

## **3D. Fiscal: Keeping Tabs on Related and Sponsored Entities**

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**CAPLAW**  
Community Action Program Legal Services, Inc.

**Keeping Tabs on  
Related & Sponsored Entities**

June 16,2011  
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**CAPLAW**  
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**Your Related Entities?**

- Affordable Housing
- Facilities ownership
- Social Enterprise - Business Ventures
- Foundation
  - fund raising
  - endowment management
- C(3) – C(4) tandem

2

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**CAPLAW**  
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**Your Fiscal Sponsorships?**

- Unincorporated associations
- Nonprofits without tax exempt status
- Tax exempt organizations
- Coalitions
- Individuals

3

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**Workshop Plan**

**Related Entities:**  
Opportunities & Risks  
GAAP  
IRS  
Challenges

**Fiscal Sponsorships**

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**Related Entity Opportunities**

- Opens access to investor \$\$\$
- Required by HUD & other funding programs
- Facilitates debt financing of facilities
- Promotes private support through separation from government identity
- Protects C-3 status of CAA
- Liability protections

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**Related Entity Risks**

- Compliance with funding agreements
- Cash flow burdens
- Collectability of receivables
- Assessment of credit-worthiness
- Community perception
- Demands on management
- Board inattention or confusion

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**3 Perspectives on Related Entities**

- State law
- GAAP
- Internal Revenue Code

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**State Law Framework**

State Statutes govern:

- Nonprofit corporations
- Partnerships
- Limited Liability Corporations
- Other for-profit corporations

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**Each Related Entity:**

- Organized & operated under State law
- Must have its own governance & records
- May own assets
- Legally responsible for own debts & tax liabilities

9

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### Nonprofit to Nonprofit Relationships

- GAAP “related entities” include:  
Parent/Subsidiary relationship  
Must have “control” & “economic interest”
- IRS “related organizations” include:  
Parent/Subsidiary relationships  
Sister/Brother relationships

10

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### Related NP Organizations on 990

- **Parent/Subsidiary:** Parent controls selection of majority of Subsidiary Board Members
- **Brother/Sister:** Overlapping Boards without control of 1 entity by the other
- **Both** Parent/Sub and Brother/Sister relationships must be **disclosed on 990 Schedule R**

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### IRS: Nonprofit & For-Profit are *Related Organizations* if

- Nonprofit is the **Managing Partner** or **General Partner** in LLC, or
- If the nonprofit owns:  
>50% of stock, or  
>50% profits or capital interest in partnerships

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### Form 990 Schedule R

- **Schedule R: Related Organizations and Unrelated Partnerships**
- **990 Part VII** requires disclosure of **compensation** paid by “Related Organizations” reported on Schedule R

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### Compensation by Related Organizations:

- Must **combine** amounts from related organizations for reporting on Compensation for:
  - Board
  - Officers
  - Key Employees
  - Highly Compensated Employees
  - Top vendors

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### Unrelated Business Income from Related Organizations:

- Interest
- Annuities
- Rent
- Royalties

**Even if the activity that gave rise to the income is related to the nonprofit's exempt purpose**

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### GAAP Treatment of Parent/Subsidiary Relationship

- ASC 958-810-25 requires **consolidation of Parent & Subsidiary financial statements** if:
  - Parent has **economic interest** in subsidiary
  - Parent has **“control”** of subsidiary – evidenced through Parent **appointment of Subsidiary Board**

16

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### Consolidated Financials

- Present the financial condition & activity of the Parent & Sub as if they were 1 entity
- Combine the Assets, Liabilities, Net Assets, Revenues, and Expenses of the Parent & Sub
- Eliminate intercompany transactions

17

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### Impact of Consolidation

- Help readers understand the **full scope** of the Parent’s activity & resources
- May make financial condition of Parent look **better or worse** than stand alone reporting of Parent
- Potentially **confuse** readers

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University of California Legal Services, Inc.

### GAAP for Relationships with a For-Profit Entity

- ASC 958-810-05-5
- Guides choice between:
  - Equity** method of accounting
  - Consolidation**
  - Combination** of Financial Statements

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### GAAP Treatment of For-Profit Entities Related to Nonprofits

- Nonprofits generally use the “**equity** method” (not consolidation) to present investments in for-profit entities
- If nonprofit owns or “**controls**” the for-profit, **consolidation** may be required

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### Hot Topic in Affordable Housing

- Nonprofit General Partner in **LIHTC** partnership may be required to **consolidate the financial statements** of the nonprofit and the for-profit partnership **despite minority ownership**
- Presumption that General Partner controls the Partnership
- See ASC 958-810-05

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**LIHTC Consolidation**  
**not required if:**

- **Rights** of Nonprofit General Partner are **limited** by **partnership agreement** granting Limited Partners power to:
  - **Remove** the General Partner
  - **Approve** the operating budget of the Partnership

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**CAA/Related Entity Challenges**

- Structure for oversight
- Clarity on goals & progress indicators
- Risk identification
- Financial information flow
- CAA Board preparation & support

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**CAPLAW**  
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**Shift Gears to  
Fiscal Sponsorship**



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## Key Differences

<p><b>Fiscal Sponsor</b></p> <ul style="list-style-type: none"> <li>• Applies for &amp; receives funds for a project</li> <li>• Retains <b>discretion</b> in determining what organization will carry out that purpose</li> <li>• May select <b>non- 501 (c)(3)</b> entities through agreement</li> </ul>	<p><b>Fiscal Agent</b></p> <ul style="list-style-type: none"> <li>• Provides oversight &amp; management of funds</li> <li>• <b>Funder determines</b> which organization is the <b>ultimate recipient</b> of funds</li> <li>• Typically acts as <b>agent</b> for another <b>501 (c)(3)</b></li> </ul>
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## Fiscal Sponsor

- Controls use of funds
- Responsible for fulfilling funding agreement
- May face risks related to activity of the sponsored project

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## Why CAA's Become Fiscal Sponsors

- Community engagement
- Support for innovation
- Coalition building
- Funder or community pressure
- Wishful thinking about sponsorship fee income

27

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**Risks in Fiscal Sponsorship**

- Misunderstandings with sponsored projects and/or funders
- Project mistakes threaten sponsor's tax exempt status
- Project failures attributed to sponsor
- Liability relating to employment, contracts, and other project activities

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**Sponsorship Pitfalls**

- Sponsor transfers of awards for sponsored Project without clear agreement requiring detailed reporting
- Sponsored Project violates requirements of funders or IRS

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**Traps for the Unwary**

- Beginning the relationship
- Donors and funder expectations
- Fiscal processes
- Financial reporting
- IRS reporting
- Sponsor oversight
- Ending the relationship

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### Core Agreements

- Sponsor's ultimate control of funds
- Donor/funder communications
- Approval of proposals/applications
- Cash management

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### More Agreements

- Payment for services: employees or independent contractors
- Accounting and financial reporting
- Program oversight and reporting
- Prohibited activities

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*In the beginning:*

### Proposals for Funding

- Sponsor controls the submission of applications
- Consistent statement of relationship
- Awards made directly to sponsor

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*At the end:*  
**Sponsor/Project Agreements**

- Notification
- Final accounting
- Control/use of remaining funds
- Communications

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**Projects by  
Unincorporated Groups**

- Decision-making structure for the sponsored project
- Sponsor “charter” for Advisory Group
- Sponsor-approval prior to submission of proposals for funding

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**More Unincorporated Assoc.  
Agreement Issues**

- Employment or independent contractor relationships
- Fiscal processing/ reporting
- Program reporting
- Multiple fiscal sponsors for one group?

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### Projects by Corporations

- Boards of Sponsor & Project approve agreement clarifying:
  - Sponsor's ultimate control
  - Identity of the Project
  - Oversight responsibilities
  - Sponsor approval required prior to submission of proposals
  - Financial procedures & reporting

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### Projects by Individuals

- Define relationship between the Sponsor and the individual carefully
- Clarify status as employee or independent contractor
- If employee, subject to Sponsor's employee handbook

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### Individuals: tough issues

- Operating and fiscal procedures
- Risk analysis and insurance
- Representation of the relationship
- Oversight of program accomplishments
- Reporting responsibilities

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### GAAP Treatment of Sponsorship

- Awards received for sponsored Projects are **income to Sponsor**
- Use of funds results in **Sponsor expenses**
- Most awards are deemed **Temporarily Restricted contributions**
- Unused portion of TR contributions shown as **TR Net Assets**

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### Sponsored Project Reporting

- **Source** of funds received through fiscal sponsorship is the **Fiscal Sponsor**
- **Expenses paid directly by the Sponsor** may be reported as **in-kind expenses**
- **Expenses paid by the Project** with funds through the sponsorship are reported as **expenses of the sponsored Project**

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### 2 Models for Disbursements

- **Project handles** disbursement & accounting: Transfer "**initial advance**" to Project & **require accounting** prior to release of additional funds
- **Sponsor handles** disbursements & accounting: Sponsor **does not transfer** cash to Project, **pays all bills**, and **provides accounting** to Project

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### Fiscal Sponsorship on the 990

- Sponsor reports grant/gift as contribution income
- Sponsor reports expenses incurred to carry out project as expenses

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### Next Steps

- Review CAA oversight of Related Entities
- Review Fiscal Sponsorship agreements and practices
- Review accounting and reporting practices for both
- Review 990 treatment for both

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### Related Entity Resources

- [www.strengthmatters.net](http://www.strengthmatters.net) –Fiscal management recommendations relating to affordable housing accounting & compliance issues
- **IRS Guidance on Related Organizations**  
<http://www.irs.gov/pub/irs-pdf/i990sr.pdf>
- **GAAP for Not-for-Profit Organizations – FASB Accounting Standards Codification:**  
[http://asc.fasb.org/topic&trid=2209682&nav\\_type=left\\_nav&analyticsAssetName= left\\_nav\\_topic](http://asc.fasb.org/topic&trid=2209682&nav_type=left_nav&analyticsAssetName= left_nav_topic)

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## **Fiscal Sponsorship Resources**

- **Fiscal Sponsorship: 6 Ways to Do It Right**, Greg Colvin  
[http://www.studycenter.org/test/scp\\_fs.html](http://www.studycenter.org/test/scp_fs.html)

- **National Council of Nonprofits**  
<http://www.councilofnonprofits.org/fiscal-sponsorship-resources>

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