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News for Nonprofits

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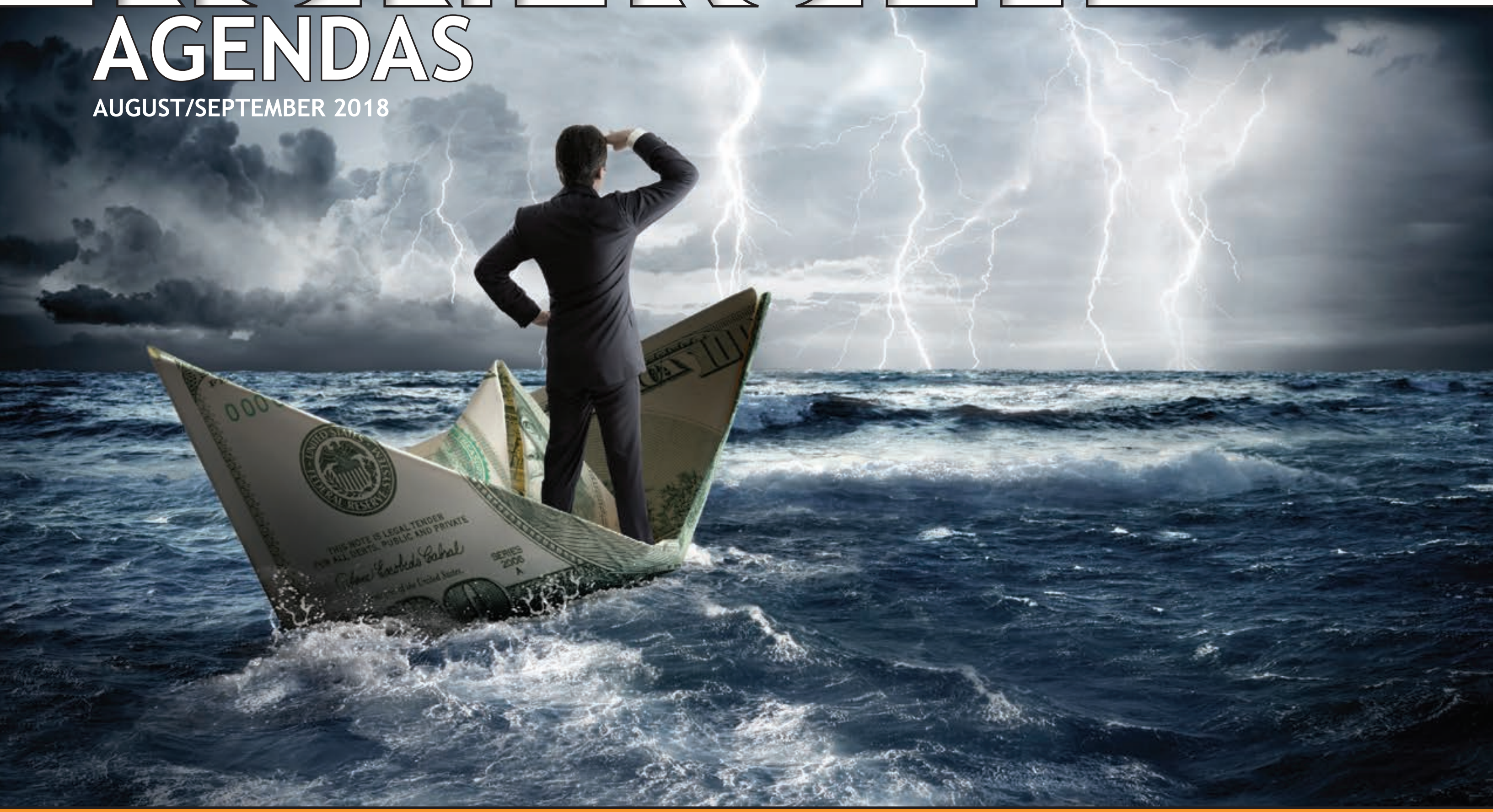

SECHLER MORGAN CPAs PLLC

TAKING CARE OF BUSINESS

info@azcpa.com
2418 W Barrow Drive, Chandler, AZ 85224
Tel: 602.230.2700/Fax: 602.230.2705
www.azcpa.com

Financial trouble spots that should trigger alarms for your board

When not-for-profits are losing funding sources, defaulting on loans or leaving employees unpaid, board members can clearly see that they're in financial crisis. Often, though, the board could have averted such disasters if it had recognized some of the subtler signs of distress. By keeping an eye out for the following problems, a board can take prompt action to minimize the damage and ensure the organization's long-term survival.

Budget bellwethers

Several budget-related issues hint at rocky financial times to come. Most obviously, board members should worry a great deal about a nonprofit with no budget. The lack of an operating budget suggests an undisciplined approach to fiscal matters. And larger nonprofits also should have budgets for each program or department. Ideally, board members will see that budgets proposed by management are in line with the strategies already developed and approved by the board.

Once a budget has been approved, the board should monitor it for unexplained variances. Some variances are bound to happen, but staff must explain *significant* discrepancies. There may be a reasonable explanation. The staff might, for example, point to program expansion, funding changes or economic factors beyond the organization's control. Where necessary, the board should direct management to modify activities to mitigate negative variances, for example by instituting cost-saving measures.

Board members also should beware of overspending in one program that is funded by another. Watch, too, for dipping into the organization's "rainy day" fund (its "reserves"), raiding an endowment or engaging in unplanned borrowing. Such moves might mark the beginning of a financially unsustainable cycle.

Financial statement flaws

Untimely, inconsistent financial statements — or statements that aren't prepared using U.S. Generally Accepted Accounting Principles (GAAP) — can lead to poor decision-making and undermine a nonprofit's reputation. They also can make it difficult to obtain funding or financing if deemed necessary.

Financial statements not prepared in accordance with GAAP, or another comprehensive basis of accounting, also can be unreliable and are difficult to compare to others in the industry. For larger nonprofits, the board or audit committee should also insist on annual audits and expect to select the audit firm. Members of the responsible group should communicate directly with auditors before and during the process. And all board members should have the opportunity to review and question the audit report.

The board generally should receive the nonprofit's financial statements within 30 days of the close of a period. Late or inconsistent financials could signal understaffing, poor internal controls, an indifference to proper accounting practices or efforts to conceal.

Donor doubts

If the board starts hearing from long-standing, passionate supporters who're harboring doubts about the organization's finances, that's a very bad sign. What are they seeing or hearing that prompts their concerns?

The board also should note when development staff begins reaching out to historically major donors outside of the usual fundraising cycle. These contacts could mean the organization is scrambling for cash and hoping its most dependable donors can help fill the gaps.

Excessive executive power

It's understandable that board members who have full-time jobs and other responsibilities might cede some of their responsibilities to a trusted executive director. It's also risky.

So, what are the signs of an executive director who wields too much power? The board should think about making some changes if the executive director chooses the auditor or adds board members, is allowed to ignore expense limits, or makes strategic decisions without board input and guidance.

Proceed with caution

While board members need to remain alert for trouble spots, it's important not to jump to immediate conclusions if a red flag is uncovered. Further investigation is almost always required. The mere existence of a warning sign doesn't necessarily merit a dramatic response, especially if it's the *only* warning sign.

Some problems prove easily correctable by, for instance, outsourcing some accounting functions if the finance department is understaffed. On the other hand, multiple or chronic issues could call for significant strategic changes. One thing is certain, though: Inaction in the face of trouble spots is a mistake.

Get ready for the new revenue recognition rules

The new accounting rules for recognizing revenue will take effect for most not-for-profits at the beginning of their next fiscal year. While the total revenue recognized over time won't change, you should understand how the timing and information you must share will — and how you can prepare.

Nonprofits with public bond issues have already been required to implement the new rules.

What's it all about?

The Financial Accounting Standards Board's (FASB's) Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, lays out five steps organizations that follow U.S. Generally Accepted Accounting Principles (GAAP) must take to recognize revenue:

1. **Identify the contract with a customer.** The rules generally apply to each contract that an organization has with a customer.

2. **Identify the performance obligations under the contract.** If a contract contains more than one performance obligation (that is, a good or service the organization promises to provide), it can account for each separately only if each promised good or service is 1) distinct or 2) a series of distinct but substantially similar goods or services.

3. **Determine the transaction price.** The organization must determine the amount it expects to receive in exchange for transferring promised goods or services to the customer.

4. **Allocate the transaction price to the performance obligations under the contract.** The organization will typically allocate the transaction price to each performance obligation based on the relative "standalone selling price" of each distinct good or service promised.

5. **Recognize revenue as performance obligations are satisfied.** The organization must recognize revenue when it satisfies a performance obligation by transferring the promised good or service to a customer. The amount recognized is the amount allocated to that performance obligation. When a performance obligation is satisfied over time, as opposed to a single point in time, the organization must recognize revenue over time.

The new rules also require disclosures of both quantitative and qualitative information about the organization's contracts with customers, significant judgments and assets recognized from the costs to obtain or fulfill a contract. Significant judgments requiring disclosure include those surrounding the price and timing of the satisfaction of performance obligations.

What about nonprofit revenues?

ASU 2014-09 generally applies to "reciprocal transactions," in which each party receives and sacrifices something of approximately equal value. Contributions to a nonprofit are received as a nonreciprocal transfer, though, so they don't fall within the scope of these rules. (See "Guidance on contributions is coming" on page 5 for more information.)

But you might receive several other types of revenue that *are* covered, including:

- Membership dues,
- Sales of products and services,
- Conference and seminar fees,
- Tuition,
- Subscriptions,
- Advertising,
- Licenses and royalties,
- Sponsorships, and
- Special events.

The payment structure of some transactions could complicate the fourth revenue recognition step — allocating the transaction price.

For example, membership dues may include a contribution, as well as a variety of membership benefits the organization will provide at different points in time. You would need to separate out the contribution component, and only recognize the revenues associated with the benefits when the good or service is transferred to the member. Compliance with ASU 2014-09

Guidance on contributions is coming

Contributions generally are reported in the period the pledge or commitment to donate the funds is received. Nonprofits should be aware, though, that the FASB is working on new guidance about the proper accounting for contributions.

In August 2017, the board issued an exposure draft of a new ASU, *Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*. It provides a framework for determining whether grants and similar contracts are contributions subject to the general rule or are reciprocal transactions subject to the rules in ASU 2014-09. According to the FASB, the guidance on distinguishing contributions from reciprocal transactions could result in more grants and contracts being accounted for as contributions.

As of this writing, the FASB had directed staff to draft an ASU for vote. If approved, the new guidance will take effect for most nonprofits for annual reporting periods starting after December 15, 2018, with early adoption permitted. Check with your CPA regarding the current status.

will thus call for more estimates and greater judgment than currently required.

Act now

Nonprofits must apply the new rules to annual reporting periods starting after December 15, 2018. With the effective date looming near, you need to take several steps to prepare now.

For example, you'll need to assess your accounting policies, processes and controls to ensure that you capture any additional information required to comply with the rules. You also should determine whether you have employees qualified to make the requisite estimates and judgments. And you may need to meet with lenders to renegotiate any loan covenants affected by revenue. ■

A match game

What to look for before becoming a fiscal sponsor

More and more these days, smaller nonprofit organizations, or groups of individuals who aren't tax-exempt, are asking larger, more senior nonprofits to sponsor a project. What should you consider before agreeing to become a fiscal sponsor?

Understanding the concept

With a fiscal sponsorship, a 501(c)(3) organization — usually, a large, established charity — assumes control and responsibility for another group's charitable project. Donations and grants are made directly to the fiscal sponsor, which enables donors to deduct their contributions. In the comprehensive sponsorship model, the charity takes care of the nonexempt group's accounting, bill paying, auditing, insurance coverage and tax reporting, among other functions.

Sometimes fiscal sponsorships are confused with fiscal *agencies*. But fiscal agents act only as a legal representative of the smaller organization and don't have discretion or control. A fiscal agent accepts donations on the project's behalf, but donors don't qualify for charitable deductions.

Aiding fledgling organizations

Sponsorship can provide a fledgling nonprofit with the infrastructure and fiscal management needed to pursue a project. Specifically, it makes it possible for donors and grant makers to fund the project as a program of the larger tax-exempt organization. It also helps the group to jump-start its efforts when applying for tax-exempt status. Pure and simple, an established charity can lend credibility to the project.

Such relationships are more common in certain nonprofit sectors. Arts and culture, for example, is the most popular type of sponsored project. Education, youth development, and services for children and families are also frequent sponsorship participants. Projects that are temporary or periodic, too small to have staff or much infrastructure, or are based outside the United States (and, thus, need a U.S. nonprofit to receive donations) also benefit from them.

Weighing the pros and cons

When you choose to become a fiscal sponsor for a project that shares your mission and basic objectives, it can enhance your own program offerings and exposure with little monetary outlay. For example, an established theater company might sponsor an edgy upstart company and attract that theater's younger audience to some of its own productions.

Sponsorships aren't intended to be a source of income. But you can charge a nominal fee, based on the project's revenues or expenses, to offset overhead costs. Some charities also charge a small application fee.

But becoming a sponsor comes with some risks. To minimize the chance that a fiscal sponsorship will harm your organization's finances and reputation, carefully screen any applicants. Ask for — and check — references and perform background checks on the group's leaders. You also may want to consider purchasing directors and officers liability insurance.

When you decide to sponsor a project, thoroughly discuss expectations with your charitable partner and outline start and termination dates. Because nothing leads to conflict like money issues, include in your written fiscal sponsorship contract:

- The sponsor's fees and policies,
- The restricted nature of the donations received,
- The sponsor's rights to determine the use of the funds, and
- How disbursements and audit and reporting requirements will be handled.

Be aware that adding new activities can cause your organization to exceed state thresholds for an audit requirement.

Additionally, it's critical to ensure that your nonprofit has the human resources to properly administer the project given its scope, location and funding. Such activities tend to evolve over time, and what starts small could quickly become overwhelming. Plan to regularly review a project's progress and your relationship with the sponsored group.

Get advice

Becoming a fiscal sponsor is a decision you shouldn't make hastily. Your CPA and attorney can help you decide if that arrangement would be a sound move for your organization.

How are organizations using technology?

A new study confirms what you may have already suspected: Social media is now playing a prominent role in nonprofits' communications and fundraising strategies. That's just one of the findings in the *2018 Global NGO Technology Report*, sponsored by the Public Interest Registry (the nonprofit operator of the .org, .ngo and .ong domain names) and researched by Nonprofit Tech for Good (an online resource for nonprofit professionals). A survey of 5,352 organizations worldwide — almost half located in North America — found that 93% of the respondents have a Facebook page, 77% a Twitter profile, 56% a LinkedIn page and 50% an Instagram profile. Seventy-one percent agree that social media is effective for online fundraising.

The report also covers Web and email communications, online fundraising, mobile technology, and data management and security. You can download it at techreport.ngo. ■

Netflix model for donations gains popularity

Thanks to streaming services like Netflix and Spotify, consumers have become increasingly accustomed to monthly subscription models — and now that's paying off for nonprofits when they attempt to convert donors to "subscribers." Rather than asking donors to set up monthly payroll deductions, the traditional model for sustaining donations, organizations are asking donors to make monthly donations via credit card.

According to published reports, research indicates that donors who become *sustainers* in a given year are much more likely to still be active supporters years later than donors who make individual donations in the same initial year. In light of such findings, your not-for-profit might want to make monthly "sustainer giving" your website's default option. ■

Half of U.S. nonprofits teeter on brink of financial peril

A recent GuideStar–Oliver Wyman and SeaChange Capital Partners report found that many U.S. nonprofits are operating on a financial precipice. *The Financial Health of the United States Nonprofit Sector: Facts and Observations* indicates that about half of the more than 219,000 nonprofits whose Forms 990 from 2010 to 2014 were examined had less than one month of operating reserves. Thirty percent had lost money over the previous three years and 7%–8% were technically insolvent, with liabilities exceeding assets.

The report cautions that the new tax law could exacerbate these problems by reducing donations and possibly increasing future pressure on federal budgets for human services. It suggests several steps nonprofit leaders, funders, regulators and policy makers can take to improve financial health in the sector. Find the full report by visiting guidestar.org and clicking "Explore Resources." ■

The support you need. The service you're looking for.

Succeeding in the not-for-profit sector today requires more than a strong commitment to your mission. It takes shrewd fiscal management, careful regulatory compliance, skillful use of technology and the assistance of advisors who know the issues nonprofit organizations face and how to address them.

This is where Sechler Morgan CPAs, PLLC comes in. Our team of experienced professionals cherishes the opportunity to support nonprofit organizations, meet their management challenges and fulfill their missions. We offer a variety of specialized accounting, tax and consulting services including:

- Audit intermediary services
- Budget and policy design
- Outsourced accounting/bookkeeping
- Tax form preparation (990, etc.)
- Strategic and management consulting
- Speaking on financial literacy and other topics
- Technology and virtual system design

RESPONSIVE QUALITY

We are committed to providing responsive, personalized service to the highest quality. We take time to truly understand your Organization so that we can customize our recommendations to your specific situation. Our goal is to make your processes easier, streamline your operations and ensure your success in reaching *your* goals.

We welcome the opportunity to discuss your mission and vision so that we may assist you with our expertise. Please call us at 602-230-2700 or e-mail info@azcpa.com and let us know how we may support you. Be sure to visit our website at www.azcpa.com for additional tools and information, as well as our archive of this newsletter.

SECHLER MORGAN CPAs, PLLC

2418 W Barrow Drive
Chandler, AZ 85224
www.azcpa.com