NONPROFIT HOT TOPICS

QUESTIONS AND ANSWERS

Employed

Finance Committee

Board Member
STATISTICS

- How many exempt organizations in the United States (as of November 2015)
  - **1,549,296 Nonprofits**
    - 1,178,739 Charitable Organizations
      - 1,076,309 Public Charities
      - 103,430 Private Foundations
    - 369,557 Other Exempt Organizations
  - In 2010, exempt organizations accounted for **9.2% of all salaries and wages** paid in the US
  - Nonprofits’ share of the GDP was 5.3% in 2014
  - In 2013, revenue of all public charities in the US was:
    - 21% contribution revenue
    - 72% program service revenue (which includes grants from governmental entities)
    - 7% other revenue (special events, unrelated business income)

SCOPE & TYPES OF NONPROFITS

<table>
<thead>
<tr>
<th>Charitable/Public Support</th>
<th>Hybrids</th>
<th>Businesslike</th>
</tr>
</thead>
<tbody>
<tr>
<td>Voluntary Health &amp; Welfare</td>
<td>Performing Arts</td>
<td>Trade &amp; Professional Associations</td>
</tr>
<tr>
<td>• Social Service</td>
<td>• Operas</td>
<td>Social and Country Clubs</td>
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<tr>
<td>• United Ways</td>
<td>• Symphonies</td>
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<tr>
<td>Religious Organizations</td>
<td>Museums and Zoos</td>
<td>Cemetery Organizations</td>
</tr>
<tr>
<td>Community Foundations</td>
<td>Colleges &amp; Universities</td>
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<tr>
<td>Public Broadcasting</td>
<td>Fundraising and Supporting</td>
<td></td>
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<tr>
<td></td>
<td>Organizations</td>
<td></td>
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<tr>
<td>Environmental Protection</td>
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<tr>
<td>Some Children’s Hospitals</td>
<td>Research/Educational Hospitals</td>
<td>Health Care Systems</td>
</tr>
<tr>
<td>• Shriner’s Hospitals</td>
<td>• Hospitals</td>
<td></td>
</tr>
<tr>
<td>• St. Jude's</td>
<td>• Nursing Homes, CCRCs</td>
<td></td>
</tr>
<tr>
<td>• Physician Practices, HMOs</td>
<td>• Other revenue (special events,</td>
<td></td>
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<tr>
<td></td>
<td>unrelated business income)</td>
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</tbody>
</table>

Outside the Scope

Investor-owned entities, employee benefit plans, and entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants. Examples include mutual insurance companies, credit unions, and farm and rural electric cooperatives.
COMMON FINANCIAL REPORTING DEFICIENCIES

• Board designated/restricted amounts are reported as restricted

WHEN ARE DONATIONS TRULY RESTRICTED?

Donate Today
Restricted Net Assets

Is Donation Restricted?
- Yes: Is Donation Permanently Restricted?
- Yes: Restricted Endowment
- No: Is Use of Earnings Restricted?
  - Yes: Temporary Restricted or Unrestricted
  - No: Unrestricted Endowment

“Donor Intent”

Common Financial Reporting Deficiencies

- Negative balance displayed in temporarily restricted net asset class
COMMON FINANCIAL REPORTING DEFICIENCIES

• Revenue related to pledges due in future periods should be reported as temporarily restricted

COMMON FINANCIAL REPORTING DEFICIENCIES

• Contributed services that do not meet specified criteria included in Income
  • The services create or enhance a nonfinancial asset
  • All 3 of the following apply
    • Services require specialized skills
    • Services are provided by someone who possesses those skills
    • Services would typically need to be purchased or acquired by the organization if they had not been contributed
  • Could still apply if organization trained its volunteers in a specialized skill

• Not recording in-kind gifts
COMMON FINANCIAL REPORTING DEFICIENCIES

- All expenses should be reported as decreases in unrestricted net assets
  - Losses may be reported in any class (bad debt, investment losses, etc.)

FINANCIAL STATEMENTS-PROPOSED IMPROVEMENTS

- Model last overhauled ~20 years ago
  - FAS 117 (now codified in Topic 958 of the ASC)
- Improve net asset classification scheme
- Improve information in financial statements and notes about:
  - Financial/operations performance
  - Cash flows
  - Liquidity
Net Asset Classification Scheme

- Two classes of net assets
- Disclosure of amounts and purposes of board-designated net assets
- Underwater endowments
  - Modified classification
  - Enhanced disclosure.

Changes in Key GAAP Metrics

<table>
<thead>
<tr>
<th>Line Item</th>
<th>Current</th>
<th>Proposed</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance Sheet</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrestricted Net Assets</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Temporarily Restricted Net Assets</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Permanently Restricted Net Assets</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Totals for Assets, Liabilities, and Net Assets</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Revenue, Expenses, and Other Changes</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating Excess/Deficit Before Transfers</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Operating Excess/Deficit After Transfers</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Investment Return, Net</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Health Care Performance Indicator</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Change in Unrestricted Net Assets</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Change in Temporarily Restricted Net Assets</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Change in Permanently Restricted Net Assets</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Total Change in Net Assets</td>
<td>✓</td>
<td>✓</td>
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</tbody>
</table>
CASH FLOW STATEMENT

• Current GAAP – Direct or Indirect acceptable
• Proposed GAAP
  • Requires direct method for operating cash flows
  • Re-categorize certain items on the cash flow statement to better align operating information with the statement of activities

REPORTING OF FUNCTIONAL EXPENSES

• Current GAAP – required only for health and welfare organizations
• Proposed GAAP – expenses reported by nature and function either in statement of activities, schedule of functional expenses or in notes for ALL nonprofits.
REPORTING OF FUNCTIONAL EXPENSES

• Expense by nature and function – one place in the financial statement
  • Statement of activities, separate statement, or schedule in notes

<table>
<thead>
<tr>
<th>Program Activities</th>
<th>Supporting Activities</th>
<th>Total Operating Expenses</th>
<th>Non-Operating</th>
<th>Total Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Program A</td>
<td>Program B</td>
<td>M&amp;O</td>
<td>Fundraising</td>
<td></td>
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<tr>
<td>Salaries &amp; Benefits</td>
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<tr>
<td>Grants to Others</td>
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<tr>
<td>Equipment Rent &amp; Maintenance</td>
<td></td>
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<tr>
<td>Occupancy Cost</td>
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<tr>
<td>Depreciation</td>
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<tr>
<td>Information Technology</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Professional Services Fees</td>
<td></td>
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<tr>
<td>Supplies</td>
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<tr>
<td>Travel</td>
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<tr>
<td>Printing &amp; Publication</td>
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<tr>
<td>Interest</td>
<td></td>
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<tr>
<td>Other</td>
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<tr>
<td>Total</td>
<td></td>
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</tbody>
</table>

FUNCTIONAL EXPENSE ALLOCATION

• GAAP – very subjective
  • Standards indicate allocation methodology must be reasonable, consistent and documented

• Methodology
  • Time
  • Square footage
  • Meaningful trigger - Number served and Cost/student

• Benchmarking
  • Program Services – 65%
  • Management & General – 20%
  • Fundraising – 15%
FINANCIAL STATEMENTS: LIQUIDITY

- Current GAAP – no requirement
- Proposed GAAP – quantitative and qualitative disclosures required
  - Quantitative
    - The total amount of financial assets
    - Amounts that are not available to meet cash needs
    - Total amount of financial liabilities that are due
  - Qualitative
    - How the organization manages its liquidity

OVERALL FEEDBACK BY AREA

- More supportive
  - Net asset changes/disclosures
  - Underwater endowments
  - Expenses by nature and function
  - Investment return
- Mixed feedback
  - Direct method cash flows
- Less supportive (at least of some key aspects)
  - Operating measures
  - Cash flow realignments
  - Disclosure of liquidity info
DECISIONS REACHED AT LAST MEETING
(MARCH 30, 2016)

• **Transition Method**
  • Apply on a retrospective basis for all years presented.
  • If comparative financial statements, option to omit the following information for any years presented before the year of adoption:
    • Analysis of expenses by both functional and natural
    • Disclosures around liquidity and availability of resources.

• **Effective Date**
  Fiscal years beginning after December 15, 2017,
  Early adoption allowed

REVISED OVERTIME REGULATIONS

• Current exemption salary threshold of $23,660
• Increase the threshold to $50,440  $47,476
• Finalized and issued by May 18, 2016
• Takes effect December 1, 2016
• Expected to affect millions of employees who are currently classified as exempt from overtime
WHEN WILL THE REVISED OVERTIME REGULATIONS BE FINALIZED?

- Review employees whose salary falls below the $47,476 threshold
- Do individuals work more than 40 hours per week?
- If so raise salary to $47,476 or
  - convert to non-exempt pay plan and pay at time and a half or
  - limit hours to 40 hours a week or
  - Some combination of these
- Comp time options for state government agency, no others

OVERTIME REGULATIONS AND NONPROFITS

- Nonprofit charitable organizations are not covered enterprises under the FLSA, however, unless they engage in ordinary commercial activities that result in sales made or business done that meets or exceeds $500,000 or
- An employee who engages in interstate commerce is covered by the FLSA. Such activities include making out-of-state phone calls; mailing information or conducting business via the U. S. mail; ordering or receiving goods from an out-of-state supplier; handling credit card transactions; or performing the accounting or bookkeeping for such activities. Except if only on occasion, and for an insubstantial amount of time.
RESOURCES

• Department of Labor
  • The DOL has released three technical guidance documents designed to help private employers, non-profit employers and institutions of higher education
  • [https://www.dol.gov/featured/overtime](https://www.dol.gov/featured/overtime)

UNIFORM ADMINISTRATIVE REQUIREMENTS, COST PRINCIPLES, AND AUDIT REQUIREMENTS FOR FEDERAL AWARDS (UNIFORM GUIDANCE)

• Increase - threshold for a single audit from $500,000 to $750,000 or more of federal awards expended in a fiscal year
• Increase in the threshold for type A or B major program determination from $300,000 to $750,000 or more of federal awards expended (minimum)
• An increase in the questioned costs reporting threshold from $10,000 to $25,000
• Effective - fiscal years beginning on or after Dec 26, 2014
FORM 990 EXTENSION CHANGES

• Still required to file by the 15th day of the 5th month; however, the new law prescribes that the two three-month extensions will be replaced with one automatic 6 month extension

• Effective for tax years beginning after December 31, 2015

IRS CHARITABLE ROLLOVER MADE PERMANENT

• For the past several years, taxpayers who are age 70½ or older were allowed to make tax-free distributions to a charity from an Individual Retirement Account (IRA) of up to $100,000 per year.

• Distributions not included in gross income and contributions not claim as deductions, thus they subject to the charitable contribution percentage limits.
The Legacy IRA bill (close to being introduced) would authorize:

- Tax-free IRA rollovers for gifts that benefit charities and
- Provide taxable retirement income—charitable life-income plans—for the donors.
- At the donor’s death, the assets in the plan are owned outright by the qualified charity.

Housing Benefits for Ministers Back Under Attack
BUDGETING

• Usually cash basis, important to budget for capital improvements, debt & reserves
• Usually prepared based on prior years’ results, or zero based (start from scratch).
• Participation/Buy-in by department heads and others is essential.
• Should not be budgeting to break even/budget excess or reserve.
• Monitoring—the budget should be compared to actual results on a periodic basis by Staff and Finance, usually monthly. Unexplained variances should be examined.
• Cost/benefit should always be considered in developing the budget process given the resources, size and complexity of the organization.
• Finance provides oversight, not necessarily decide specifically how money will be spent - set guardrails

BUDGETING OPERATING RESERVES

Cash Flow Fluctuation
  +
Unplanned Events
  +
Potential Opportunities
  =
Reserves Balance Target
CASH OPERATING RESERVES... HOW MUCH?

- 76.5% of ECFA-certified churches has the equivalent of 2 or more months of cash operating reserves at the end of their last fiscal year. By month:
  - 76.5%............2 or more months
  - 47.1%............3 or more months
  - 32.4%............4 or more months
  - 29.5%............5 or more months
  - 11.8%............6 or more months

SEGREGATION OF DUTIES AND INTERNAL CONTROLS
INTERNAL CONTROLS

• Important for all organizations regardless of size and complexity
• Goal: Balancing asset protection with efficient operation
• Not a matter of trust

BOARD OF DIRECTORS

• Be involved
• Ask questions of management and the auditor
• Follow up on comments from the audit
• Organization’s compliance with filing requirements
  • Payroll
  • 990
SEgregation of Duties

• Important considerations that are similar for any size organization
• A financial transaction is not handled by only one person from beginning to end
• For small organizations, involvement of Board of Directors and/or nonaccounting personnel can help segregate duties

Cash Receipts

• Same person should not handle all of the following aspects:
  • Receiving the cash
  • Processing the deposit
  • Recording the transaction
  • Reconciling the bank statement
CASH DISBURSEMENTS

- Same person should not handle all of the following aspects:
  - Authorization
  - Processing
  - Check signing
  - Recording
  - Reconciling the bank statement

CASH DISBURSEMENTS

- All reimbursements and expenses should have proper supporting documentation before payment is issued and the documentation should be retained with the check.
- Consider use of purchase requisition form
- Use tax-exempt form when possible for purchases
BANK RECONCILIATIONS

• Timely reconciliation
• Reconcile to bank and financial records
• Review by person separate from deposit and disbursement function (or even prepare reconciliation)

PAYROLL

• Timely preparation of payroll tax returns and payment of taxes
• Reconciliation of wages on 941s to financial records/general ledger
Policies and Procedures

- Needs to be written
- Provides opportunity for persons involved in a process to consider whether there are inadequacies in the process or more effective or efficient ways to perform it.
- Documentation used in reinforcing established policies and procedures, evaluating performance, or training a new employee or volunteer to perform the process.

Benchmarking

- Change in headcount vs. change in revenue
- Program efficiency
  - Cost per member served vs. dollar earned per member served
- Salaries and wages as a percent of total expense
- Occupancy
  - By square foot
  - As a percent of total expenses
MORE BENCHMARKING

• Fundraising efficiency
  • Rule of thumb: benchmark between 5-20%

• Reserve Funds/Quasi Endowments
  • BBB says an NFP’s reserve fund should not be greater than:
    • 3x the amount of the past year’s total expenses
    • Current year’s total budgeted expenses

• Liquidity
  • Days cash on hand
  • Current ratio >1
  • Receivables or payables >90 days

CHARITABLE CONTRIBUTIONS

Posted by on Feb 18, 2014
MAKE SURE YOUR CHURCH AND OTHER CHARITABLE CONTRIBUTIONS WILL BE ALLOWED BY THE IRS.

The IRS is repeatedly and often referring to a tax court case (Ducanen v. Comm, T.C. Memo 2012-140) in which charitable contributions were disallowed even though the taxpayer had a receipt from the church. The receipt that the organization provided its contributors did not state that “the taxpayer received no goods or services from the charitable organization.” In this case, the taxpayer did not receive any goods or services. The deduction was disallowed!

FOR TAXPAYERS
You need to ask your charitable organization to add this to their receipts for charitable contributions if it is not already stated on the receipt. Be certain to get a new receipt before a return is filed. You will need this receipt before the return is filed.

FOR NONPROFITS
Since the phrase “the taxpayer received no goods or services from the charitable organization” is standard on most charitable donation receipts for most organizations, it is sometimes easy to leave off when doing a receipt in special situations, many times involving noncash gifts. It is very important that all nonprofit organizations make sure this statement is on all receipts/letters where this is truly the case.

For charitable organizations, this statement needs to be added to the receipts/contribution statements that you provide to contributors for charitable contributions if it is not already stated on the receipt. This receipt is needed by the contributor before he or she files a return.
PROPER RECEIPTS

This phrase must be included on every receipt for the donor to receive a tax deduction:

“The taxpayer received no goods or services from the charitable organization.”

CURRENT ISSUES TO CONSIDER

• Going Digital-Less Paper
• Cloud Software/Use of Portals
• Online Giving
• Dashboard Reporting
• Endowments
• When was your last Long Range Plan done?
Crowd Funding

- Social media trends
  - Twitter, Facebook, blogs
  - Need to consider donor base who do not use/own smartphone
- Crowd funding
  - Accountability/controls
  - Joint cost allocation

Best Practices

- Finance Committee – Active & Knowledgeable
- Good accounting and internal control systems
- Comprehensive Budget process from beginning to end
- Timely reporting, monitoring and transparency
- Invests in training & technology
- Stewardship training
- Benchmarking
NEW COLLEGE SCORECARD

• A new consumer tool, known as the College Scorecard, provides key measures of institutional performance.
• Scorecard users may also choose to look at information about financial aid and debt, graduation and retention, student body, SAT and ACT scores, and academic programs.

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• FASB Improvements to Not for Profit Financial Statements Project-Proposed Video Summary
• http://link.brighl93ImWA9UmOn01DYx4qBxBNWp0unpEPc&bclid=4191647608001&bcti
d=4194154033001tcove.com/services/player/bcpid4191633869001?bckey=AQ~~,AAACA
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**Proposed Improvements**

1. Net Asset Classification
2. Operating Performance
4. Liquidity