

Financial/990 Reporting For Dummies

Learning How to Navigate the Ever Changing State/Federal/IRS Reporting Rules

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The Overhead Myth

- Letter to “the Donors of America”
Sent from:
 - Charity Navigator
 - GuideStar
 - BBB Wise Giving Alliance
- “Overhead” is a poor measure of a charity’s performance
(See attached letter)

THE **OVERHEAD** MYTH

To the Donors of America:

We write to correct a misconception about what matters when deciding which charity to support.

The percent of charity expenses that go to administrative and fundraising costs—commonly referred to as “overhead”—is a poor measure of a charity’s performance.

We ask you to pay attention to other factors of nonprofit performance: transparency, governance, leadership, and results. For years, each of our organizations has been working to increase the depth and breadth of the information we provide to donors in these areas so as to provide a much fuller picture of a charity’s performance.

That is not to say that overhead has no role in ensuring charity accountability. At the extremes the overhead ratio can offer insight: it can be a valid data point for rooting out fraud and poor financial management. In most cases, however, focusing on overhead without considering other critical dimensions of a charity’s financial and organizational performance does more damage than good.

In fact, many charities should spend more on overhead. Overhead costs include important investments charities make to improve their work: investments in training, planning, evaluation, and internal systems—as well as their efforts to raise money so they can operate their programs. These expenses allow a charity to sustain itself (the way a family has to pay the electric bill) or to improve itself (the way a family might invest in college tuition).

When we focus solely or predominantly on overhead, we can create what the *Stanford Social Innovation Review* has called “The Nonprofit Starvation Cycle.” We starve charities of the freedom they need to best serve the people and communities they are trying to serve.

If you don’t believe us—America’s three leading sources of information about charities, each used by millions of donors every year—see the back of this letter for research from other experts including Indiana University, the Urban Institute, the Bridgespan Group, and others that proves the point.

So when you are making your charitable giving decisions, please consider the whole picture. The people and communities served by charities don’t need low overhead, they need high performance.

Thank you,



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Research shows that the overhead ratio is imprecise and inaccurate:

37%

37 percent of nonprofit organizations with private contributions of \$50,000 or more reported no fundraising or special event costs on their 2000 Internal Revenue Service (IRS) Form 990

13%

Nearly 13 percent of operating public charities reported spending nothing for management and general expenses.
(The Nonprofit Overhead Cost Study)

75-85%

Further scrutiny found that 75 percent to 85 percent of these organizations were incorrectly reporting the costs associated with grants.

But still, Americans over-emphasize the number and prioritize it over demonstrated success:

62%

62% of all Americans believe the typical charity spends more than it should on overhead.
(Giving Evidence)

A 2001 survey found that OVER HALF OF ADULT AMERICANS FELT THAT NONPROFIT ORGANIZATIONS SHOULD HAVE OVERHEAD RATES OF 20 PERCENT OR LESS; NEARLY FOUR IN FIVE FELT THAT OVERHEAD SHOULD BE HELD AT LESS THAN 30 PERCENT. In fact, those surveyed ranked overhead ratio and financial transparency to be more important attributes in determining their willingness to give to an organization than the demonstrated success of the organization's programs.
(BBB Wise Giving Alliance)

The "Overhead Myth" persists despite evidence that investments in overhead facilitate better nonprofit performance:

"ORGANIZATIONS THAT BUILD

robust infrastructure—which includes sturdy information technology systems, financial systems, skills training, fundraising processes, and other essential overhead—are more likely to succeed than those that do not."

(The Nonprofit Starvation Cycle)

2,000

2006 CompassPoint Nonprofit Services study of nearly 2,000 nonprofit executives in eight metropolitan areas reveals that receiving general operating support played a major role in reducing burnout and stress among executive directors.

(Daring to Lead 2006: A National Study of Nonprofit Executive Leadership)

11.5% VS 10.8%

In 2011, the charities which GiveWell reviewed and recommended had higher overhead than the charities they review and didn't recommend, 11.5 percent versus 10.8 percent.

(Giving Evidence)

Underinvesting in overhead creates a range of negative outcomes which undermine quality and sustainability:

Description of Underinvestment	Consequences
<ul style="list-style-type: none"> Limited/no staff for administrative roles (e.g. finance, development, operations) 	<ul style="list-style-type: none"> Limited ability for organization to manage/monitor finance, development, etc.
<ul style="list-style-type: none"> Limited investment in staff training and development 	<ul style="list-style-type: none"> Increased turnover among staff, particularly those looking for ongoing professional development Limited ability to continually enhance skills of employees Difficulty building senior team from within
<ul style="list-style-type: none"> Inexperienced staff for administrative roles 	<ul style="list-style-type: none"> High turnover Poor work quality
<ul style="list-style-type: none"> Poor IT infrastructure 	<ul style="list-style-type: none"> System crashes, downtime Loss of data/information, limited information sharing
<ul style="list-style-type: none"> Poor donation management systems 	<ul style="list-style-type: none"> Inability to track donors and fundraising progress Limited ability to target fundraising
<ul style="list-style-type: none"> Poor performance management systems 	<ul style="list-style-type: none"> Limited ability to track beneficiary outcomes, particularly across sites Limited ability to easily generate reports for grantmakers

Source: Mark A. Hager, Thomas Pollak, Kennard Wing, and Patrick M. Rooney, "Getting What We Pay For: Low Overhead Limits Nonprofit Effectiveness," Nonprofit Overhead Cost Project of the Center on Nonprofits and Philanthropy at the Urban Institute and the Center on Philanthropy at Indiana University, August 2004; case study interviews.

Primary Sources:

The Nonprofit Starvation Cycle

Stanford Social Innovation Review, Fall 2009

Getting What We Pay For: Low Overhead Limits Nonprofit Effectiveness

Center on Nonprofits and Philanthropy, Urban Institute, Center on Philanthropy, Indiana University

What We Know About Overhead Costs in the Nonprofit Sector

Center on Nonprofits and Philanthropy, Urban Institute, Center on Philanthropy, Indiana University

Nonprofit Overhead Costs: Breaking the Vicious Cycle of Misleading Reporting, Unrealistic Expectations, and Pressure to Conform
The Bridgespan Group, April 2008

Where'd My Money Go?

Americans' Perceptions of the Financial Efficiency of Nonprofit Organizations
GreyMatter Research, 2008

Good Charities Spend More on Administration than Less Good Charities Spend
Giving Evidence, May 2013

Management and General Expenses: The Other Half of Overhead
The Nonprofit Quarterly, Spring 2003

The Worst Way to Judge a Charity
Los Angeles Times, April 2012

Ratio Discrimination in Charity Fundraising: The Inappropriate Use of Cost Ratios Has Harmful Side-Effects**
Voluntary Sector Review, March 2010 **Behind pay wall



Charity Navigator

How Do They Rate Charities?

Financial Health – Based on 7 performance metrics:

1. Program Expenses
2. Administrative Expenses
3. Fundraising Expenses
4. Fundraising Efficiency
5. Primary Revenue Growth
6. Program Expenses Growth
7. Working Capital Ratio

Functional Expense Ratios

Per Charity Navigator: Seven out of ten charities evaluated spend at least 75% of their budget on the programs and services they exist to provide, and nine out of ten spend at least 65%. Those spending less than a third of their budget on program expenses may not be living up to their missions.

Administrative Expenses					
Percent of total functional expenses spent on management/general (lower is better)					
Converted Score:	10	7.5	5	2.5	0
General:	0% - 15%	15% - 20%	20% - 25%	25% - 30%	> 30%
Food Banks, Food Pantries & Food Distribution	0% - 3%	3% - 5%	5% - 10%	10% - 15%	> 15%
Fundraising Organizations	0% - 7.5%	7.5% - 12.5%	12.5% - 20%	20% - 25%	> 25%
Community Foundations	0% - 10%	10% - 15%	15% - 20%	20% - 25%	> 25%
Museums	0% - 17.5%	17.5% - 25%	25% - 30%	30% - 45%	> 45%

* Source: Charity Navigator.org



Functional Expense Ratios

Fundraising Expenses

Percent of total functional expenses spent on fundraising (lower is better)

Converted Score:	10	7.5	5	2.5	0
General:	0% - 10%	10% - 15%	15% - 20%	20% - 25%	> 25%

* Source: *Charity Navigator.org*

Fundraising Efficiency

Fundraising Efficiency

Amount a charity spends to raise \$1 (lower is generally better)

Converted Score:	10	7.5	5	2.5	0
General:	\$0.00 - \$0.10	\$0.10 - \$0.20	\$0.20 - \$0.35	\$0.35 - \$1.00	> \$1.00
Food Banks, Food Pantries & Food Distribution	\$0.00 - \$0.03	\$0.03 - \$0.10	\$0.10 - \$0.15	\$0.15 - \$0.20	> \$0.20
Community Foundations	\$0.00 - \$0.03	\$0.03 - \$0.10	\$0.10 - \$0.15	\$0.15 - \$0.20	> \$0.20
Public Broadcasting and Media	\$0.00 - \$0.20	\$0.20 - \$0.30	\$0.30 - \$0.45	\$0.45 - \$1.00	> \$1.00

* Source: *Charity Navigator.org*

Charity Navigator

How Do They Rate Charities? - Continued

Accountability and Transparency

1. Accountability – evaluating fiduciary actions
2. Transparency – obligation/willingness to publish critical data

Data Sources

- Information from the IRS Form 990 (12 different items)
- A review of the organization's website (5 different items)



Charity Navigator – Cont.

Data culled from Form 990

Performance Metric

Deductions from Score

Less than 5 independent voting members of the board; or independent members do not constitute a voting majority

15 points

Material diversion of assets within the last two years, **without** a satisfactory explanation

15 points

Material diversion of assets within the last two years, **with** a satisfactory explanation

7 points

Audited financial statements **are not** prepared or reviewed by an independent accountant

15 points

Audited financial statements **are** prepared or reviewed by an independent accountant, but that accountant is not selected and overseen by an internal committee

7 points

Loans to or from officers or other interested parties

4 points

Organization does not keep board meeting minutes

4 points

Forms 990 not distributed to the board before filing

4 points



Charity Navigator – Cont.

Data culled from Form 990 – Cont.

<u>Performance Metric</u>	<u>Deductions from Score</u>
No Conflict of Interest policy	4 points
No Whistleblower policy	4 points
No Records Retention and Destruction policy	4 points
Does not properly report CEO compensation on Form 990	4 points
Does not have a process for reviewing and updating CEO compensation	4 points
Fails to report board members and compensation fully on the Form 990, or reports that board members are compensated for their participation	4 points

Charity Navigator – Cont.

A Review of the Charity’s Website

<u>Performance Metric</u>	<u>Deductions from Score</u>
Does not publish board members on website	4 points
Does not publish senior staff on website	3 points
Does not publish latest audited financial statements on website	4 points
Does not publish latest Form 990 on website	3 points
No donor privacy policy	4 points
Opt-out donor privacy policy	3 points

Summation of Accountability and Transparency Scores

We take the charity’s Accountability and Transparency total score and issue a star rating for its Accountability and Transparency based on this table:

Accountability and Transparency Rating:	★★★★	★★★	★★	★	0 Stars	Donor Advisory
Accountability and Transparency Score:	≥ 60	50-60	40-50	25-40	< 25	N/A



Charity Navigator – Cont.

What is in the Future?

Results Reporting – will utilize five rating elements:

1. Alignment of Mission, Solicitations and Resources
2. Results Logic and Measures
3. Validators
4. Constituent Voice
5. Published Evaluation Reports

Currently this data is reported on Charity Navigators website for informational purposes only. They do not intend to rate charities on this information until they have gathered data for every organization in their database. They expect this process to be complete in 2016 provided they are able to secure the needed funding and related resources to accomplish this.



Filing Compliance- What Form Should You file?

File Form 990 if:

- Gross Receipts of \$200,000 or more
- OR**
- Total Assets of \$500,000 or more at end of year

File Form 990EZ if:

- Gross Receipts less than \$200,000
- OR**
- Total Assets of less than \$500,000

File Form 990N if:

- Gross Receipts normally less than \$50,000
- Based on average 3 immediately preceding years, including year being filed.
- If in existence 1 year or less - \$75,000
- More than 1 year, less than 3 - \$60,000

Filing Compliance Cont.

Gross Receipts:

- Gross amounts from all sources during the year without reduction for any costs or expenses
- Does not include any receipts collected as an agent for another
- Gross sales may be reduced for returns and allowances

When to File:

- Due 15th day of the 5th month after end of year
- Form 8868- Extension of up to 6 months (no more than 3 months at a time allowed)
- There is not an extension for a 990-N

Penalties

- Failure to file penalties of \$20/day not to exceed \$10,000 or 5% of the gross receipts of the organization for the year
- For Organizations with annual gross receipts > \$1M, the amounts jump to \$100/day and \$50,000 maximum
- One of 5 permitted attachments to the 990 is a reasonable cause explanation for a delinquent return
- After 3 years of non-filing, IRS automatically revokes your exemption

5 Permitted Attachments

Schedule O is used to report information that requires additional explanation.

Only five other attachments are permitted.

1. Name Change amendment to organizing document required by item B in the 990 heading
2. List of subordinate organizations included in a group return, required by item H in the 990 heading
3. Articles or merger, dissolution, resolutions and plans of liquidation required by Schedule N
4. Reasonable cause explanation for a delinquent return
5. Copy of the most recent Audited financial statements of a hospital organization that files Schedule H

Using The 990 To Share Your Message

- Use public disclosure to your advantage
- Form 990, Part III- Offers the organization an opportunity to increase awareness about itself by using this section to fully describe its Mission and Program service accomplishments
- Make sure the individual in your organization charged with marketing and branding reads the descriptions in this section



IRS Hot Issues- Interested or Disqualified Persons

- Transactions with ***interested persons*** require disclosure on Schedule L
 - ***Interested Person*** – Any current or former officer, director, trustee, key employee and highest compensated employees
 - Also includes *disqualified persons*
- Part I – Excess Benefit Transactions
- Part II – Loans to/from Interested Persons
- Part III – Grants or Assistance benefitting interested persons
- Part IV – Business Transactions involving Interested persons

Excess Benefit Transactions

- Exists when the economic benefit provided (either directly or indirectly) by an applicable tax exempt organization to, or for the use of, a **disqualified person** exceeds the value of the consideration received.
 - **Disqualified person** – Anyone who was *at any time* during the 5 year period, (ending on the date of the EBT), in a position to exercise substantial influence over affairs of the organization. Also includes members of such person's family and any entity in which the person (or family) have more than a 35% interest.
- Section 4958 Excise taxes – DP-25% of excess benefit received. If not corrected within the prescribed period this goes up to 200%.
- Organization manager who participated in the EBT is subject to 10% of the excess benefit.

Executive Compensation

- Board members have fiduciary responsibility
- Obtain a rebuttable presumption of reasonableness
 - Annual review by an independent body
 - Comparable data should be used
 - There should be concurrent and adequate documentation of the board's consideration in the minutes.

Related Organizations

- Requires Disclosure on Schedule R
- For purposes of determining related organizations must look to control of the organization
- Transactions with related organizations must be disclosed on part V

Unrelated Business Income (UBI)

An activity is an unrelated trade or business if all of the following conditions exist [Reg. 1.513-1(a)-1(d)]:

1. Trade or Business

The organization is conducting a trade or business for the production of income from selling goods or performing services.

2. Regularly Carried On

The trade or business is regularly carried on.

3. Unrelated to Exempt Purpose

The activity is “not substantially related” to the carrying out of the organization's exempt purpose.

UBI Exceptions

Although an activity is generally taxable if all of these conditions are met, certain activities are statutorily excluded from taxation even if they meet all three criteria.

- Any activity in which substantially all of the work is performed by **unpaid volunteers**
- An activity carried on by a Section 501(c)(3) entity or by a governmental college or university, primarily for the **convenience** of its members, students, patients, officers, or employees.
- The sale of merchandise, substantially all of which has been received by the organization as a gift or contribution
- A qualified public entertainment activity, or certain convention/trade show activity, when conducted by a **qualifying organization**
- “Games of chance,” such as bingo, pull tabs, raffles, video games, poker, and lotteries. Typically the organization operates the games with unpaid volunteers

Five Things the Board Should Check before Filing Form 990:

1. Compensation of key executives - Is the amount about what you expected?
2. Statement of Program Service Accomplishments - Does this section convey the message you want to send to the public and the IRS?
3. If applicable, review transactions with “interested persons” on Schedule L and Transactions with related organizations on Schedule R - Any surprises?
4. Prepare a public disclosure copy which excludes list of substantial contributors from Schedule A and blank out donor names and addresses on Schedule B
5. Make sure the return is filed on time - Fines and penalties can be imposed

Thank You for Attending

Please feel free to contact us at:

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