(c)(3) organization in their conducting of lobbying and/or political activities.
- A §501(c)(4) organization does not need to complete Schedule B of the Form 990 to disclose the identities of their contributors.



# The EO Accounting Spotlight

## fraud and the tax exempt organization

Fraud within an exempt organization will never be 100% preventable. But understanding the characteristics and typical signs associated with fraudulent behavior can help mitigate some of the risks for the exempt organization, specifically a smaller exempt organization where complete segregation of duties may not be feasible.

The most common type of fraud present within an exempt organization is the misappropriation of assets. Not surprisingly, the most common asset to be misused or stolen is, of course, cash. Perpetrators will generally start stealing small, seemingly unnoticeable amounts, and should those acts go undetected, increased levels of courage may result in attempts at pilfering larger sums. These attempts may be as blatant as larceny (physically removing assets from the exempt organization's property), or as subtle as skimming (pocketing cash from a transaction before it is ever recorded on the exempt organization's books). However, in our experience, the most common form of misappropriation of an exempt organization's assets deals with fraudulent disbursements.

So how can management and the governing body of an exempt organization lessen the likelihood of fraud occurring within their organization? By knowing the signs, keeping assets secure and regularly reviewing the financial statements of the organization.

For a fraudulent act to be committed, three attributes must typically be present: incentive or pressure to commit fraud, a perceived opportunity to do so and some rationalization of the act. Many employees on the verge of committing a fraudulent act may feel disconnected from the exempt organization or feel that they are "owed" something for their efforts. Creating a culture within the exempt organization that encourages accountability and openness with employees will allow management to better know who is working for them and may create opportunities to grant employee praise or reward. In doing so, this creates the feeling of a "team" environment where all employees feel that they are contributing to the common goal.

In addition, this openness will allow management to see when changes in an employee's behavior occur. Perhaps the employee is suddenly reluctant to take time off, may want to work additional hours when no one else is around, or recently is observed gallivanting off on exotic vacations that previously wouldn't have been conceivable. Whatever the signs may be, being able to recognize and address them early will give the organization the best chance of minimizing fraudulent activity.

Keeping assets secured seems like such a straightforward proposition, yet so many exempt organizations don't take this simple step. Petty cash is likely the first asset which is thought of in terms of a physical asset that should be secured. Additional items to consider are credit or debit cards, blank checks, parking validations and signature stamps. By limiting access to only those with legitimate need, the chances of these assets being misused are lessened.

Finally, and probably the most effective means by which an exempt organization can detect fraud in its early stages, is having more than one set of eyes on the finances of the exempt organization. This means regular management and Board review of the periodic internal financial statements and even the underlying books and records. As an Executive Director, COO or Board member, it is fine if you do not fully understand the debits and credits supporting the financial statements. Ask questions. Inquire as to why a specific item is being reported on the financials; why something was recorded a certain way; and what is the nature of a particular transaction. This process of inquiry will not only allow the executives to better understand the exempt organization's financial statements, it will also "inform" the staff of the exempt organization that management is watching their actions.

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## The YH EO Resource Alert

In this resource alert, we are highlighting IRS Publication 4386 which provides very valuable guidance regarding compliance checks which are undertaken by the Internal Revenue Service. In the exempt organization area, we see the Internal Revenue Service conducting a good many compliance checks. Please see supra for an example of a compliance check currently being conducted by the Internal Revenue Service in the exempt organization areas.

IRS Publication 4386 can be downloaded from the Forms and Publications section of the IRS' web site.

## YH EO Conference

YH Advisors is excited to announce the launch of our two-day comprehensive exempt organization educational conference titled, "YH EO University". More information will be forthcoming, but in the meantime, please save the date for one of the following locations:

July 18 - 19 | Santa Monica, California

October 17 - 18 | San Francisco, California

The conference will provide at least 16 units of continuing education credits and will offer an in-depth look at exempt organization tax and legal issues faced by all types of exempt organizations. Topics discussed will include the following:

- Non-charitable exempt entities, including social welfare entities, labor unions, business leagues, social clubs, and title holding entities
- Unrelated business income
- Indirect taxes (sales, use and property taxes) imposed on EOs
- Most prominent EO "red-flag" issues
- Comprehensive Form 990 & Form 990-PF Case Studies
- Lobbying and political activities

Space is limited! If you would like more information on the two-day conference or would like to sign up, please email [info@yhadvisors.com](mailto:info@yhadvisors.com) or call 310-982-2806 for more information.

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## Upcoming Webinars

YH Advisors will continue to periodically conduct (about once every 2.5 months) 100-minute interactive technical webinars focusing on the tax, legal and accounting issues most relevant to exempt organizations. Because of the upcoming YH Exempt Org University course, our next webinar will not be conducted until September, 2013. As with all the webinars conducted by YH Advisors, 2 hours of CPE credit will be available to all registered attendees.

## YH Presentations

Please find following a listing of the various presentations which YH Advisors has presented, or will be presenting, during the June 2013 through August 2013 time period.

June 13, 2013	Form 990 Introductory Course (CPA Firm) Orange County, CA
June 20-21, 2013	Form 990 Doctor's Report (AICPA) Washington DC
June 25, 2013	Form 990 Workshop (Comm. Fdn San Joaquin) Lodi, CA
July 18-19, 2013	YH Exempt Org University Santa Monica, CA
July 24, 2013	Form 990-PF Introductory Course (CalCPA) San Mateo, CA
Aug 13, 2013	Form 990 Introductory Course (CalCPA) San Mateo, CA

*The Summer 2013 edition of the YH Exempt Org Advisor will be published after the relatively busy August 15, 2013 exempt organization information tax return filing deadline.*