NONPROFIT EXAMINER

Financial & Management Issues for Nonprofit Organizations & Their Boards

New Accounting Rules May Affect Your Merger or Acquisition

by T.J. Leahy, CPA

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In today's economy many nonprofits have been combining and pooling resources to better enhance their ability to compete in a tighter marketplace. In an effort to develop better reporting of these combinations, the Financial Accounting Standards Board has issued standards (a Statement) governing whether a combination by two or more nonprofits is actually a merger or an acquisition. It has further required that specific accounting methods be used in order to account for assets and liabilities acquired by a nonprofit during a merger or acquisition.

The Statement is intended to improve the relevance, representational faithfulness and comparability of the information that a not-for-profit entity provides in its financial reports about a combination with one or more other not-for-profit entities, businesses or nonprofit activities. In order to accomplish this, the Statement includes several different principles and requirements to ensure that the information being presented by nonprofits is accurate and allows for others to easily compare financial information between nonprofits.

The rules provide guidance on specific accounting methods to be used for mergers and acquisitions. Furthermore, it provides procedures and requirements for determining whether a transaction was a merger or an acquisition. And, in the cases of acquisitions, it provides a mechanism for clearly determining which the acquiring entity was.

(Continued on page 2)

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(Continued from page 1)

Specifically, the Statement defines an acquisition as, "[A] transaction or other event in which a not-for-profit acquires control of more or more nonprofit activities or businesses and initially recognizes their assets and liabilities in the acquirer's financial statements."

The accounting method required for acquisitions requires nonprofits that have acquired other entities to specifically measure and account the assets, liabilities and any non-controlling ownership interests that have been obtained from the acquired entity at fair value at the date of acquisition. Furthermore, intangibles, such as goodwill, also will have to be valued during this process.

Merged entities, however, are subject to a different type of accounting method that will take the value of various categories of assets and liabilities at face value, merely carrying them over from one entity to the other. One important requirement of which nonprofits should be aware is that merged organizations must have a newly formed governing body, even if the nonprofit resulting from the merger is not legally a new entity.

Your accounting professional should be able to give you more information about the items presented in this article. We recommend that you call him or her today with any questions you may have.

Child Care Provider Audit Guide Released by IRS

by Steven P. DePasquale, CPA

While no one wants to be audited, it may help to know for what the IRS will be searching should you ever face an audit. The IRS regularly releases guides for various industries so that auditors have guidelines to follow when conducting an audit. Recently, the IRS released its "Child Care Provider Audit Technique Guide," which provides a number of issues that IRS auditors may look for when conducting an audit on these types of entities. Should you become the subject of an audit, please contact your financial advisor immediately.

Family day care centers, which are more traditional day care centers operated as a business out of an individual's home as defined by the IRS, must be sure to be prepared for an audit. In order to ensure that you are allowed to take all of the deductions that you've claimed, be sure that your business has obtained all of the proper licenses. Failing to do so may make claiming many deductions more difficult, if not impossible.

Auditors use IRS guides to ensure that the business's revenues are in line with industry standards. Typically, one of the first actions the IRS will take will be to match your revenues with the formula that the agent has in his or her guide. For child care centers, this formula multiplies the number of children, the number of weeks each child has stayed with you and an amount that is determined by the IRS to be the industry standard.

Next, the IRS may look at any claims you have made under the Child and Adult Care Food Program (CACFP). One of the most important provisions of the CACFP is that you have to be licensed in your state as a child or day-care provider in order to receive funds from the program. The IRS will also ensure that you are claiming the correct tier. Tiers in the CACFP are related to income so that child care providers in low-income areas will receive a larger subsidy than those not in low-income areas.

Also, if you have received a loan whose principal was forgiven, the IRS will ensure that you claimed the forgiven amount as taxable income. This will also apply to income

from interest, rental fees for day care facilities and other sources of miscellaneous income.

Examining the expenses for a child care provider is difficult as there are a number of considerations – the main difficulty for auditors is that items in the provider's home are used for both personal and business use. It is important in this case, as in all cases, to carefully document your purchases and have evidence to support any depreciation claims or deductions you are making for items that you use for both personal and business use. In most areas, the examiner will use his or her judgment to decide what constitutes an ordinary and necessary expense.

In addition to objects in the home, auditors will likely review your food expenses to ensure that they are in line with the number of children for whom you are caring. In addition, they will ensure that you are not deducting the cost of any food that is being used for personal consumption. They will also review your income to ensure that you are recording and reporting your income from CACFP in accordance with IRS practices and regulations.

Continuing with his or her examination, an auditor will likely review your business use of the home and deductions associated with such a claim. This is another complicated section for auditors because most other businesses in the home require that the business areas of the home are to be used exclusively to carry on business. Child care providers, however, may use all areas of their home for personal and business use. They are bound to "regularly" use an area of the home for business purposes.

Should you ever face an IRS audit, we recommend that you contact your tax professional immediately. He or she should have the expertise necessary to help you navigate through this process.

Economy Affecting Nonprofit Healthcare

by Jeff M. Keating, C.P.A.

It is well known that economic changes have been affecting many sectors in the economy, but our office has been finding that many nonprofit healthcare systems are choosing to cut services and reduce capital spending as a result of changes in the economy.

A recent survey conducted by a national nonprofit advisory firm confirmed what many of us suspected concerning the economy's impact on healthcare. The causes, however, are surprising as the variables driving these decisions are not necessarily tied to profit. The survey found that many healthcare organizations were more concerned with investment losses, which were significant over the past year and are uncertain in the future. Investment income was a significant source of operating revenue for many institutions. Therefore, the economic downturn had a great impact on those institutions that were relying too heavily on those revenue streams.

That being said, profit is a concern for most organizations as more than 56 percent saw a decrease in operating margin over the first quarter 2009 and approximately 40% anticipate that the trend will continue throughout 2009.

Despite lower profitability, according to the survey, most organizations expect the utilization at their facilities will continue to grow. Seventy-one percent of participants expect inpatient utilization to increase slightly during the next 12 months, and 82 percent expect outpatient utilization to increase in the same time period. Unfortunately, underinsurance and a lack of insurance from patients are negatively affecting some hospitals. In addition, many hospitals are significantly underreimbursed by Medicare, further impacting the bottom line.

(Continued on page 4)

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(Continued from page 3)

Finding donors was split nearly evenly as 27 percent said that they are seeing an increase in donations where the same number of hospitals is seeing a decrease. Some hospitals have seen an increase due to the construction of new, "signature" projects. When construction on these projects is completed, however, it is uncertain whether these hospitals will continue to see an increase.

Many of the hospitals involved in the survey have implemented or are implementing procedures to help combat slumping profits and a lack of investment returns. Thirty-one percent of the hospitals had reduced or were planning to reduce routine capital and other spending by more than 30 percent at the time of the survey. Furthermore, many had instituted a hiring freeze or were cautious about new hiring. Finally, some hospitals have considered closing locations, discontinuing services that were losing money or were not essential to the hospital's survival.

If you are looking for ways to cut costs in light of economic realities, please contact your financial advisor today. He or she should be able to assist you in developing strategies that will help you develop methods of moving back toward profitability.