



*Helping Organizations
Take the Next Step*

If the IRS Comes Calling, Can You Bare It All?

By John Heymann

Funding has always been a challenge for nonprofit organizations. Today, times are even tougher than usual. Private donations could well decline as slow growth in personal income, coupled with high prices for everything from food to gasoline, forces consumers to make difficult spending decisions. Declines and uncertainty in the stock market have reduced the value of donor and foundation investment portfolios. Slowing economic activity lowers tax revenues for all levels of government, at the same time the pressure to fund expanded services is increasing.

Remember Enron?

The spectacular collapse of energy giant Enron, which took the prominent accounting firm of Arthur Andersen down with it, brought on federal legislation, known as Sarbanes-Oxley, to regulate the fiduciary and audit procedures of publicly-traded companies. In California, we have what is known as the Nonprofit Integrity Act of 2005, which essentially acts as the nonprofit equivalent of Sarbanes-Oxley. The act was passed mainly in response to financial shenanigans in some very prominent and successful charitable organizations. In 2008, with public confidence in nonprofits hovering near all-time lows, the IRS has rolled-out an updated 990 reporting form that requires more detailed disclosure of how a tax-exempt charity's funds are spent. They've also announced efforts to dramatically increase monitoring of the efficiency and effectiveness of charitable organizations, including consideration of a test to determine if a nonprofit's charitable activities are commensurate in scope with its financial resources. In other words, is too much of the organization's money going to fundraising, salaries, and building endowments, and not enough to programs. If a nonprofit's spending on fundraising is found to be out of balance with what it spends on programs, the IRS could revoke their tax-exempt status. Although the IRS hasn't yet said what they consider to be acceptable target ranges, the pending changes are causing significant concern and uncertainty within the nonprofit sector.

What is a 501(c)(3)?

501(c)(3) refers to a section of the Internal Revenue Code that confers tax-exempt status on certain organizations formed to carry out charitable activities, meaning the organization pays no income taxes and can also accept donations that are tax deductible to the donor. How does a 501(c)(3) differ from a for-profit corporation? Both types of organizations can make a profit, but while a for-profit corporation is run for the benefit of stockholders (profits can be distributed), a nonprofit is run for the benefit of the public (all profits must go back into fulfilling the charitable mission). The implications of this public-benefit status for U.S. charities should be a key focus for every organization's governing board.

Act as a fiduciary, or face the judiciary

Being aware of, thoroughly understanding, and complying with the fiduciary responsibilities of a nonprofit board can mean the difference between success or woe for the organization, as well as protection or liability for the individual board members. Board members should:

- 1) Always act in a responsible, prudent manner – ask questions and keep engaged in the organization's key governance issues.
- 2) Put the organization's best interests first – avoid conflicts of interest or even the appearance of conflicts. (If in doubt, ask yourself how you'd feel about seeing it as a story in the news.)
- 3) Be aware of the laws and regulations that apply to the organization and make a best faith effort to make sure they are being followed.

Passion is not enough

Because nonprofits are run ultimately for the benefit of the public, nonprofit boards have a fundamental obligation to make sure that the funds that are raised on behalf of their organization are always spent for maximum impact of the organization's mission. Funding comes from many sources, but none are more generous than the American taxpayers who really provide the 501(c)(3) tax break subsidy. We deserve to have that investment managed prudently and effectively.

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