Accounting and IRS Reporting

By now, if you have followed this series of articles, you realize that it's a lot easier not to pour cream into the coffee than to get it out. Simplified cash accounting for all your transactions makes it much easier to compile monthly and year-end reports.

Fiscal Year

Your exempt organization's Board of Directors should authorize reporting on the same basis as your parent organization (most National Veterans' organizations use a fiscal (or financial) year starting July 1 and ending on June 30 of the next calendar year.

Whichever time period your Board selects, it must have one year's (in rare instances, 52 or 53 weeks') transactions to report.

Two months ago, I wrote about due dates. For the IRS, an exempt organization's returns are due no later than the fifteenth day of the fifth month following the close of the fiscal year (i.e., May 15th for calendar year filers, November 15th if the fiscal year ends on June 30). Your parent organization, if filing a group return on behalf of your local unit, must also adhere to these deadlines.

Your exempt organization's Board of Directors should also authorize reporting on the cash basis (i.e., only actual cash transactions are reported). There are some modifications for those organizations which have credit cards or have incurred other debt (e.g., a mortgage to build their current facilities) which will be addressed later.

Throughout this discussion, I use the term "bank" as a shorthand for Commercial Banks, Savings Banks, Internet Banks, Credit Unions and other institutions offering one or more banking services.

Cash Receipts

All cash receipts are reportable. Most cash receipts are generated from:

1. Contributions, Grants, Gifts (all Donations for which the donor received no tangible benefit) and gross proceeds of fund raising events, itemized as
    a. Government Grants (all levels of Government)
    b. Federated Campaigns (interstate fund-raising campaigns, such as the Combined Federal Campaign to which servicemembers and federal employees contribute)
    c. Funds received from related organizations (e.g., state or national parent org.)
    d. Membership Dues
    e. Fund Raising Events (gross contributions)
2. Program Service Revenue
    a. Fees to apply for benefits
    b. Costs to avail of program services (e.g., bus fares for Council on Aging)
3. Investment Income (interest, dividends and similar returns on investments)
4. separately itemize income from investment of tax-exempt bond proceeds
5. Royalties
6. Gross Rents of Real or Personal Property

   a. separately itemize by property
   b. deduct rental expenses by property to determine net rents

7. Gross Receipts of sales of assets other than inventory
   a. separately itemize each security or other property
   b. subtract cost (or donated basis) and sales expenses to determine net gain (loss)

8. Gross income from fund raising events (also reported above in item 1e)
   a. separately track each event
   b. subtract contributions included in gross proceeds (contribution is the difference between the gross proceeds of admission and the anticipated total costs of the event (e.g., a dinner fund raiser ticket cost $100; total cost of all meals, entertainment, facility rental and gratuities divided by estimated number attending determined a cost per person of $60; estimated contribution is $40—this amount should also be included in any document publicizing the event). Report this contribution as Revenues from Fundraising Events (item 1 above).
   c. Identify the direct costs of each event, and subtract the direct costs as well as the contribution determined above, from the gross income to determine the net surplus (or deficit) from each event.

9. Gross income from gaming activities (note; recent Florida legislation has severely restricted gaming activities, especially those of Veterans' organizations. Bingo continues to be an acceptable fund raising activity for Veterans' Organizations. Consult the Florida Department of Agriculture and Consumer Affairs for other permitted gaming.
   a. Subtract direct expenses (including winnings by participants) to arrive at net income from gaming activities.
   b. These activities are subject to additional reporting by the exempt organization
   c. Should your organization use a professional fund raiser, include the gross amounts (before the professional fund raiser's fees), then include the fund raiser's fees as direct expenses. Professional fund raisers must be previously registered with the Florida Dept. of Agriculture and Consumer Affairs under the Florida Solicitation of Contributions Act.
   d. If the event is run by volunteers, ensure that all tips received by the volunteers go directly to the exempt organization. Failure to comply with this may result in:
      i. all gaming activities become unrelated business taxable income
      ii. the exempt organization becoming an employer, with requirements to withhold and report income tax, Social Security and Medicare tax, and pay Workers' Compensation and Unemployment Insurance premiums.
   e. Those winning more than $600 and at least 300 times the amount wagered[1] are subject to withholding tax. If the winner has provided a valid taxpayer identification number (obtain on Form W-9; I also recommend obtaining a photocopy of the winner's drivers license). Medicare cards often contain the Social Security number.

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[1] higher limits apply to winnings from bingo or slot machines ($1,200); keno ($1,500); poker tournament ($5,000)

i. Withhold and remit withholding taxes on gaming winnings of more than $5,000; the withholding rate is 25% on the gross proceeds (total winnings less amount wagered) or total winnings (at the winner's option).
    1. Enter the gross proceeds on Form W2G Box 1 and the withholding amount in Box 4.

ii. Non-cash winnings (e.g., a car) must be valued at fair market value
    1. For non-cash winnings, there is an alternate withholding method if the payer of the tax is the sponsoring exempt organization. The withholding rate will 33 1/3% of the gross proceeds.
    2. On Form W2-G, add the fair market value of the non-cash winnings and the withholding tax paid by the sponsoring exempt organization and enter this amount in box 1. Enter the withholding tax in Box 4.

iii. Should the winner not be able to provide a correct tax identification number, the winner is subject to higher "backup" withholding at 28% of the gross proceeds (or total winnings, at the winner's option).

10. Gross sales of inventory, less returns and allowances (e.g., logo'd shirts for your organization's members)
    a. subtract the cost of inventory sales to arrive at net income (loss) from sales of inventory
    b. If inventory is a substantial portion of your revenues, you may be required to register as a sales tax vendor, collect and remit sales tax on all non-exempt merchandise.

11. Miscellaneous Revenues
    a. all revenues not better described as belonging to lines 2 thru 10.

Restricted or Dedicated Funds

Occasionally, a donor may make a contribution for a specific purpose (e.g., purchase of US Flags for Memorial Day). These funds, once received, are considered "encumbered" and should be separately listed on the exempt organization's balance sheet until spent for the intended purpose.

There is little need to open separate bank accounts for such encumbered or restricted funds; however, they should not be included in the general fund balance reported to the Board; rather, each such fund should be separately itemized in each financial report.

Debit Cards

Bank debit cards should generally be avoided at all costs, as there is little to no control over their misuse. Debit card transactions should be recorded immediately, as an increase (debit) to an expense account and a decrease (credit) to the bank account linked to the debit card. Transactions made using bank debit cards do not require two signatures:

1. Each transaction automatically draws funds from the bank account to which the card is linked. Inadvertent overdrafts can run up bank fees rapidly (one local bank reportedly

has charged four overdraft $35 fees on one day, because someone forgot to enter a debit card transaction which resulted in the account being overdrawn).

2. There is virtually no protection against fraudulent use by someone who has skimmed (illegally swiped the card to get the magnetic data) or cloned (duplicated) the debit card. Further, any refund (a) can take days or even weeks and (b) have a deductible (often $50 or more).
3. There is often no protection should an unauthorized person use the debit card to make on-line purchases.
4. There is a very short window (often only until the next bank statement is received) to make a claim that the transaction is fraudulent.

Credit Cards

Credit card transactions should also be recorded immediately as an increase (debit) in an expense account and an identical increase (credit) in a short-term liability account [Credit Card Liability]. Short-term liabilities are those due and payable within one year. Like debit cards, credit cards do not require two signatures. Depending upon your organization's credit agreement with your bank, liability for transactions may be shared with the authorized holder of the organization's credit card. Credit cards, under US Banking Law, also have more protections, such as:

1. Your right to dispute unauthorized charges (these must be "suspended" during the investigation and your organization would not be charged interest during this period
2. There is no deductible if your dispute is upheld
3. There is a "look-back" 60-day window for you to discover and dispute the unauthorized transaction.

Mortgages and Other Debt

Mortgages, by their nature, are Long-term Liabilities (principal balances due and payable in future years) with a Short-term Liability component (the principal payments due within one calendar year). For simplicity, at the start of the organization's fiscal year, determine the principal due during the next year, and reclassify that debt from Long-term Liability to Short-term Liability. Future interest is not recorded as a liability. However, if points were paid to refinance the debt, those points should be capitalized and amortized over the remaining life of the refinanced debt.

When payment is made, the difference between the amortized principal due and the amount paid the bank is billed as current interest expense. Every mortgage or other long-term debt should have an amortization table (a table showing each month's interest, principal payment and balance due after the payment is made).

Late payments, even if described as penalties, should be recorded as an interest expense. For management purposes, these penalties should not be lumped into the mortgage interest expense account, but reported in a separate account. When preparing information returns, consolidate the two accounts' balances.

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Expenses

Aside from transactions involving debt(as discussed above), all expenses should be recorded when incurred. When using cash accounting, many of the fund-accounting steps used by larger organizations are omitted (while appropriate, small organizations often do not have the resources to perform all these steps for each transaction).

It is therefore important to “set aside” funds when obligated by the Board of Directors, so that the cash will be available when the expense bill comes due.

Checks and other payments must be recorded immediately to avoid the possibility of overdrawing the bank account.

Expenses fall into four main categories:

- Program Expenses (often called Operating Expenses)
- Management Expenses (often call General and Administrative)
- Fundraising Expenses
- Capital Expenditures

Program Expenses are those incurred to generate Program Service Revenues (see above). This includes expenses incurred to further the organization’s exempt purposes. Include the costs of applying for grants (whether successful or not). They also include expenses related to the management investments which generate Program Service Revenues.

Management Expenses are those that relate to maintaining the operations of the exempt organization and those that are not more properly described as Program Expenses or Fundraising Expenses. Expenses related to the management of investments which do not generate Program Service Revenues are reported here. Lobbying expenses (whether allowable or not), costs of meetings (but not events which raise funds), insurance and rents are some of the more popular general and administrative expenses.

Fundraising Expenses are recorded separately because exempt organizations are often measured by the ratio of program costs to fundraising costs. An efficient exempt organization often has fundraising costs of less than 10% of gross revenues.

Expenses for events which both further the exempt organizations purposes and raise funds must be separated into direct costs (reported as an offset to the Revenues as noted in item 8 above), and indirect costs, which are reported as fundraising costs.

Should your organization use professional solicitors (i.e., solicitors who receive a portion of the funds collected, or a fixed fee), verify that each solicitor is properly registered and licensed with the Florida Department of Agriculture and Consumer Affairs.

Capital Expenditures are those made to acquire assets with a useful life of one year or more. In the business world, these are depreciated and the cost recognized as spread over the useful life of the asset. In the not-for-profit world, these costs (if not grossly out of proportion to the organization’s revenues) are often expensed. The obvious exception is a capital asset purchased with a mortgage. Such purchases are recorded as assets (debits on the balance sheet) offset by the decrease in cash spent to acquire the asset and an increase in a liability account (credit) to reflect the existence of the mortgage.

Transactions with Interested Parties

In small organizations, it is virtually impossible to avoid transactions involving “Interested Parties”, that is, people who are present or past officials of the exempt organization or who have significant influence over the activities and actions of the exempt organization. A family relative of an Interested Party may also become an Interested Party.

Not all of these transactions are forbidden. Transactions involving the purchase of goods and services at fair market value should be verified against independent sources (e.g., retail prices). Donated property should not be sold to Interested Parties unless there is no other market—even then, the property should be sold at fair market value.

Reimbursement for out-of-pocket expenses, such as postage, should only be made when a properly-completed receipt is provided the Treasurer.

Indirect expenses, such as reimbursement for local mileage, should not be reimbursed as there often is little to substantiate these incidental expenses.

In certain circumstances, Interested Parties can become “Disqualified Persons” who should not receive any benefit from the exempt organization. An Interested Person of any other exempt organization which is a substantial supporter (i.e., has donated $5,000 or more) to the organization providing the benefit is also considered a Disqualified Person.

There is a fine line that must not be crossed when conducting transactions with Interested Parties. Please contact me before the transaction, so I may provide specific guidance on the situation at hand.