

Financial Issues for Fire Departments

Presentation Notes

Slide 1 – Title

Slide 2

Are you from a

- 1) Municipal department?
- 2) Private corporation?

Slide 3

Municipal department

- Under town or city governance
- No board of directors
- Most accounting & bookkeeping functions handled by municipality

Slide 4

Private Corporation

- Legal checkup
- Are you really tax-exempt?
- 501(c)(3) or 501(c)(4) – which one to choose?
- IRS filings
- Sales tax refunds

Slide 5

Payroll issues – the slippery slope of compliance

- Who is an employee?
- IRS rules on compensating volunteers
- Do I file W-2s?
- What the heck is FLSA?
- Working & volunteering for the same department

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Financial structure

- Independence of treasurer
- Dual signatures
- Fidelity bonds
- Financial reporting
- Relief Fund rules

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Financial health

- Budget
- Long range plan
- Building and equipment financing

Slide 3 – Municipal Departments

If you are from a municipal department, much of the financial functions are out of your control such as bill paying, payroll compliance issues and so forth. You are all familiar with the annual budget preparation, but the day-to-day accounting is handled by the municipalities finance officer. You don't have a board of directors, but probably worse, you have a board of aldermen or commissioners with whom you have little or no input as to their election. Most boards of directors have some fire department representation in their makeup, but such is not the case in most municipal boards.

Slide 4 – Private Corporation

If your department is not organized under a municipality, then you are probably a private corporation. Many of you are now serving in departments that have been around for years and you have no idea when or how the department was organized or incorporated. The North Carolina Secretary of State maintains these records. Log on to www.secretary.state.nc.us/corporations/ and search the corporate database by name to check the status of your corporation. Hopefully, the report will indicate that you are current and not in suspension. Non-profit corporations are exempt from filing annual reports and paying the associated fee so you should not be suspended. This page should also indicate that you are a non-profit corporation. This page will also give you the ability to view certain documents from their PDF files and print a copy if you do not have copies.

Tax Exemption

First of all, your Secretary of State report should indicate that you are a non-profit corporation. This simply means that your department was incorporated under NCGS 55A which is the non-profit statute. It does not mean that you are automatically exempt from Federal income tax nor does it mean that the public's contributions to you are tax deductible. The department has to apply to the IRS to get this special status. If the IRS approves the application, they will issue a determination letter. This letter is very important since it is your proof that you are tax exempt. You should make every effort to locate this letter. Any current or potential contributor has the right to request to see this letter. What if you can't find a letter for your department? The IRS maintains a list for potential contributors to review called "Publication 78" which lists organizations which the IRS has qualified as tax exempt. This is available at www.irs.gov. The site warns you that the list is not all inclusive – so there can be organizations missing that have bona fide tax exemption. Your letter of determination is the key. If you are still unsure of your status you can always call the IRS and give them your Federal ID number and have them research the matter for you. Oh yes – there is no such thing as a "tax exempt number". All corporations have a Federal ID number but it in no way indicates tax exemption.

There are probably hundreds of departments in North Carolina who are not tax exempt in accordance with the IRS regulations. Many have operated for years in this situation. If you are soliciting donations from your property owners or the general public, you owe it to them to guarantee their tax deduction for their good faith contribution to your organization. Not to mention the fact that if your department were audited, you probably couldn't pay the tax bill assessed on years of operating profits.

So how do you apply? You should be aware that there are 2 different IRS Code sections which apply to exemption for fire departments. You need to determine if you want to be exempt under Section 501(c)(3) or (c)(4). The first one is for any "charitable, religious or scientific" organization and the

application is more involved than for the (c)(4). The (c)(4) application covers “Civic Leagues and Social Welfare Organizations” which, believe it or not, includes volunteer fire departments. Both exemptions allow for tax deductibility of donations but the (c)(3) is more broad in its exemptions, and most grant agencies look for (c)(3) status in awarding grants since these organizations are considered charities. An IRS Form 1023 is submitted for (c)(3) status and Form 1024 for (c)(4) status. The forms are available on the IRS web site at www.irs.gov. The applications for each are quite lengthy and technical in nature and you probably should consult a CPA experienced in these matters if you do not have anyone qualified in your department to help. A word of warning – the IRS charges a user fee to submit the application. It’s currently \$400 or \$850 depending on the 4-year average gross receipts for the organization.

Once you are determined by the IRS to be tax exempt, be aware that there is an annual tax return to be filed by the department called a Form 990. Be also aware that even though you are tax exempt, certain “unrelated business income” sources of \$1,000 or more are considered outside the non-profit boundary and can be taxed; so your organization can still wind up paying Federal income tax. This is a very complicated subject, so consult a tax advisor. The IRS Publication 557, “Tax-exempt Status for Your Organization” is an excellent source of information. The main thing is to be aware of these rules as a chief.

Does your department file for refunds of North Carolina sales tax paid on its purchases? Many persons have the misconception that fire departments do not pay sales tax and even talk vendors into not charging them sales tax. Departments should pay the tax and then file for refunds semi-annually. The North Carolina Department of Revenue made a rule a couple of years ago that a department had to be 501(c)(3) exempt to be able to receive the refunds, The NCSFA led the fight to lobby for a repeal of this and was successful. Volunteer fire and rescue agencies can still receive refunds even if they are not Federal tax exempt, but such legislation is a sign of the times and another reason to obtain full tax exemption.

Slide 5 – Payroll Issues

Most of you in the audience are from fully volunteer departments. Many, however, are making the move to a combination department or, at least, are considering some form of compensation to your members as a means of recruitment or retention. In either event, you now are an employer and you have employees. The issues and rules surrounding tax withholding and compliance are beyond the scope of this presentation and again, you should consult an accountant for help in this area if you have never had employees before. The emphasis of this discussion is to make you as a chief aware of several pitfalls in the employment area of which you should be aware.

The IRS recently passed legislation aimed directly at fire departments concerning the payment of compensation to its members. Many departments pay small amounts to their members either on a per call basis, or possibly a quarterly or annual amount. The purpose is not to compensate the member for time worked, but to pay a small amount to offset the cost of operating their personal vehicle or to give some incentive to make calls. In the past, departments have either ignored this for tax purposes or some have reported it on a Form 1099, which was incorrect. In any event, neither the department nor the individual member considered it income. The IRS now says that any payment to the member must be reported on Form W-2 at year-end and appropriate taxes withheld. Not only are Social Security taxes required to be withheld, but the employer (the department) must pay the matching tax. This creates

both a paperwork and financial burden to the department, not to mention taxing the member on something that was never intended to be income.

There are 2 exclusions to this rule, neither of which are probably feasible. First, the Internal Revenue Code has always exempted payments made to employees for expense reimbursements made under an “accountable plan”. This means that if the member employee keeps a mileage log of his travel and submits it to the employer and the employer reimburses him at a rate not exceeding the Federal maximum (\$.50 per mile for 2010), the reimbursement will not be subject to tax or reporting. Now really – how many of us are going to do that? It must be a part of an accountable plan – just because the department calls a payment a travel reimbursement doesn’t mean it is unless, of course, it meets the criteria.

The second exclusion probably only applies to municipal departments. If the department compensates the members by a reduction in taxes, water or utility bills or some other city-supplied service, then the payment is not taxable or reportable. Try selling this idea to your city manager.

This ruling creates a double problem for us in North Carolina. Volunteer fire and rescue squad members get a small tax credit against NC income tax. The definition from the Department of Revenue of a volunteer is one who is “uncompensated”. So under the IRS reporting rules, a payment for vehicle use appearing on a W-2 Form will disqualify the individual from the State tax credit, small as it is. The NCSFA has lobbied with NC Senators and Representatives to get this repealed, but there is no indication of its success.

It is unfortunate that possibly a successful recruitment and retention tool has invoked the displeasure of the IRS and is now a complicated matter.

Speaking of complicated matters and government interference in things – who in the audience knows what FLSA is? This is the Fair Labor Standards Act and it has been around since the 1930s. It has been modified surprisingly little since its inception. It deals primarily with 2 issues – child or youth employment and overtime rules. The overtime rules give the fire service the most heartburn. Again, this is far too involved for an adequate discussion here, but a few points need to be mentioned. These topics involve combination departments where someone is a volunteer for a department and also works there. The short answer is – you can’t or shouldn’t if you are working very many hours. The Act says you cannot choose to work for your employer without compensation. I don’t think the Act had volunteer fire departments in mind when it was written – it was created to look after the health, welfare and fair treatment of the workforce. A labor consultant on the Act once said in a seminar that the fire service was the only industry he knew of where the workers didn’t care how long they worked and didn’t expect overtime pay for their labor. The fact is that if you work as a paid firefighter full-time and answer calls or do training on your time off for the same department, the department must compensate you at overtime rates for the extra time. Most departments starting to hire personnel would naturally look to its current volunteers for hiring since they are already familiar with the equipment, protocols and response district. However, this can lead to violation of labor laws, unless the department is willing to lose that person for volunteer call. Most of us can’t afford to lose any volunteer response.

If you are caught violating the law, the US Department of Labor would be the entity with which you would have to deal. Fire departments of any size come under the jurisdiction of the USDOL and not the NCDOL. If we operate a vehicle or respond to accidents on highways funded by the Federal government, we are involved in interstate commerce and therefore we are under Federal jurisdiction. This is a serious area and citations can be costly, in addition to the payment of missed overtime to the employee. If your department is in this situation now, you should consult either an attorney experienced in this area or a labor law consultant. If your department is considering transitioning to combination status, consult a professional or at least contact another department who has successfully made the transition. Both the NCSFA and NCAFC have had seminars and roundtable discussions on this topic at their conferences and have been very successful and informative.

Slide 6 – Financial Structure

Every year we read in the news of a fire department or rescue squad treasurer who has been charged or suspected of embezzling or misappropriating funds. While we are not suspecting this in any department, establishing good financial controls is a good starting point to insure your department does not make the headlines in a negative way. While the ideal set-up would be to have separate individuals handle various financial functions within the department (called segregation of duties), the lack of personnel or funding to pay an accounting department is a reality. At the very least, the treasurer should be independent of other officers in the department structure. For example, I know of departments in which the chief's wife is the treasurer. While this is not implicitly wrong, it obviously has visual problems – it just doesn't look right! Some good practical solutions to the segregation of duty problems would include having dual signatures on checks; having the chief or purchasing officer approve and document approval of invoices for payment and possibly have the secretary or chief check and open the mail; recording any funds received for contributor lists, thank-you notes etc. and then giving to the treasurer for deposit.

While dual signatures can be a pain, it is a good internal control. Getting both officials together to sign can be a problem, admittedly. Using a signature stamp for one of the signatures helps the inconvenience but unless access to the stamp is controlled, you have not accomplished anything as far as internal control. Approval of invoices by an independent person prior to payment is very important. Many financial crimes do not involve the actual theft of cash, but the misuse of funds by paying personal bills with department money. Credit cards seem to be the most common vehicle for this type of crime.

Most package insurance policies contain a "fidelity bond" which covers the treasurer and any other department members handling money. This is a policy which reimburses the department for losses from misappropriations. Check with your insurance carrier regarding this feature. If your policy does not cover this, it can be added very simply.

Many financial improprieties can be discovered through an in-house review of financial reports by the officers or board of directors. These persons know about purchases or other items from their role as an officer and can look for these transactions in the financial reports or notice the inclusion of items they are not familiar with. The board of directors should get regular fairly detailed financial reports for their review. Software such as QuickBooks produces basic financial reports suitable for presentation to the board or membership. The governing board needs good information to make sound decisions for the department. The degree of detail in financial reporting to the membership is a matter of departmental

choice. I have been in departments and heard financial reports which consisted of only the checking account balance. It is imperative that the membership have confidence in the financial leadership of the department and good reporting and clear communication is the key. An audit by an external CPA is usually unnecessary and cost prohibitive and really does not yield the information that the department desires. Many departments appoint an “audit committee” from the membership to periodically look over all the financial records, including invoices, etc. in lieu of an external audit. Check your bylaws, grant provider or County requirements – some of these could require an audit.

Hopefully all of you are aware of the need for an independent board, treasurer and bank account for Relief Fund monies. This account should be interest-bearing and must be reported on the annual Relief Fund report due July 31 of each year to the NCSFA.

Slide 7 – Financial Health

While many of you in municipal departments must participate in the annual blood-letting process called the budget, it is surprising how many corporate fire departments operate without one. A budget is an important document but is only good if it is reasonable, realistic, dynamic, compared to actual revenues and expenditures regularly and modified when situations change. Comparison with budgeted amounts is also another tool to help uncover financial misappropriations.

Along with budgets, a long range plan is important for financial health. Apparatus and equipment replacements, hiring of personnel and opening of new stations for improved coverage must be planned for well in advance. Planning for these expenditures can indicate when and how much tax increases or contribution drives are necessary. Like a budget, it is important that the plan is a living document – it must change as new information becomes available. The plan should be well documented and have benchmarks to measure progress and adherence to the plan. Involve enough stakeholders to insure broad input.

As a part of the financial plan, investigate all sources of financing for capital outlays. Many banks and companies offer lease/purchase arrangements which allow purchases at tax exempt interest rates. The Local Government Federal Credit Union offers competitive rates for construction and apparatus purchases. Finally, be aware of grant funds available and non-traditional revenue sources.