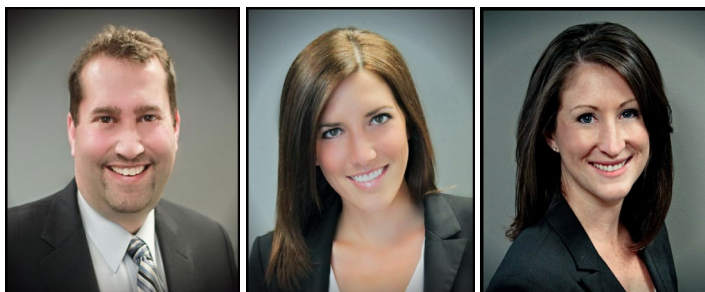




**YH ADVISORS**  
THE EXEMPT ORG EXPERTS

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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

### shining a brighter light on california charities

In late May of 2014, California AB2077 was introduced by California Assemblyman Travis Allen of Huntington Beach. AB2077 would permit the Department of Justice in California to access a fund of approximately \$7 million to exercise oversight and dispense discipline over charities gone wrong operating within the state of California. This fund of approximately \$7 million has been built up over the years as a result of the registration fees paid by California charities when they file their annual Form RRF-1 with the California Attorney General and by the registration fees paid by professional fundraisers operating within California. Not surprisingly, AB2077 was passed unanimously by the California Assembly and is now being considered by the California Senate.

Specifically, the \$7 million fund would be utilized to support positions to handle court actions against California charities, provide outreach to unregistered charities in California, review Forms RRF-1, review audited financial statements of charities and provide public education in California regarding the charitable sector.

### how low can it go - the §4940 net investment income tax

Notwithstanding the fact that, in our professional opinion, it will be quite a while before the private foundation net investment income tax rate, under Section 4940 of the Internal Revenue Code, will be altered in any way, please note the recent introduction of H.R. 4691. H.R. 4691 is a bill which proposes to modify the tax rate for the Section 4940 excise tax imposed on the net investment income of a private foundation.

Currently, pursuant to Section 4940(a) of the Internal Revenue Code, a private foundation (other than an exempt operating foundation) is subject to a two-percent excise tax on its net investment income. Net investment income

generally includes interest, dividends, rents, royalties (and income from similar sources), and capital gain net income, and is reduced by expenses incurred to earn this income. The two percent rate of tax is reduced to one percent in any year in which a private foundation exceeds the average historical level (measured over the previous five years) of its charitable distributions.

The proposal set forth in H.R. 4691 replaces the two rates of excise tax on a private foundation with a single rate of tax of one percent. Thus, under the proposal, a tax-exempt private foundation generally is subject to an excise tax of one percent on its net investment income. If enacted, this proposed net investment income tax rate reduction would be effective for taxable years beginning after the date of enactment.

### 46 months for theft

As reported in the Washington Post, a Maryland woman recently received a prison sentence of 46 months for stealing approximately \$5.1 million from a charitable organization. A former administrative assistant for a network of medical schools was sentenced to 46 months in prison for embezzling over \$5 million from the charitable organization. This woman pleaded guilty to serially stealing from the Association of American Medical Colleges from 2005 to 2013. According to court files, the woman created phony invoices with names that closely resembled those of legitimate vendors and directed the payments into bank accounts she controlled. The scheme fell apart when a bank notified the charitable organization of a suspicious transaction.

Please be aware that we will be conducting a webinar at the beginning of the new year (2015) regarding internal controls for exempt organizations

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

### streamlined form 1023-ez redux

In the Spring '14 issue of the YH Exempt Org Advisor, we referenced a proposal by the Internal Revenue Service to introduce a streamlined Tax Exemption Application, the Form 1023-EZ. On July 1, 2014, such proposal became a reality with the official implementation of the Form 1023-EZ. In theory, the introduction of the Form 1023-EZ will allow the IRS to speed the approval process for smaller applicants and free up resources to review applications from larger, more complex applicants while reducing the current Tax Exemption Application backlog (estimated to be over 50,000 applications).

Please find following the essentials regarding the preparation and filing of the Form 1023-EZ:

- The Form 1023-EZ is three pages long as opposed to the "regular" Form 1023 which is a minimum of twelve pages in length.
- Most would-be exempt organizations with annual gross receipts of \$50,000 or less and assets of \$250,000 or less will generally be eligible to file the Form 1023-EZ.
- Regarding the gross receipts test, an applicant will not be able to file the Form 1023-EZ if they expect their gross receipts to exceed \$50,000 for any of the first three years of their existence.
- The new 1023-EZ form must be filed online at [www.pay.gov](http://www.pay.gov), accompanied by a \$400 user fee.
- The Form 1023-EZ Instructions include an eligibility checklist that applicants must complete before filing the form.
- If an applicant's Tax Exemption Application (the "regular" Form 1023) hasn't yet been assigned to an IRS Determinations agent, and the applicant would have been eligible to file the Form 1023-EZ, the applicant can choose to file a Form 1023-EZ; however, such will be treated as a withdrawal of the original application; there will be no refund of the Form 1023 user fee;

and the date of the application will be treated as the date the applicant filed the Form 1023-EZ (applicants should thus accordingly think twice if they are up against the 27 month retroactive deadline).

- It was initially thought that the personal addresses of the applicant's Directors would be required to be reported on the Form 1023-EZ; however, the IRS has set forth that the organization's mailing address is sufficient.

For more information regarding the Form 1023-EZ, please see the Instructions to such and also IRS Rev. Proc. 2014-40.

### irs audits of churches

Before the Internal Revenue Service can undertake an audit of a church, pursuant to Section 7611 of the Internal Revenue Code, an appropriate high-level Treasury official must reasonably believe that the church may be carrying on an unrelated trade or business or may be otherwise engaged in activities subject to tax. This appropriate high-level Treasury official must document in writing the basis of their reasonable belief before the Internal Revenue Service can initiate a church tax inquiry.

Section 7611 defines an "appropriate high-level Treasury official" as "the Secretary of the Treasury or any delegate of the Secretary whose rank is no lower than that of a principal Internal Revenue Officer for an internal revenue region." In 2009, the Internal Revenue Service released Proposed Regulations under Section 7611 which changed "appropriate high-level Treasury official," for purposes of a church examination, from "appropriate Regional Commissioner" to "Director, Exempt Organizations."

It was recently brought to light that the IRS has recently processed several cases involving churches with the reasonable belief determination made by the Commissioner, TE/GE. In addition, the IRS stated that it has determined that, as of June 2014, 99 churches merit a high priority examination for possible violation of the political intervention prohibition. Accordingly, it appears that the IRS has decided that the Commissioner, TE/GE, (currently Sunita Lough) is an "appropriate high-level Treasury official" for purposes of a church examination.

## summary of recent eo plrs

**PLR 201430017** – This private letter ruling presents an excellent summary regarding the excess business holding rules as applicable to private foundations, including an analysis of what constitutes a “business enterprise”. The private foundation in this particular instance was deemed to have not violated the prohibition against excess business holdings set forth in §4943 of the Internal Revenue Code.

**PLR 201429029** – This private letter ruling addressed unrelated business income issues within a museum setting, particularly the issues related to the museum’s operation of a gift shop. The Internal Revenue Service concluded that the sale of merchandise in their museum gift shop contributed importantly to the furtherance of their exempt purposes, and as such, did not constitute the conducting of an unrelated business activity under §511 of the Internal Revenue Code.

**PLR 201426029** – The unrelated business income tax, from the perspective of a §501(c)(6) organization, was addressed by the Internal Revenue Service in this private letter ruling. Here, the Internal Revenue Service, citing Rev. Rul. 81-127, concluded that income received by the §501(c)(6) organization from the operating of a testing laboratory was not subject to the unrelated business income tax as a result of the fact that the operating of a testing laboratory was found to be a related function 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 recent IRS activities in the exempt organizations sector.

## Charitable Solicitation Registration Trends

Please find following some trends which we have noticed within the past couple of months in the state charitable solicitation registration area:

- Regarding contributions thresholds contained in a particular state’s charitable solicitation laws, most

states now take the position that total contributions, and not just contributions generated from residents of such particular state, should be considered to ascertain whether an applicable threshold has been exceeded.

- More states are now requiring initial registration and renewal submissions to be made electronically and not manually.
- More states are now posting registration documents on their web sites.
- More states are now becoming stricter regarding the necessity of filing an extension if the charitable organization does not have all required documents available by the particular state’s filing deadline.

## YH Case Study

### conversion from private foundation to public charity

Thus far in 2014, we have consulted with five of our clients who approached us with a desire to convert from a private foundation to a public charity. To their collective surprise, the conversion process is not a terribly complicated one, however, it is an elongated one. Notwithstanding the length of the process from beginning to end, since the benefits of converting from a private foundation to a public charity can be substantial, all five of the clients who approached us decided to initiate the conversion process.

The first step in the private foundation conversion process is to complete IRS Form 8940; such must be filed before the first day of the tax year when the private foundation wants to initiate the conversion process. The Form 8940 is relatively straight-forward to complete and there is a \$400 user fee payable to the United States Treasury. The information necessary to be included as part of the Form 8940 filing includes the type of public charity which the private foundation desires to convert to and the beginning date of the converting private foundation’s 60-month termination period.

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After such filing of the Form 8940, the converting private foundation must continue to file the Form 990-PF for the subsequent five years. That being said, the organization can be treated as a public charity from a donor's perspective for the full extent of the 60-month termination period. At the end of the five-year period, if the organization satisfies the applicable public support test, then the Internal Revenue Service will recognize them as a public charity.

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 private foundation conversion process.

## YH Quick Tips

### operational legal checklist

Please find following a "legal" checklist which can be utilized by exempt organizations, new and existing, small and large, to best ensure that they are adequately addressing all of their myriad legal requirements and obligations.

- Ensure that the organization possess the most updated copies of documents subject to public inspection:
  - Tax Exemption Application
  - Determination Letter
  - Form 990 for the past three years
  - Form 990-T for the past three years (if applicable)
- Ensure that the exempt organization's Bylaws have been recently updated
- Ensure that the exempt organization's Bylaws are actually being followed
- Ensure that the exempt organization is contemporaneously documenting all Board meetings and Board Committee meetings through the production of minutes
- Ensure that the exempt organization has implemented (and is following) these policies:
  - Conflict of interest policy

- Whistleblower policy
- Document retention and destruction policy
- Ensure that the exempt organization is in good standing with the Internal Revenue Service
  - Utilize IRS EO Select Check
- Ensure that the exempt organization is in good standing with their "home state" authorities
- Ensure that the exempt organization has adequately registered in all states where the exempt organization solicits contributions from
- Undertake a Reasonable Compensation Study when necessary
- Ensure the preparation of charitable contribution acknowledgements when necessary
- Maintain listing of all current and previous insiders of the exempt organization for the past five years

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## YH Timely Guidance

### foreign bank account reporting

We have a good number of exempt organization clients that are the owners and/or have signatory authority over a foreign bank account. That being said, we annually complete more than a few foreign bank account reporting forms. In the "olden days", that would mean filing the Form TD F 90-22.1 with Department of the Treasury in Detroit by June 30th of each year. However, the landscape has changed, the Form TD F 90-22.1 is no longer relevant and now the filing of a FinCEN 114 needs to be considered by exempt organization holders of foreign bank accounts.

Please find following a summary of the important aspects regarding the filing of the FinCEN 114:

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- The FinCEN 114 is required to be filed by any exempt organizations with a financial interest in, or signature authority over, a foreign financial account (or accounts) with aggregate value of more than \$10,000 at any time during the calendar year.
- The FinCEN 114 must be filed by June 30th of each year, regardless of the tax year end of the exempt organization.
- There are no extensions granted for the filing of the FinCEN 114.
- The FinCEN 114 must be filed electronically.
- An exempt organization is deemed to possess a financial interest in a foreign bank account if they are the owner of record or holder of legal title in a foreign bank account.
- An exempt organization is deemed to possess signature authority over a foreign bank account if they have authority to control the disposition of the assets in the account by direct communication with the financial institution maintaining the account.
- The amounts reported on the FinCEN 114 are the maximum value of specified foreign assets, including financial accounts with foreign financial institutions and certain other foreign non-account investment assets.
- The penalties for failure to timely file the FinCEN 114 are up to \$10,000 for failure to disclose and an additional \$10,000 for each 30 days of non-filing after IRS notice of a failure to disclose, for a potential maximum penalty of \$60,000; criminal penalties may also apply.

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## YH EO Practical Accounting Guidance

### financial statement audits

A financial statement audit is an objective examination of an exempt organization's financial statements. At the conclusion of an audit, the auditor's present a report that expresses an opinion as to the conformity of the financial statements to GAAP (Generally Accepted Accounting Principles). Below is a brief list of tips that exempt organizations can utilize in an effort to make the daunting audit process smoother:

- Ensure that internal controls are not only documented, but are being followed on a contemporaneous and consistent basis throughout the year (not just when the auditor arrives).
- Maintain contemporaneous documentation for all accounting transactions.
- Prepare all "closing" journal entries (reclassification of net assets, depreciation, recording multi-year pledges, etc.) before sending the Trial Balance to the exempt organization's auditor.
- Reach out to your internal/external bookkeeper or CPA as needed.
- Once you have received the audit request list, make copies of all items being requested so that your original documents stay intact and properly filed.
- Be prepared to talk with the auditor about risks associated with the exempt organization and what mitigating controls have been implemented to reduce the risk of fraud or misreporting.

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 accounting or audit services that YH Advisors provides or if you need any additional information.

## YH EO Accounting Spotlight

### allocating functional expenses

In order to report expenses in their functional classifications - program, management and general and fundraising – a policy to allocate indirect costs is required. Some exempt organizations have formal indirect cost allocation methodologies which calculate the rate at which they charge particular costs to particular activities. However, before determining the methodology by which an exempt organization allocates indirect expenses, it is important to understand the distinction between direct and indirect costs.

Direct costs are those that can be attributed to a specific activity. Direct costs can include various types of expenses, everything from salary expense of a particular employee to supplies, and even subcontractor payments. Indirect expenses are those which cannot be directly attributed to a specific activity; these usually consist of rent, utilities and other general entity expenditures.

There is no specific GAAP guidance governing how an indirect cost allocation methodology should be formulated. Essentially, as long as the methodology is “reasonable” and followed consistently, there is a great variety of methods that can be utilized. Please keep in mind that exempt organizations that are required to report their financial statements for purposes of a grant or contract may have specific guidance they are required to follow as a result of the grant or contract.

The first step in determining an appropriate indirect cost allocation framework for an exempt organization is to identify which expenditures will be considered indirect costs. The next step is to choose a basis over which to allocate the indirect costs. Examples of such would be to perform a time study of the Executive Director or COO (or both). Using the time allocations of the top management and/or top financial individual as a basis for which to allocate indirect expenditures would be a reasonable approach. Additionally, if an exempt organization does not have any employees, an alternative approach would be to calculate the total direct versus

indirect expenditures and then use the resulting percentage of indirect to total expenses as the allocation factor.

These allocation methods will most likely result in very different allocation percentages. So what is the best approach? Unfortunately, there is no bright line, it simply comes down to determining what is representative of that specific exempt organization’s activities. While there is a great disparity in practice as to how indirect cost allocation plans work, an exempt organization must ultimately define its methodology and apply it consistently.

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## YH EO Resource Alert

This feature of the YH Exempt Org Advisor will highlight different exempt organization resources which are free of charge in the public domain.

This quarter we are highlighting an excellent and free resource from the Internal Revenue Service, the EO Update: e-News for Charities & Nonprofits. Such can be subscribed to by accessing the following link:

<http://www.irs.gov/Charities-&-Non-Profits/Subscribe-to-Exempt-Organization-Update>

The Internal Revenue Service sets forth that the EO Update provides e-mail updates about issues of tax policy, services and available information that impact exempt organizations, such as:

- news releases from the IRS related to exempt organizations;
- new forms, guidance and other publications;
- changes and additions to the IRS Charities and Nonprofits Website; and
- upcoming IRS training and outreach events.

## YH Presentations

Please find following a listing of the presentations which YH Advisors has presented, or will present, during the August 2014 – October 2014 time period. Please do not hesitate to contact us for more information if you have interest in receiving the presentation materials or attending any of the upcoming presentations

Aug 12, 2014	A Guided Tour of the Form 990 (HI CPA Society) Honolulu, HI
Aug 13, 2014	YH Exempt Org University (HI CPA Society) Honolulu, HI
Sept 9, 2014	Form 990-PF Tax Primer (AICPA) Birmingham, AL
Sept 11, 2014	Important §501(c)(6) Tax Considerations (CA State Bar) San Diego, CA
Sept 17, 2014	Form 990 Basics (CA Board of Equalization) La Habra, CA
Sept 17, 2014	Form 990-PF Tax Primer (AICPA) Tulsa, OK
Sept 18, 2014	Form 990: What You Need to Know (AICPA) Tulsa, OK
Sept 18, 2014	Form 990: What You Need to Know (CPE, Inc.) New York, NY
Oct 16, 2014	Nuts & Bolts of Exempt Organizations (NCCI) Webcast
Oct 16, 2014	QuickBooks for Exempt Organizations (NCCI) Webcast
Oct 17, 2014	Form 990-PF Tax Primer (AICPA) Chicago, IL
Oct 21, 2014	Form 990 v. GAAP Reporting (AICPA) Las Vegas, NV
Oct 22, 2014	The Unrelated Business Income Tax (AICPA) Las Vegas, NV
Oct 22, 2014	Conducting of Gaming Events (AICPA) Las Vegas, NV

## Upcoming Webinars

YH Advisors will continue to periodically conduct (about 8 times per year) 100-200 minute interactive technical webinars focusing on the tax, legal and accounting issues most relevant to exempt organizations. Please find following our upcoming YH Webinar schedule (please be aware that this is of course subject to change):

Oct 1, 2014	A Case Study Approach to the Unrelated Business Income Tax
Dec 2014	Charitable Gaming Events
Jan 2015	Internal Controls for Exempt Organizations
Feb 2015	Ripped from the EO Headlines

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The Fall 2014 edition of the YH Exempt Org Advisor will be published after the busy November 15, 2014 exempt organization information tax return filing deadline.

