

MUSE

A monthly publication dedicated to providing ideas and education to tax exempt organizations

Second Quarter 2010

Enterprise Risk Management: A Sound Strategy for the Recovery

With the economic outlook in the United States beginning to brighten, now represents a valuable opportunity for organizations to evaluate their stance on risk management. The economic turmoil of the past few years and the difficulties that some organizations have faced can be greatly attributed to misjudging risk or not having sufficient risk management procedures in place. Implementing an Enterprise Risk Management (ERM) program can help to more holistically define what risks your organization may be facing. Additionally, once the risks have been defined, you can then associate risks with the strategic objectives of your organization to align controls that will be complementary to the pursuit of your mission.

In today's increased regulatory environment, there is more emphasis on transparency, but also more attention on your control environment. There is greater scrutiny on the policies and procedures that your organization has in place, and ERM can help to address and better define these procedures.

While an ERM system is not required for not-for-profit organizations, it is considered a best practice to encourage the development of a proactive risk environment and a clear and consistent risk strategy across your organization.

What is ERM?

ERM represents an evolution from operational and business risk management, by evaluating all processes and departments and taking a much broader view of the risks that are apparent to your organization. It is an organization-wide initiative impacting all levels of management and all departments. Risk can impact different areas of your organization in a variety of ways. With that in mind, ERM helps to identify, measure, mitigate and monitor risks so that you and the board of directors can make more informed decisions.

This process can be very beneficial for many not-for-profit organizations, helping to identify the organization's risk appetite, align strategic objectives with risk tolerance, maximize efficiencies through risk analysis and minimize operational expenses and losses. Other benefits include more strategic

training and allocation of resources as well as creating a more conducive regulatory environment.

ERM is an ongoing process, and there are several internal and external factors which can impact its scope or focus such as the economy, expansion of services, or changes to your organizational structure. Your ERM strategy can and should evolve along with your organization.

Getting started with ERM

Often, the biggest challenge associated with ERM is getting started. ERM is not a checklist for risk, it is a cultural change that involves bringing risk more to the forefront and making it a part of the strategic thought process.

Two integral factors in establishing ERM are setting a successful tone from the top and determining your risk appetite. Tone from the top is the overall organizational direction set forth by the board of directors and senior management for the entire organization. This includes identifying risks and the corresponding controls to mitigate those risks including entity level controls that affect the entire organization, such as a code of conduct, policies and procedures and training guidelines. Communication is also important, as buy in from all levels and knowledge of objectives is critical to the success of an ERM program.

Before establishing an ERM framework, you also have to consider your risk appetite and how it aligns with the mission of your organization. This is important because some organizations are more aggressive toward risk, while others tend to be more conservative and cautious. You want to make sure that your ERM system does not leave you under, or over exposed to risk.

Your ERM system analyzes the threats to your organization depending on impact and probability, according to your risk appetite. Those events that are deemed unlikely and low impact will not receive as high a level of attention as those

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IRS Publishes Interim Nonprofit College and University Compliance Report

In October 2008, the Internal Revenue Service (IRS) sent compliance questionnaires to 400 not-for-profit, tax-exempt colleges and universities to take part in the Colleges and Universities Compliance Project. Preliminary information gained from the responses is summarized in an interim report recently released by the IRS. The report includes information on organizational structure, governance, compensation, endowments and demographics, as well as exempt and unrelated business activities.

As one of the largest and most complex not-for-profit segments, it is important for the IRS to be cognizant of trends and activities that tax-exempt colleges and universities take part in. The findings of this project will help in enforcement, but will also assist the IRS in ensuring that they are providing and developing useful services to institutions. Respondents were separated into three groups depending on student population to illustrate specific trends and issues at institutions of varying enrollment and resources.

The interim report reflects information reported by 344 respondents — 177 private and 167 public institutions. The questionnaire requested information from the tax year ending in 2006, so while strategies may have changed due to the turbulent economy, survey information should still paint a representative picture of the activities of many not-for-profit institutions.

A compliance check was included in the project, to help determine compliance with specific requirements, provide education about reporting obligations and encourage voluntary compliance. As an example for all not-for-profit organizations, 13 institutions did not respond to the questionnaire and a subsequent examination was opened on each by the Exempt Organizations arm of the IRS. If your organization receives a similar questionnaire in the future, it would be in your best interests to complete it.

To view the full interim report, visit the IRS website. Among the highlights of the IRS' interim report:

Organizational Information/Demographics

- Large institutions had the highest percentage of respondents with related entities (96 percent), followed by medium organizations at 82 percent and small institutions at 45 percent. The most common type of related entity for all sizes were related tax-exempt organizations, followed by taxable corporations and trusts, disregarded entities and partnerships.

- Large institutions were also most likely to be controlling entities with 45 percent, compared to 34 percent for medium organizations and 26 percent for small institutions. However, only 26 percent of large institutions with at least one controlled entity indicated receiving income from such an entity. Forty-five percent of medium organizations and 29 percent of small institutions reported receiving income.

Activities

- Almost half of small institution respondents indicated never having filed a Form 990-T, compared to 29 percent of medium organizations and 4 percent of large institutions.
- Large institutions reported the greatest percentage of respondents engaging in various activities and the highest percentage generating unrelated business income (UBI) on their Form 990-T.
- A higher number of institutions indicated engaging in an activity than the amount that reported listing that activity on their Form 990-T.

Endowments

- Most organizations reported having an endowment fund or an endowment fund managed by another entity (100 percent of large institutions, 97 percent of medium and 87 percent of small).
- All respondents report a consistent target spending rate – from 4.7-5.0 percent.
- Institutions of all sizes reported investing endowment assets, with U.S. fixed income and equity investments as the most popular.
- The majority of institutions of all sizes reported being active in foreign investments, with many using investment entities to make foreign investments of endowment funds.

Compensation

- The indicated compensation of the highest paid officer, director, trustee or key employee (ODTKE) was highest for small institutions and lowest for small colleges and universities. This was also true for the highest paid employee that was not an ODTKE.
- A faculty member was most often the highest paid employee (other than ODTKE) at small and medium institutions, while at large institutions, it is most often a sports coach.

New Form 990 Schedule F Requires Additional Information for Organizations With International Activities

The introduction of the new Form 990 by the Internal Revenue Service (IRS) for 2008 tax years in some respects has streamlined reporting, but in other respects has significantly increased disclosure requirements to be made by exempt organizations. For example, additional reporting requirements apply to exempt organization activities outside the United States. This article is intended to introduce and clarify the foreign disclosure requirements reported on Schedule F of the new Form 990.

Prior to the new Form 990, reporting foreign activities on the old Form 990 was limited to a few questions/areas regarding foreign bank accounts (including indirectly held accounts through an over 50 percent owned stock entity) (line 91(b)), foreign grants (checkbox in Part III) and foreign offices (line 91(c)). The new Form 990, introduced in 2008, requires exempt organizations that meet certain dollar amount thresholds regarding their international activities to present detailed information on Schedule F. Schedule F is a four page schedule that consists of four parts. Supplementary Schedule F-1 is available for users that need extra space to report certain activities. Only the activities which the filing exempt organization performed directly, or those performed indirectly through a disregarded entity or joint venture taxed as a partnership are required to be reported. In addition, financial accounts reported on Part V, lines 4a and 4b are also not considered for Schedule F disclosure. If the exempt organization qualifies and chooses to file Form 990-EZ, Schedule F does not need to be completed, even if foreign activities may exist which meet Schedule F filing requirements.

The article examines filing strategies for exempt organizations and looks closely at:

- Part I: Grant-Maker Information and Activities per Region
- Part II: Grants and Other Assistance to Organizations or Entities Outside the United States
- Part III: Grants and Other Assistance to Organizations or Entities Outside the United States
- Part IV: Supplementary Information

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that will likely come to fruition and could have a harmful impact on the organization. This helps to determine where your organization directs your energy and focus in terms of addressing and mitigating risk.

ERM framework

A key for successful ERM implementation is to find a methodology that fits with the goals and mission of your organization and implementing it consistently and successfully over time. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework is widely used as the basis for implementing ERM, but other methodologies are also utilized depending on the needs of your organization.

As an example, the COSO framework identifies four critical risk areas of your organization: strategic, operations, reporting and compliance. For each of those areas, eight layers are evaluated to help build a platform for measuring and evaluating risk:

- Internal environment – The foundation of ERM, defining your risk management culture
- Objective setting – Aligning organizational objectives with strategy and risk appetite
- Event identification – Identifying external opportunities and threats
- Risk assessment – Identifying the impact and probability of risks
- Risk response – Assigning strategic actions to address risks; several potential actions ranging from evading a specific risk to exploiting it
- Control activities – Policies and procedures
- Information & Communication – Strategy for communication throughout the organization
- Monitoring – Actions for monitoring and remediation of the risks that are important to your organization

An organization will never be able to fully eliminate risk, but with the right controls in place, you can more effectively take advantage of risks that may present opportunities and avoid those that could adversely affect your operations. Implementing an ERM system could help your organization to create a more proactive atmosphere to successfully identify and address risk.



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