

Nonprofit Observer

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How to stay safe during election season

Winners aside, some things are certain every election season. For example, when November 8 finally rolls around, you'll probably never want to see or hear another political advertisement again. One thing nonprofit organizations can be sure of is that their political activities will be watched by the IRS. To ensure that your tax-exempt status survives this election year, learn the rules regarding political activities and follow them.

Campaign intervention

To protect their exempt status, 501(c)(3) organizations don't have to remain on the political sidelines. In fact, many nonprofits exist to advocate for or against certain issues. What you need to be cautious about is political campaigning or what the IRS calls "campaign intervention" — promoting or opposing particular political parties or candidates and encouraging supporters to vote in certain ways.

Generally prohibited activities include:

- Endorsing candidates,
- Donating to and fundraising on behalf of parties and candidates,

- Contributing to political action committees (PACs),
- Engaging in business with particular candidates (such as selling mailing lists or renting office space) without offering the same to opposing candidates or the public, and
- Inviting a candidate to speak at an event in anything other than a noncandidate capacity.

Encouraging people to vote — as long as you don't tell them which box to tick — is acceptable.

If, for example, a speaker who is also running for office mentions his or her campaign at the event or the nonprofit sponsoring the event displays partisan materials or solicits campaign contributions, the organization's nonexempt status will likely come under scrutiny.

Acceptable activities

Of course, there are plenty of ways for nonprofits to participate in the electoral process. Encouraging people to vote — as long as you don't tell them which box to tick — is acceptable. It's also generally OK to host nonpartisan candidate forums, distribute nonbiased voter guides and sponsor voter registration drives.

And in both election and nonelection years, 501(c)(3) organizations can



participate in advocacy and lobbying, within limits. In most cases, educating supporters and the public about issues is acceptable. You also are free to explain to elected officials your nonprofit's positions and ask supporters to contact officials and voice their opinions about legislative proposals. However, lobbying activities must remain an "insubstantial" part of your organization's business. The IRS doesn't define "insubstantial," so most nonprofits are advised to keep it to a minimum.



Complex and nuanced

Unfortunately, the rules governing the campaign activities of 501(c)(3) organizations are complex and can be confusing. For example, the IRS advises nonprofits to be careful to extend equitable offers to political candidates. If your nonprofit invites one candidate to speak at a well-attended annual gala but invites the opposing candidate to address a sparsely attended weekday meeting, you may be in trouble. Even if you present both candidates in a neutral, nonbiased way, you've provided greater exposure to one of them and implied your support of that candidate.

Examples illustrating such nuanced interpretations of the rules can be found in the IRS fact sheet, "Election Year Activities and the Prohibition on Political Campaign Intervention for Section 501(c)(3) Organizations." Search for "fact sheet 2006-17" at irs.gov.

Greater flexibility

The rules governing political campaigning are a little different for 501(c)(4), 501(c)(5) and 501(c)(6) organizations. In general, these nonprofits may participate in campaigns for or against candidates and parties, provided that campaigning isn't their primary activity.

Participation includes donating directly to candidates' campaigns and to PACs. (See "*Citizens*

United and nonprofit politics" below.)

However, organizations can't deduct campaign contributions as a business expense and their members may not deduct on their individual tax returns membership dues that are used to support campaigns. It's the responsibility of organizations to inform members what percentage of their dues has been used for political activities.

Don't be sorry

Determining whether your nonprofit is in compliance with IRS rules isn't always simple or straightforward. Whenever you're unsure about an election-related activity, check with your tax and legal advisors. Otherwise, you risk your nonprofit's exempt status — and may even owe excise taxes on campaign expenditures. ●

CITIZENS UNITED AND NONPROFIT POLITICS

Whether you characterize the U.S. Supreme Court's 2010 ruling in *Citizens United v. FEC* as a victory for free speech or a blow to responsible campaign spending, it has altered the political landscape. In a nutshell, the Court declared as unconstitutional limits on campaign spending by corporations and unions.

But the decision's impact has been broader — emboldening political action committees known as super PACs and causing individuals to pour millions of dollars into politically active 501(c)(4) and 501(c)(6) organizations. Most of these nonprofits follow IRS rules and conduct their activities independent of specific parties or candidates. However, some have been accused of crossing the line and coordinating with campaigns. Unfortunately, the law is murky about where exactly the line lies, so your organization is probably safest to deploy its political dollars carefully and consult your tax advisor when uncertain about political activities.

Q and A: Does my nonprofit need to register in multiple states?

Nonprofits that solicit funds online — or use other fundraising methods that cross state boundaries — may need to register in multiple jurisdictions. If this is news to you, read on.

Commonly asked questions

My charity receives only occasional contributions from out-of-state donors. Do I need to register with those states? Yes, but only if you're actually asking for donations in those states. The critical activity is *soliciting*, not accepting, funds. But remember, email and text blasts and Twitter and Facebook appeals are likely to be considered multistate solicitations.

That said, some nonprofits are generally exempt from registering or may need to register but aren't required to file annually. For example, many states exempt churches, synagogues and other religious congregations, as well as nonprofits with total annual incomes from all sources of less than \$25,000. Some exceptions include Illinois and California, which require even charities with income of less than \$25,000 to register and file annually.

It sounds like registration rules vary by state.

Yep, that's what makes the registration process so difficult! A handful of states don't require charities to register at all. The remaining ones have varying rules, income thresholds, exceptions, registration fees and fines for violations. Even the agencies that regulate charities differ by state. For example, if your charity wants to raise funds in Utah, you register with the Department of Commerce; in Connecticut, the Department of Consumer Protection; and in Alabama, the Office of the Attorney General, to name a few variations. The



National Association of State Charity Officials provides a list of the state offices that regulate charitable solicitations; search for “us charity” at nasconet.org to reach the link.

How much does it cost to register? Again, this varies by state — ranging from \$0 to \$2,000. And some states require nonprofits to jump through additional hoops. In West Virginia, charities receiving more than \$200,000 must submit audited financial statements when they register. In Pennsylvania, nonprofits with contributions totaling \$300,000 or more must submit such statements annually. Some states require charities to prepare “disclosure statements” and include them in all solicitation materials.

Is there a simple way to register with every state?

Unfortunately not. Most states require you to complete a general information form and submit it with your last financial statement, a list of officers and directors, a copy of your originating document and your IRS-issued tax-exempt determination

letter. First-time registrants can use a Unified Registration Statement in 37 states. However, even in those states, annual renewals and reports must be submitted using individual state forms.

Your charity could lose its ability to solicit funds in certain states or even lose its nonprofit status with the IRS.

What are the consequences of not registering in states where my nonprofit raises funds? Your organization, officers and board members could face civil and criminal penalties, including fines as high as \$25,000. Your charity might lose its ability to solicit funds in certain states or even lose its nonprofit status with the IRS. Note that states expect charities to register *before* they begin soliciting funds. If you've been accepting donations

in a state where you're not registered, you may be vulnerable to penalties.

Do I need to tell the IRS where my nonprofit is registered? Yes, Form 990 asks you to list the states where you're required to file a copy of your return.

Weighing benefits and drawbacks

Given the resources involved, think about whether the amount your charity collects from cross-border solicitations is worth all the trouble. For some nonprofits, it may make sense to pull back and focus exclusively on local fundraising.

But if out-of-state contributions are critical to your nonprofit's health and you can't spare the time to register your nonprofit in every last state, consider outsourcing the task. Several companies specialize in registering nonprofits. Also talk to your CPA for ways to make the job less onerous. For example, because IRS and state filings cover similar ground, your tax advisor might be able to prepare and submit them at the same time. ●

The case for internal controls

Reducing fraud is easier than you may think

The core of any organization's fraud-prevention program is strong internal controls. Yet too many nonprofits either fail to develop controls that address common risks or, if they establish controls, neglect to enforce them. Your nonprofit must do both if it wants to help prevent occupational theft and fraud perpetrated by outsiders.

Charities at risk

According to the Association of Certified Fraud Examiners (ACFE), billing fraud, check tampering and expense reimbursement fraud are the three most common types of employee theft found in religious, charitable and social service organizations. But proper segregation of duties — for example, assigning account reconciliation and fund



depositing to two different staff members — is a relatively easy and effective method of preventing such fraud.

For all types of organizations, such controls as strong management oversight, regular audits and confidential fraud hotlines are associated with decreases in financial losses. The ACFE has found that proactive data monitoring and analysis is the most effective means of limiting the duration and cost of fraud schemes — 50% shorter and 60% smaller than organizations that don't monitor data.

Getting priorities straight

Most nonprofits have at least a rudimentary set of controls, but employees bent on fraud can usually find gaps in the fence. For example, charities tend to devote the lion's share of their budgets to programming and can be stingy about allocating dollars to enforcing internal controls. This can be especially problematic when the "tone at the top" is lax and executive directors or board members indicate that preventing fraud is low on their priority list.

Nonprofit boards may also inadvertently enable fraud when they place too much trust in the executive director and fail to challenge that person's financial representations. Unlike for-profit companies, nonprofit boards may lack members with financial oversight experience, which means they may miss important warning signs that something is amiss.

Trust is an Achilles' heel throughout many nonprofits. Organizations often regard their staff members as family and skip such important fraud-prevention measures as conducting background checks. In some cases, managers are allowed to override internal controls without recourse and volunteers are trusted to accept cash donations or keep the books without the oversight of a staff member — both very risky activities.

Send the right message

How nonprofits deal with perpetrators can also increase their fraud risk. A reputation for honesty and fiscal responsibility is any charity's bedrock. So it's not surprising that many organizations choose to quietly fire fraud perpetrators and sweep such incidents under the rug.

Proper segregation of duties is an easy and effective method of preventing fraud.

Unfortunately, such actions encourage fraud by telling potential thieves that the consequences of getting caught are relatively minor. And even if an incident is hushed up, it could fuel insidious rumors that do more reputational damage than publicly addressing the issue head-on would. It's better, therefore, to file a police report, consult an attorney and inform major stakeholders about the incident and what you're doing to prevent it from happening again.

Cover all bases

Internal control policies should address both common fraud risks and those specific to your organization, its mission and constituents. To ensure you cover all the bases, work with knowledgeable advisors. ●

Grants can help firm up your financial foundation

There are approximately 87,000 foundations in the United States — including family, corporate and community foundations — giving more than \$55 billion annually. If your nonprofit isn't actively seeking grants from these groups, you're neglecting a potentially significant income source. As government grants become smaller and harder to come by, consider refocusing your energies on getting — and keeping — foundation support.

Know your target

Probably the most important thing to remember when approaching foundations is that they tend to specialize — making grants to certain types of charities or in specific geographic regions. It's not enough to be a 501(c)(3) organization (though your exempt status is critical). Your nonprofit's mission and programs will need to match the interests of the foundation to which you're applying.

So it's essential to research foundations before you apply for grants. Review annual reports, tax filings, press releases and any other information you can get your hands on. One place to start is the Foundation Center's online directory at foundationcenter.org. Charity watchdog group Guidestar (guidestar.org) also gathers information about foundations.

Once you have a list of matches, don't just start sending out long, detailed proposals. A Foundation Center survey found that three-quarters of these funders don't consider unsolicited requests. So call your target foundations and talk to staff members about the kind of information they need and their communication preferences. Most will be happy to provide insights into their decision-making process and shed light on your chances of securing a grant from them.

Successful qualities

The most successful foundation grant proposals have several qualities in common. For example, foundations like projects that are well defined and data driven with specific goals. They also want to know that their gifts are effective, so achievement of such goals needs to be measurable.

It's important to outline a project's life cycle and how you plan to fund it to completion. Many foundations provide the money to initiate projects but expect nonprofits to use their own funds and other grants to continue them. In fact, if you hope to establish a long-term relationship with a foundation that has given you a grant, you must successfully finish what you started.

If at first ...

Keep in mind that a rejected proposal doesn't have to shut the door on future opportunities. If your request is turned down, ask the foundation to explain its decision and to provide tips on making your proposals stronger. Many organizations are competing for the same foundation funds, so tenacity is crucial. ●

