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News for Nonprofits

NONPROFIT AGENDAS

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Program service or supporting activity? Get your expense allocation right

The push for more transparency from nonprofits has placed a greater emphasis on how an organization's expenses break down — in other words, how it uses its resources. In 2016, the Financial Accounting Standards Board (FASB) released a new rule that reflects this priority. While the rule has been in effect for almost two years, some nonprofits still struggle with properly allocating their costs.

FASB requirements

In 2016, FASB issued its Accounting Standards Update (ASU) No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities.* The standard, which generally took effect for 2018, requires all nonprofits to include in their financial statements an analysis of expenses by nature (for example, salaries, rent or utilities) and function (program service or supporting activity, including management and general, fundraising, and membership development when significant). Your organization must present information about expenses in one location on its statement of activities, in the financial statement notes or in a separate financial statement.

Organizations that provide voluntary services to solve health or welfare problems have long been required to functionally allocate their expenses. But that doesn't mean they've necessarily been doing so according to FASB standards. Other nonprofits had never performed such allocations. Both types of organizations have run into some common difficulties.

Mishandling of joint costs

Nonprofits often engage in fundraising activities that also have elements of another function. One example: a special event or direct mail campaign that includes both fundraising and program components. Some organizations make the mistake of lumping all joint costs (for example, salaries, consultants, paper and postage) into fundraising.

Under ASU 2016-14, though, you must allocate such costs between fundraising and the other function(s) if certain criteria related to purpose, audience and content are met. If those criteria aren't satisfied, you should report all costs of the joint activity as fundraising.

Overallocating to management and general function

It's easy to regard the management and general function as a catchall, especially for expenses that seem like overhead. Some of these expenses, however, properly belong elsewhere. For example, the standard dictates that interest costs (such as mortgage interest on a building) be allocated to specific programs or supporting services whenever possible.

Similarly, certain costs that appear to relate to the management and general function at first glance benefit more than one function. For instance, information technology costs can benefit management and general, fundraising and program delivery. Insurance could cover property that houses multiple functions or a single program. You must allocate these costs accordingly.

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Overallocation to management and general conversely results in underallocation to other functions. An employee who normally works as support staff for the executive department might spend some time directly conducting or supervising program services. The executive director may spend a significant chunk of time drumming up donations. You need to allocate their salaries and benefits among those functions, requiring more careful tracking of employees' time and activities than in the past.

Allocation methods

ASU 2016-14 requires nonprofits to disclose the method they use to allocate expenses among the functions — "guesstimates" won't cut it. Because it's both acceptable and advisable to employ different allocation methods for different expenses, you can simplify the disclosure process by developing and adhering to a documented allocation plan.

You might opt to allocate rent, mortgage, utility and building depreciation expense based on total square footage — allocating 40% of the expense to the fundraising department that takes up 40% of the square footage. You can allocate overhead costs to programs based on salary, with a function benefiting from 30% of your total salary expense allocated 30% of overhead. Salaries should be allocated based on actual time and effort expended per function.

Identifying activities the FASB way

The Financial Accounting Standards Board (FASB) provides definitions for program services and supporting activities in its Accounting Standards Codification (ASC) *Not-for-Profit Entities (Topic 958)*. Knowing the definitions makes it easier to properly identify your expenses.

Program services are activities that result in goods and services being distributed to beneficiaries, customers or members that fulfill your purposes or mission. They're the organization's major priority.

FASB breaks supporting activities down into three categories. *Management and general services* aren't identifiable with a single program, fundraising activity or membership activity but are indispensable to them and the nonprofit's existence. They generally include budgeting, oversight, administration, human resources and obtaining fee-based revenues.

Fundraising encompasses activities involved in soliciting contributions from individuals, foundations, government agencies and others. *Membership development* refers to soliciting prospective members, collecting membership dues and managing member relationships. The ASC notes that membership development activities needn't be separately stated in your financial statements if no significant benefits or duties are associated with membership.

Tread carefully

Proper expense allocation isn't just important for financial reporting compliance; it's also critical for grant reporting and fundraising. Your CPA can help you develop the processes and procedures to get it right.

Gifts to donor-advised funds continue to bloom

Fully understand these popular gifts before acceptance

Donor-advised funds (DAFs) are flourishing, at a rate not observed before by fund followers. According to a 2018 report from the National Philanthropic Trust, "For the eighth consecutive year, there was growth in all key metrics: the number of individual donor-advised funds, total grant dollars from them, total contributions to them and total charitable assets in them."

The Trust's *2018 Donor-Advised Fund Report*, which examined 2013 to 2017 fiscal year data from 1,002 charities, says that, as of 2017, there were 463,622 donor-advised funds across the nation. And your organization, if it wants to, may be able to take advantage of the trend.

Sizing up DAFs

The popularity of DAFs isn't surprising, sparked in part by the 2017 Tax Cuts and Jobs Act. DAFs enable donors to contribute assets, including cash, securities and real estate, to an account controlled by a "sponsoring organization." Donors receive an immediate tax deduction, which may be limited based on their adjusted gross income and the type of assets they contribute, in exchange for their irrevocable gifts.

Most sponsoring organizations in the nation fall into one of two basic categories: 1) community foundations and 2) independent charities affiliated with investment-service companies, such as Vanguard Charitable and Schwab Charitable. A smaller group of sponsoring organizations focus on single issues or charitable grantees. All types generally:

- Screen charities that will receive grants,
- Invest and manage DAF assets, and
- Make distributions.

Although there are similarities, policies about issues such as the types of assets accepted, how funds are invested and how often donors may recommend distributions vary widely by sponsor.

Gauging sponsors' roles

Donors make grant recommendations, and, although supporting organizations aren't legally required to honor them, they almost always do. But it's worth noting that sponsors play a major role in which organizations ultimately receive grants. Sponsors often suggest charities to donors that match their charitable criteria.

Sponsors also may step in when donors fail to request distributions. For example, if Fidelity Charitable donors don't start naming grantees after four years, Fidelity names charities for them. After five years of donor inactivity, Fidelity grants the entire DAF balance to nonprofits approved by its trustees. But not all sponsoring organizations have such policies. And some critics contend that sponsoring organizations have too many incentives to hold onto DAF money when they can.

Attracting gifts

To encourage sponsoring organizations to direct gifts to your charity, prioritize these relationships. Let community foundations know that you welcome such gifts and are equipped to handle them. As your mission and programming evolve, keep your sponsors up to date so they can accurately match your organization with donor interests.

Because some DAFs are anonymous, building relationships with potential donors can be somewhat harder. But if you've already received a DAF grant, you'll likely find the name of the fund in the gift letter. Be sure to send the donor a thank-you note (via the sponsoring organization, if necessary) and indicate your interest in receiving future gifts or being named beneficiary of a trust. Also put prominent notices on your website and social media pages. And think about featuring DAF supporters in your newsletter and annual report.

Following the rules

The IRS hasn't issued much guidance about DAFs, so tread carefully when accepting these gifts. For example, there's some uncertainty about whether DAF funds can be used to fulfill pledges. The IRS has stated that DAF funds may be used for this purpose, with no additional tax deduction. However, sponsoring organizations aren't allowed to tell grantees that a gift is being issued to fulfill a pledge.

Also, nonprofits shouldn't accept DAF funds if the donor will receive something of value in return, such as dinner or entertainment. For this reason, don't let donors use DAF gifts to buy event tickets.

All's not rosy

Proposed California legislation would require regulation by the state attorney general with more disclosure by sponsors of DAFs. A similar bill is in motion in Minnesota. Driving the legislation are claims that DAFs allow donors to plant funds indefinitely without making charitable distributions and without requirements to report the activity of each fund. Such stockpiling poses a challenge for charities that want to put the money to good use.

If your nonprofit is hoping to benefit from the largesse of DAFs, start by learning as much as you can about them. Contact your CPA for advice.

Returnships might fill your talent gap

In today's tight job market, employers must innovate when it comes to filling their positions. A growing number of for-profit businesses — including such big names as Walmart, BP, Goldman Sachs and JP Morgan Chase & Co. — have found success with returnship programs. These arrangements also could provide welcome and valuable relief for nonprofits facing hiring challenges.

What's a returnship?

Many organizations have long relied on *intern*ships, and *return*ships aren't that different. The main distinction is that, instead of bringing on board almost total novices, you obtain access to experienced individuals.

Returnships target workers who've taken a career break. The pool ranges from early retirees, who find they need or want to return to work, to professionals who took time off to travel the globe. Frequently, returnships involve individuals who left the workforce to serve as caregivers for children or other family members. For this reason, the programs aren't restricted to older workers; they attract people of all ages who've taken a break from the workforce. Applicants with a gap in employment can often be overlooked for no other reason — a luxury fewer organizations have these days.

During these short-term programs, "returnees," like interns, typically are given mentors to offer guidance and support as they are "up-skilled," and groomed for full-time positions that require skills they don't yet possess. Returnees also may receive opportunities to interact with organizational leaders.

What are the benefits?

Most obviously, returnships are a new resource for tapping workers with proven, but perhaps not up-to-date, abilities and a strong desire to contribute. It's also an effective technique for achieving a more inclusive work environment, introducing workers with different perspectives and backgrounds. Moreover, returnships can help overcome the biases hiring managers can harbor against people re-entering the workforce by stereotyping such candidates as out of touch and lacking in essential skills.

But these candidates often boast impressive social media, research, collaborative and organizational skills. They may have leveraged such abilities for years on their children's school or team projects, as well as other volunteer and community efforts. Returnees have developed hard and soft skills regardless of whether they've been compensated financially.

What are the potential risks?

It may be difficult for seasoned professionals to start in lower-level positions where they take direction from managers who are younger or less experienced than they are. While many workplaces can overcome generational differences among their employees, it could be more difficult when returnees view themselves as deserving more respect or deference due to past accomplishments in unrelated jobs.

Some returnees also might struggle with the smaller paychecks they'll receive in returnships. Ideally, they'll understand the tradeoff: reduced compensation in the short term for the opportunity to make themselves more employable in the long term. But it's worth exploring such issues during the interview process.

Remember, though, that returnships are designed for the short term, usually three to six months. If it turns out someone isn't the right fit, you needn't offer them a full-time permanent position.

How can you connect?

Both for-profit and nonprofit organizations have recently become available as returnship resources. They connect employers who need experienced employees with would-be workers who've significant time gaps on their resumés. These organizations can help you determine if returnships might work well for you and, if so, assist in finding the right people.

NEWS FOR NONPROFITS

Uneven nonprofit concentrations leave communities vulnerable

Nonprofits often step in when governments can't or won't provide necessary services. But, according to an article in *Governing*, a magazine about state and local government, some locations have much stronger nonprofit support than others. For example, the top 10 metro areas have more than twice the number of nonprofits per capita as all of those in the bottom quarter.

Older, more established communities — particularly in the Northeast and the industrial Midwest — have more nonprofits than more newly developed regions, like the South and West. Capital cities, such as Madison, Wis., and Trenton, N.J., generally are home to more nonprofits, too.

Gender matters: Study examines women donors

Women's fund and foundation donors give more than general high-net-worth-donors. That's just one nugget found in *All in for Women & Girls*, a report from the Women's Philanthropy Institute at Indiana University. The report explores the characteristics of these donors, the vast majority of whom are women, and reveals how they stand out.

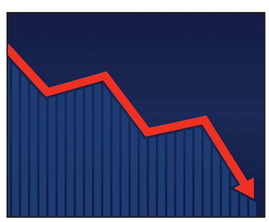
For example, these donors often are motivated to give by serving on the board of directors or volunteering for an organization, as well as believing their gift can make a difference. Only 11% indicate they're more motivated by tax benefits, compared to 23% of general donors.

Disaster-related giving trends point north

In 2017 and 2018, the United States was hit by 30 natural disasters, each causing more than $1 billion in damage and prompting a surge in charitable donations. The Center for Disaster Philanthropy, Candid and the Indiana University Lilly Family School of Philanthropy recently released a comprehensive study on household disaster giving, based on the 2017–2018 events.

Among other things, the *U.S. Household Disaster Giving in 2017 and 2018* report finds that the top drivers for giving were the scale of an event and personal connections to the location. Each year about 30% of U.S. households made a disaster-related donation. But support for a specific disaster wanes as time passes, despite the continuing need for support.

Charitable deduction claims drop sharply



A new study says the number of taxpayers qualifying for itemization status fell from about 30% in 2017 to 10.2% in 2018 — and only 8.5% of taxpayers took a charitable deduction in 2018. Every income group saw significant reductions in charitable deductions after passage of the Tax Cuts and Jobs Act. Even the very wealthy saw a 20% drop in their 2018 deductions compared to 2017. With the charitable deduction now off the table for many taxpayers, the researchers suggest that the number of donors could continue to fall.

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.

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