

Fundamentals

First Quarter 2008

Ways and means for the public sector

Not-for-profits talked and the IRS listened Input helps with redesign of Form 990

Big changes are coming over the horizon for most not-for-profit organizations. In June 2007 the IRS introduced a redesigned Form 990. More than five years in the making, this form — and its accompanying 15 schedules — instituted ambitious changes to the 990 NFPs have come to know (and sometimes love).

Seeking input from the industry, the IRS received more than 650 comment letters. In December 2007, it issued the “final” Form 990 and schedules for 2008. To be filed beginning in the 2009 filing season, the new Form 990 has an 11-page core form and 16 “if applicable” schedules. Overall, the new form responds to the most prevalent concerns voiced by the NFP sector. For example, the form continues to allow group filings for organizations with group exemption rulings.

Although Form 990 and its set of schedules are final, the IRS is still working on the instructions and expects to have those available in June or July 2008. While there aren't final instructions, there are explanatory documents released with the core form and each of the 15 schedules that give insight into what will be required in completing these forms.

Highlights of the new Form 990 include:

Part I — Summary: The IRS designed this section to be a “snapshot” of the organization's key financial, management and operational data. Part I of the draft was extremely controversial in that there were questions on compensation, fundraising percentages and strange ratios that might provide a cloudy picture of the organization's performance. But these line items have been eliminated in the final version. Now there are questions about the number of board members, employees and volunteers. In addition, revenue and expense items are required to be entered in a two-year format (prior year and current year). Interestingly, expenses are reported in Part I by type of expense (e.g., grants, benefits to members, salaries) rather than by functional categories (program, management and general, fundraising).

Part II is merely a signature block.

Part III — Statement of program service accomplishments: In this part, an organization describes its mission, program services and accomplishments and any changes in program services. The draft had this information placed at the end of the core form, but many comments requested it be moved forward and in response the IRS moved it from page 10 to page 2.

Part IV — Checklist of required schedules: This section contains 37 yes or no questions wherein an affirmative answer requires the organization to complete one of the 16 additional schedules.

Part V — Statements regarding other IRS filings and tax compliance: This part contains 12 multipart questions and attempts to move required information regarding tax compliance into one section of the form. It's intended to alert the organization to other potential federal tax compliance matters and obligations.

Part VI — Governance, management and disclosure: “The IRS believes that the existence of an independent governing body and well-defined governance and management policies and practices increases the likelihood that an organization is operating in compliance with federal tax law.” This statement is the rationale for the information required in the three sections (A. Governing body and management, B. Policies, C. Disclosure) that make up this part. Many comments on the draft questioned the IRS' authorities to delve into these issues and whether the way the questions were worded created a presumption of wrongdoing and noncompliance. The IRS responded by saying the section requests “information about policies not required by the Internal Revenue Code” at the top of the page.

Part VII — Compensation of [current and former] officers, directors, key employees, etc: Note first that the highest compensated employees and independent contractors have been moved from Schedule A of the current 990 to the core form.

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IRS issues final 403(b) regulations - what your organization needs to know

In July 2007, the U.S. Treasury Department published the long awaited final regulations for 403(b) plans, which had been issued in proposed form in November 2004. The detailed guidance found in these regulations – the first 403(b) regulations since 1964 – will make it much easier for employers who sponsor 403(b) plans to determine if their plans are operating properly.

The new regulations will be effective Jan. 1, 2009, with certain transitional exceptions. Several key highlights include:

- **Written plan document requirement.** All 403(b) plans, including salary deferral only plans that aren't subject to the Employee Retirement Income Security Act, must now be maintained pursuant to a written plan document. The document must contain all material terms and conditions for eligibility, benefits, applicable limitations, the contracts available under the plan and the time and form under which benefit distributions will be made. Some of these terms and conditions may be found in the annuity or custodial agreements and can be incorporated into the plan document by reference. If a plan is funded using multiple investment providers, the IRS expects the employer to have a single plan document rather than having a separate document for each provider. Each provider will have to enter into an agreement with the employer to comply with the terms of the employer's plan. An employer must have its written plan document in place no later than Jan. 1, 2009.
- **Universal availability requirement.** Employers have always been required to offer all employees, with certain limited exceptions, the right to make salary deferral contributions into the 403(b) plan. The IRS has found extensive violations of the universal availability requirement when auditing 403(b) plans, either through employers ignoring the rule entirely or not providing employees with an effective opportunity to enroll. The new regulations narrowed the number of exceptions to the universal availability requirement and established new written notice requirements for informing all eligible employees of their right to make 403(b) salary deferral contributions. The regulations also specifically noted that governmental employers,

such as public school districts, are subject to this requirement. Correcting a failure to meet the universal availability requirement is expensive, so all 403(b) sponsors should carefully review their practices in this area.

- **Plan termination.** Under former rules, an employer that wanted to terminate its 403(b) plan could not distribute the 403(b) account balances to participants who were still actively employed. Under the new regulations, employers will be able to terminate a 403(b) plan and distribute account balances to all participants, as long as the employer doesn't make any contributions to another 403(b) plan within 12 months from the date the distributions were issued. Employees would have the option to roll over their distributions from the terminated 403(b) plan to the employer's 401(k) plan; however, the employer couldn't mandate such rollovers.
- **Transferring or exchanging contracts.** Employees will no longer be allowed to transfer money from one 403(b) contract to a contract with a provider that isn't a provider under the plan – unless the employer consents and the issuer of the new contract agrees to be bound by the terms of the employer's plan. The provider must agree to supply information about the employee's account as the employer may request.
- **Guidance on controlled groups.** The final regulations formalize guidance the IRS had previously given – that a controlled group exists when one tax-exempt organization has the ability to control 80 percent or more of the board of directors of another tax-exempt organization. For plan purposes, those organizations are considered to be a single employer. These new controlled group rules will apply to issues far beyond 403(b) plans.

For a more information about the new 403(b) regulations, go to the RSM McGladrey Web site (www.rsmmcgladrey.com/RSM-Resources/Offers-Whitepapers/-403bplanguidance/403bplanguidance.pdf) to download the free white paper, "Tax Exempt Employees Receive Guidance on 403(b) Plans."

Can your NFP afford a dishonest employee?

Collectively, not-for-profits represent a significant portion of our gross national product and employ millions of people. Approximately 50 percent of these organizations are in the human service sector. They help mentally challenged individuals live independently, provide housing and services to the economically or socially disadvantaged. These activities and services may supply employees with access to clients' financial assets such as assisting with managing checking accounts and bill paying. Longtime employees in these organizations sometimes develop close relationships with clients.

Your organization's care and concern for clients, demonstrated in part through these close relationships, are important elements in organizational success. They can also represent a business risk that should be acknowledged and managed.

While the vast majority of employees will honor and respect professional boundaries, the dishonest employee may manipulate a relationship to defraud your client. The reputation impact may be even greater, and more lasting, than the immediate economic impact. To further complicate the issue, legally there are no bright lines defining when activities and relationships are within the scope of employment and when they are personal friendships. Employers have no legal right to regulate personal friendships.

Following are best practices that will define a framework for employees, provide for an annual affirmation from employees and outline policy violation outcomes. Your attorney should review policies for this key component of your employee handbook.

Employee handbooks should include policies related to:

- Allowable and non-allowable access to client financial information, as well as periodic statements and account numbers
- Signature authority on client accounts
- Gifts from clients
- Ability to serve as Power of Attorney, trustee or be named as beneficiary for clients
- Policy violation outcomes

Annual reporting to management by employees should include the following:

- Statement describing existing relationships with clients
- Affirmation that they have read and understand the policies
- Affirmation that no unallowable relationships exist

While written policies and annual reporting to management by employees will not prevent every occurrence, they will define expectations, support client confidence and leave no doubt about management's path should a violation occur.

Form 990 redesign, continued from page 1

This means that many organizations will be disclosing this information for the first time. This section hasn't significantly changed from the current 990. However, most organizations will have to file the additional Schedule J to provide more data about executive compensation.

Part VIII — Statement of Revenue: This part combines the current Part I, Statement of Revenue with the current Part VII, Analysis of Income Producing Activities and hasn't significantly changed from the draft.

Part IX — Statement of functional expenses: Uses the same format as the current Part II of Form 990. Adds line items for "Insurance," "Information technology," "Investment management fees" and

"Payments of travel or entertainment expenses for any federal, state or local public officials."

Part X — Balance sheet: This part hasn't significantly changed from the current Form 990.

Part XI — Financial statements and reporting: Here organizations tell the IRS what method of accounting they use, whether financial statements were compiled, reviewed or audited and whether the organization is required to have a "yellow book" audit completed.

Note: The remaining 16 schedules will be covered in a forthcoming issue of Fundamentals.

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Printed in U.S.A.