Nonprofit Advisor
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Windes Nonprofit Advisor

The Windes Nonprofit Advisor is a periodic technical publication focusing on the tax, regulatory, and accounting issues that nonprofit organizations routinely confront.

The Windes Nonprofit Group possesses extensive experience in preparing and reviewing more than 150 Forms 990, 990-T, 990-PF, and state tax-exempt forms, in addition to having experience in the preparation and filing of both federal and state tax exemption applications for public charities, private foundations, and other exempt organizations. Furthermore, we can assist in providing valuable guidance (governance / reasonable compensation documentation / public support test / special events / lobbying / transactions with related parties) to nonprofit organizations.

The Windes Nonprofit Group prepares audited financial statements and ERISA audits for more than 85 nonprofit organizations. For retirement plans, Windes has experts on staff for 403(b) plan administration and compliance, including plan document issues, Form 5500 preparation and filing, non-discrimination testing and government compliance programs.

Our Nonprofit Group is composed of the following individuals who are dedicated to providing nonprofit organizations with high-level tax, regulatory and accounting consulting, tax compliance services, and financial statement audit and assurance services:

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Please do not hesitate to contact any member of the Windes Nonprofit Group toll free at **844.4WINDES** (844.494.6337) or via email at nonprofit@windes.com.

The Benefits of Developing (and Updating) Policies and Procedures for Nonprofits

Summer typically means time to enjoy activities like family vacations, beach trips, and backyard barbecues. However, for some people in the nonprofit accounting world, summer also means the closing out of the old fiscal year and preparing budgets for the upcoming fiscal year. Between the juggling of making year-end journal entries, getting prepared for the year-end audit, and preparing information for the tax return, we sometimes forget to take a step back and analyze how the year went and determine whether any operational changes would benefit the upcoming year. This would also be an ideal opportunity to review the organization's written policies and procedures.

While it is well known that written policies and procedures are key to an organization's continued success, surprisingly, some organizations have not even taken the first steps to establish such basic tools of operation. For those organizations with policies and procedures in place, failure to regularly review them could render them out of date and irrelevant for the current organizational structure. There are those who believe that for smaller organizations, the benefits of developing and maintaining policies and procedures do not justify the costs and time involved. Others have argued that nonprofit organizations are already strapped for resources and updating written policies and procedures would take up valuable resources that could be focused on fulfilling the organization's mission and goals.

In the long run, a well-written policies and procedure manual will provide guidance for everyone at the organization. They will provide the communication link between administrative, programmatic, and fund-raising staff so that there is no confusion on how things should be done. It will also provide some continuity in operations and minimize disruptions for new employees, as it provides guidance on how things are done at the organization. Periodic updating of the policies and procedures will help management and the board establish a strong foundation for successfully fulfilling the organization's mission and goals.

How does an organization determine exactly what policies and procedures should be documented? Every organization will need to assess its organizational structure and operations to determine the key risk areas that need to be addressed. In evaluating those risks, the organization should also make sure it understands its own operational limitations so that policies and procedures are tailored to, and understood, by all employees.

Regardless of the size of the organization, here are some key risk areas in which an organization should invest some time and effort in developing or updating policies and procedures:

Revenue and Support: Contributions are the lifeline of a nonprofit. Therefore, developing policies and procedures to safeguard those contributions is essential. The key in this area is making sure all contributions are properly deposited and recorded in the financial records. Periodic reconciliations between cash receipts, deposits, bank statements, and financial records would help mitigate losses and thefts. If possible, the ideal situation would be to have a different person handling the contributions, performing the reconciliation, and reviewing the bank statements.

Expense Disbursement: Organizations can quickly get into a financial hole if they are not watching where their cash is being spent. Authorization and approval is an essential control to help monitor overall spending. Designating key personnel with knowledge of budgets and operational constraints to review and approve expenditures would minimize any unauthorized cash outlays. Different key personnel can have different dollar threshold authority so that the approval responsibility is not restricted to one person. If credit cards are utilized, make sure employees understand the policies of what can and can not be purchased, as well as the procedures for recovery of any unauthorized purchases. Establishing policies and procedures over disbursements will help minimize fraud and loss as more of the funds are utilized towards the organization's goals and missions.

Conflict of Interest / Whistleblower: The number one source of uncovering fraud has been with employees informing the appropriate personnel of something they did not think was right. By establishing policies and procedures in this area, you would be promoting transparency and an avenue for employees to voice their suspicions. Just because it was reported does not mean it is true, so there need to be policies and procedures on how reported incidents are investigated and handled. The policies and procedures should also prevent any retaliation on any of the employees involved with the allegations. Employees tend to be vested and loyal to an organization if they feel they have contributed to the organization's success, and what better way to ensure the organization's success then by protecting it from fraud and losses?

IT / Cybersecurity: Today's society makes it almost impossible ignore the internet and social media outlets. Whether it be Facebook, Instagram, or whatever favorite social media you like to use, more and more organizations are using social media to promote themselves or their activities. Organizations are also utilizing smart phone/tablet applications to collect donations at fundraising events. All of these activities are a risk for the organization, as they create portals for fraudsters to gain unauthorized inside access to an organization. Policies and procedures in this area should focus on creating security protocols securing the organization's information, as well as defining who has access to that information. The policies and procedures should also promote awareness on how employees can help protect the organization, which includes watching for phony emails that are phishing for information or contain viruses that can damage your computer system. The news is constantly full of stories where an organization's computer systems are hacked and information is stolen. Whether the information is intellectual property, financial data, or private information, the loss can be devastating let alone the bad press that goes along with such incidents.

The bottom line is that no matter the size the organization, developing sensible written policies and procedures is essential for a nonprofit organization. They provide the foundation and guidance for management to execute their daily duties in fulfilling the nonprofit's goals and missions. Periodically reviewing and updating the policies and procedures will help keep the nonprofit relevant in the constantly changing world environment.

For questions or more information, please contact Tom Huey at thuey@windes.com or toll free at **844.4WINDES** (844.494.6337).

Tom Huey, CPA

Partner, Audit & Assurance Services

Elective Deferral Plans: 403(b) vs. 401(k)

Since 1997, nonprofit entities have been able to establish either a 403(b) plan or a 401(k) plan for their employees. There are distinct differences between these two types of plans that employers should consider before deciding which plan is best suited for their organization.

One distinct advantage 403(b) plans have over 401(k) programs is that employee salary deferral contributions are not subject to nondiscrimination testing. Section 401(k) plan salary deferrals must be tested on an annual basis to determine whether the contributions favored the highly paid employees, based on standards defined under the Internal Revenue Code (IRC). The Section 403(b) plan exemption from testing allows highly paid participants to make contributions during the year without concern that any of their salary deferrals will be returned to them due to failed nondiscrimination testing. This is an important consideration in many nonprofit organizations, where there may be a small number of highly paid employees that would have a negative impact on nondiscrimination testing in a Section 401(k) plan.

In exchange for being exempted from nondiscrimination testing, Section 403(b) plans must allow for "universal availability," which opens up the plan to practically all of the organization's employees. An important advantage of Section 401(k) plans is the ability to exclude certain classes of employees and to impose eligibility requirements on new employees. Nonprofits with high turnover or with a segment of employee populations they want to exclude from benefits would likely find more flexibility in a Section 401(k) arrangement.

Some Section 403(b) plans sponsored by a nonprofit organization can qualify for an exemption from the regulations and rules of the Employee Retirement Income Security Act (ERISA), including the annual Form 5500 filing requirements. Section 401(k) plans are not exempt from the regulations and rules of ERISA.

Another key differentiator between these plans is their funding vehicles and investment options. Section 403(b) plans are invested through variable annuity contracts or custodial accounts that invest in mutual funds, which have traditionally been serviced through large insurance companies. Section 401(k) plans are open to any type of investment vehicle, although they are predominantly invested in mutual funds. Section 401(k) plan funding vehicles range from individual brokerage accounts to annuity contracts to pooled investment accounts.

The chart on the next page summarizes the key differences between the two plans and is only a brief summary of the differences in these plans authorized by two distinct sections of the IRC.

For an analysis of the best program for your organization, please contact Richard Green at rgreen@windes.com or toll free at **844.4WINDES** (844.494.6337).

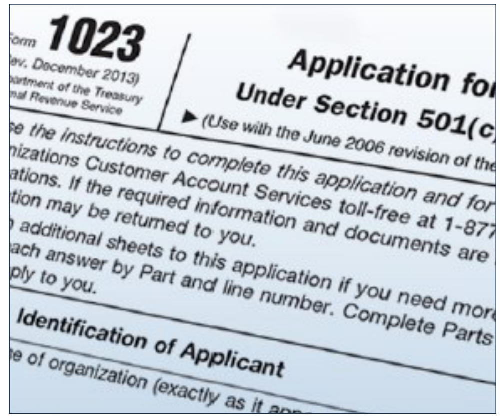
Richard Green, CPC, QPA, QKA, APA, ERPA

Partner, Employee Benefit Services

Comparison of 401(k) and 403(b) Plans

Feature	401(k) Plan	403(b) Plan
Eligible Employers	All non-governmental employers	501(c)(3) tax-exempt and public educational organizations
Eligible Employees	May impose age 21 and up to one year of service requirement. Can exclude non discriminatory classification of employees if plan meets coverage requirements	All employees must be eligible for elective deferrals, with limited exceptions. Can impose eligibility requirements on employer contributions
Employee Contribution Limits (2017)	$18,000 plus $6,000 catch up (age 50)	Same limit, with a special catch-up for 15 years of service with certain employers
Roth Contributions	Allowed	Allowed
Employer Contribution Limits (2017)	100% of compensation up to $54,000, including salary deferrals	Same
Non Discrimination Testing		
Employee Deferrals	ADP test	Not applicable
Employer Contributions	ACP test (match), nondiscrimination testing on non-match contributions	Same
ERISA	Applies	Plans with only elective deferrals, multiple vendors and limited employer involvement may be exempt
Deferrals from Post Severance Compensation	Generally limited to compensation for services rendered, paid within 2.5 months after separation from service	Same, but employer nonmatching contributions can be made up to 5 years after severance based on compensation in last year
In-Service Withdrawal Provisions	Allowed due to hardship, after a certain age or fixed years of service	Same for annuity contracts, but custodial contracts restrict distribution until age 59.5 or disability
Plan Termination	Allowed, successor plan rules apply	Same, but some older contracts considered in control of employee may pose practical issues
Investment Options	Any investment option allowed under ERISA	Annuity contracts or custodial accounts invested in mutual funds

A Step-by-Step Guide to Forming an Exempt Organization



Currently, there are over 1.5 million exempt organizations in the United States, with the Internal Revenue Service (IRS) granting exempt status to approximately 50,000 new organizations annually. This article focuses on the steps to create an exempt organization, particularly a §501(c)(3) public charity, which constitutes the great majority of all exempt organizations in the United States.

Similar to the formation of any corporation, there are required steps an organization must undertake before commencing charitable operations. First, a corporate entity must be formed, generally within the state where the exempt organization plans to operate. There are generally no advantages to incorporating in a state such as Nevada or Delaware if the exempt organization plans to be based in California. Next, and most importantly, the organization must obtain tax-exempt status from the IRS.

For an organization seeking to be recognized as a non-charitable exempt organization, Form 1024 should be filed with the IRS. For public charities and private foundations, the process to obtaining tax-exempt status is more burdensome; the Form 1023 is required to be filed with the IRS in order to receive recognition as a §501(c)(3) entity.

Step 1: Formation of Corporation

An organization must first file its Articles of Incorporation in the state in which it is planning to operate. In many states, including California, the Articles of Incorporation for an exempt organization or public benefit corporation require certain clauses, wording, and provisions. In California, it currently takes approximately six to eight weeks to receive a certified copy of the Articles of Incorporation. This time frame can be reduced to two weeks if the Articles of Incorporation are personally delivered to an office of the California Secretary of State.

Step 2: Applying for Federal Employer Identification Number

An Employer Identification Number (EIN) for the exempt organization can be obtained relatively quickly from the IRS' web site (www.irs.gov). However, in order to do this, the exempt organization's Articles of Incorporation must have been accepted by the state of incorporation.

Step 3: Completion of the Form 1023 (Federal Tax Exemption Application)

This is the most essential and time-consuming step in the entire process. The Form 1023 includes a 12-page core form with eight different schedules to be completed, if applicable. To file a complete and accurate Form 1023, the organization should have an initial Board of Directors in place, by-laws implemented, and a conflict-of-interest policy in effect. The Form 1023 also requests many details regarding the planned operations of the charitable organization, including a projected budget, detail on fundraising activities, and documentation regarding the entity's planned governance practices. The Form 1023 is filed with a fee of $850. If the exempt organization meets the standards of being a "small" exempt organization (projected revenues of less than $10,000 a year), the filing fee is decreased to $400. Some of these small exempt organizations may be eligible to file the Form 1023-EZ. This simplified form is only three pages long and can be completed online at www.pay.gov.

After filing the Form 1023, it could take the IRS anywhere from two months (for a green-lighted application) to more than one year (for a yellow-lighted application) to determine whether to approve the Tax Exemption Application. There are options for expediting the process, but certain requirements need to be met in order to take advantage of this. Once the organization receives a Determination Letter from the IRS, it is considered to be a tax-exempt entity for federal tax purposes retroactively back to the date that the entity was formed (assuming that date was less than 27 months before the date noted on the organization's Determination Letter).

Step 4: Filing for State Tax-Exempt Status

Although each state has its own set of exemption rules, once the organization receives its Determination Letter from the IRS, the state determination process should be relatively straight-forward. For example, within California, a charitable entity needs to file a Form 3500A with the California Franchise Tax Board to seek tax exemption status.

Step 5: Filing with the State Attorney General

The final step in the process will generally be a filing with the Attorney General in the exempt organization's particular state of operation. For example, in California, the Attorney General requires that most charitable organizations (churches, schools, hospitals are excluded) register with the Registry of Charitable Trusts by filing Form CT-1. A $25 fee is required to be included with this filing.

Steps of Exempt Organization Application Process

STEP	DESCRIPTION	WHEN TO START	TIMING
1	Formation of Corporation	Immediately	6 - 8 Weeks
2	Apply for Federal EIN	After Receipt of Certified Articles of Incorporation	Online: Immediate Paper: 2-3 weeks
3	File Form 1023 with the IRS & Respond to Any IRS Follow Up Questions	After Receipt of EIN	3 - 18 months
4	File for State Exempt Status	After Receipt of Federal Determination Letter	1 - 2 months
5	Register with State Attorney General	After Receipt of Federal Determination Letter	1 - 2 months
	Total Estimated Time Frame for Formation of Corporation		6 - 24 months

Completion of the above five steps, while seemingly straightforward, are almost never as simple in practice. In 2015, 101,962 organizations applied for exempt status, with the IRS rejecting 67 (less than 0.07%) of those applications. While this rejection rate is not severe, it excludes the 6,590 applications that were withdrawn or returned as "incomplete." The process from start to finish can be much more efficient and effective if each step is accurately completed in the most appropriate way. We have seen firsthand the importance of filing a complete Tax Exemption Application and responding quickly to follow-up inquiries from the IRS.

The Windes Nonprofit Group can assist organizations in the formation process. We can prepare the Form 1023 or undertake a top-level review of the Form 1023 if the organization has created a draft of it themselves.

For more information about forming an exempt organization, please contact Donita Joseph at djoseph@windes.com or toll free at **844.4WINDES** (844.494.6337).

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Windes is a recognized leader in the field of accounting, assurance, tax, and business consulting services. Our goal is to exceed your expectations by providing timely, high-quality, and personalized service that is directed at improving your bottom-line results. Quality and value-added solutions from your accounting firm are essential steps toward success in today’s marketplace. You can depend on Windes to deliver exceptional client service in each engagement. Since 1926, we have gone beyond traditional services to provide proactive solutions and the highest level of capabilities and experience.

The Windes team approach allows you to benefit from a wealth of technical expertise and extensive resources. We service a broad range of clients, from high-net-worth individuals and nonprofit organizations, to privately held businesses. We act as business advisors, working with you to set strategies, maximize efficiencies, minimize taxes, and elevate your business to the next level.

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