



NOT-FOR-PROFIT NEWS

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Exempt Organizations and Financial Committees

An exempt organization (EO) may have several board committees in place to help it function in an effective and efficient way. The finance area should have more than one committee and three committees are appropriate for an EO with investments. The three committees are the finance committee, the audit committee and the investment committee.

The role of the finance committee is to provide oversight, approve budgets, and counsel management in significant business decisions and contracts. The finance committee is also responsible for safeguarding the assets of the organization. The finance committee should understand and review the internal controls of the organization and review the insurance coverage and risks of the organization. The cash flow and financial planning for near term and future objectives of the organization would also fall under the finance committee's area of responsibility. The full board relies on the finance committee for adoption of accounting policies and for accurate and timely financial reports as a basis for their decision making. As a group, the finance committee members should have the appropriate skills and experience to provide effective oversight and advice to management. The activities of the finance committee tend to be year round.

In comparison to the finance committee, the audit committee has a narrow focus. The primary duty of the audit committee is selection of the auditor and interaction with the auditor on audit planning, expectations, scope of work, preparing for the audit, and review and approval of the audit, the audit findings, and recommendations and communication with the full board. The audit committee can take over the responsibilities of review and approval of internal control policies of the organization from the overall duties of the finance committee. In California, an EO with gross revenue of \$2 million or more (exclusive of government grants and contracts) must have an audit and must establish an audit committee separate from the finance committee to comply with the Nonprofit Integrity Act of 2004. Under this law, the audit committee should not have 50% or more of its members from the members of the finance committee.

Many EOs have accumulated investments to help provide a reserve they can draw upon in difficult years or to meet unexpected obligations and needs. Some organizations have donor restricted funds which may be permanently restricted or temporarily restricted by the donor. There have been relatively recent developments in the area of investment management, investment and spending policies and financial statement disclosure. A separate investment committee may be the best way to deal with the responsibilities associated with investments. An organization with investments should consider adopting investment policies which take into account the short term and long term needs of the organization. It is not the investment committee's responsibility to manage an investment

portfolio. The investment committee sets investment goals and policies, selects investment management, monitors investment performance and evaluates the professional advisors.

The members of the investment committee must follow the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as adopted in California. This law became effective in California on January 1, 2009. The board (or investment committee) is responsible for establishing guidelines for asset allocation; the procedures for selecting and monitoring investment advisors; and the establishment of spending policies with respect to investments and especially donor restricted funds. The board (or investment committee) is also responsible for determining whether permanently restricted funds will be maintained based on the original value of the gift or on an inflation adjusted purchasing power basis. Members of the board and especially members of the investment committee should be familiar with this law.

The best run exempt organizations have experienced staff and strong board support from the various finance committees to compliment the organizational structure and staff. The board can appoint public members to committees and may find it beneficial to reach out to its community of supporters to find volunteers with the appropriate financial background to serve on the finance committee, audit committee and/or investment committee. The size and complexity of the financial structure and makeup of the organization will influence the design of the committees and whether an organization needs more than a finance committee to operate effectively.

RINA has a good deal of experience with the best practices of the most effective finance committees. For more information please contact a RINA representative.

Jeopardizing 501(c)(3) Status

Qualifying for tax exemption under Internal Revenue Code Section 501(c)(3) provides a number of benefits including exemption from federal income tax, tax-deductible contributions and possible exemption from state income tax. Maintaining tax exempt status requires diligence on the part of the organization.

There are five types of activities that can jeopardize your 501(c)(3)'s tax-exempt status:

- Private benefit/inurement,
- Lobbying,
- Political activity,
- Excessive unrelated business income (UBI), and
- Failure to comply with annual reporting obligation.



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Private benefit: 501(c)(3)s must avoid all activities that will substantially benefit the private interest of any individual or organization.

Inurement: No part of an organization's net earnings may inure to the benefit of a private shareholder or individual. This means that a 501(c)(3) organization is prohibited from allowing its income or assets to accrue to insiders. The prohibition of inurement is *absolute*. *Any* amount will jeopardize the organization's 501(c)(3) status.

Lobbying: Lobbying is an activity designed to influence legislation. If its lobbying activities are *substantial*, a 501(c)(3) may risk losing its tax-exempt status. The IRS uses two tests to determine whether lobbying is substantial: the substantial part test and the expenditure test.

Political Campaign Activity: Political campaign activity involves directly or indirectly participating or intervening in any political campaign on behalf of or in opposition to any *candidate* for elective office. The prohibition of political campaign activity is *absolute*. *Any* violation may result in the loss of tax-exempt status and the imposition of excise taxes.

Excessive Unrelated Business Income (UBI): UBI is income from a *regularly-carried-on trade or business* that is *not substantially related* to the organization's exempt purpose. The term "excessive" is not defined and is based on facts and circumstances. Expert opinion is that 15% to 30% borders excessive UBI.

Failure to comply with reporting obligations: If an organization does not file Form 990, Form 990-EZ or Form 99-N for three consecutive years, its tax exempt status will be revoked as of the filing due date for the third return.

Please contact RINA if you have any questions about how these jeopardizing activities may relate to your organization.



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