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News for Nonprofits

YEAR END
2021

NONPROFIT AGENDAS

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Independent contractor or employee: What's the current test?

With a labor shortage and COVID-19-related budget crunches, some nonprofits have turned to freelancers and contractors to fill staffing gaps. But are those individuals actually employees? Employers that misclassify workers can face harsh consequences, so it's important to know the proper standard. Now is a good time for nonprofits to review the test that has long applied.

Role of economic realities

The Fair Labor Standards Act (FLSA) doesn't define the term "independent contractor." Courts, however, generally have focused on several factors related to the "economic reality" of relationships between employers and workers.

A Trump administration rule would have also emphasized economic realities, with a focus on the nature and degree of a worker's control over the work and the worker's opportunity for profit or loss based on his or her initiative and investment. But that rule, scheduled to take effect on March 8, 2021, was withdrawn by the U.S. Department of Labor (DOL) under the Biden administration.

Supreme Court's 7 factors

The DOL will continue to lean on U.S. Supreme Court rulings for guidance. The Court has repeatedly stated that no single rule or test applies to determine employment status under the FLSA. Rather, the totality of circumstances determines a worker's status, including the:

1. Extent to which the services rendered are an integral part of the employer's business,
2. Permanency of the relationship,
3. Amount of the alleged contractor's investment in facilities and equipment,
4. Nature and degree of control by the employer,
5. Alleged contractor's opportunities for profit and loss,
6. Amount of initiative, judgment or foresight in open market competition with others required for the success of the claimed independent contractor, and
7. Degree of independent business organization and operation.

The Supreme Court also has held that the time or mode of pay isn't determinative.

The DOL has identified other factors it deems relevant, including where the work is performed

(remotely or on-site), the absence of a formal written employment contract (or the existence of an "independent contractor agreement"), and whether the work is licensed by the state or local government. Providing workers with IRS Form 1099, "Miscellaneous Information" instead of Form W-2, "Wage and Tax Statement," also won't make them independent contractors.

Keep in mind that some states have even more restrictive tests. Moreover, the fact that workers qualify as independent contractors under another federal law doesn't guarantee they qualify under the FLSA. The IRS, for example, applies a different test. (See "The IRS approach to worker classification," at right.)

The fact that workers qualify as independent contractors under another federal law doesn't guarantee they qualify under the Fair Labor Standards Act.

Why it matters

When workers don't qualify as independent contractors, under the FLSA, you generally must pay covered, nonexempt employees at least the federal minimum wage of $7.25 an hour. When an employee's hours within a workweek exceed 40, you must pay at least 1½ times the employee's regular pay rate.

Failure to properly determine worker status can prove costly. In addition to having to make up the unpaid wages and employment taxes for individuals reclassified as employees, you can end up on the hook for workers' compensation premiums, unpaid leave and other benefits. Fines and penalties are possible, as well. The Obama administration launched a DOL "Misclassification Initiative" to crack down on employers that mislabeled their workers. The Biden administration might pursue a similar enforcement program.

THE IRS APPROACH TO WORKER CLASSIFICATION

The IRS traditionally has applied a 20-factor test to determine if a worker is an employee. The factors generally consider three areas related to the employer's right to control the work:

Behavioral control. To what extent do instructions, training and evaluations demonstrate that you have a right to control how the worker performs the work — regardless of whether you actually exercise the right? Thus, workers who require your approval before taking certain actions probably are employees.

Financial control. Do you have a right to control the economic aspects of the work? For example, does the worker incur significant unreimbursed expenses or is the worker available to work for other companies? Both circumstances suggest the person is an independent contractor.

The parties' relationship. How do the parties regard their relationship? For example, if you provide employee benefits, it might show you intend the worker to be an employee. Conversely, a short-term relationship could indicate a contractor relationship.

Don't take the risk

Misclassification of employees as independent contractors may produce short-term benefits. But you'll only increase your potential liability in the long run. We can help your organization ensure it's in compliance with the FLSA and other applicable standards. ●

3 tips for getting your budgeting back on track

The pandemic has wreaked havoc with many nonprofits' budgets over the past two years. Some organizations have taken a more permissive approach to budgeting, but they can't afford to continue it indefinitely. If your nonprofit is in this position, it's time to buckle down. Here are three tips to help you develop the realistic budgets you need to return to financial stability.

1. Use all the tools in your quiver

Take advantage of the various tools that can improve your budget accuracy, such as forecasting. Forecasting often is confused with budgeting, but they're distinct exercises. Budgeting essentially quantifies your organization's "business plan," showing revenue and expense expectations for the particular period. Forecasting, on the other hand, projects financial performance based on:

- Historical data (for example, giving patterns),
- Economic and other trends, and
- Assumptions about circumstances expected to affect you during the budget period (for example, a major capital campaign).

While forecasting generally takes a longer-term view than budgeting — say, five years versus the typical one-year budget — it provides valuable information to guide budget allocations and strategic planning.

In light of remaining uncertainties, you also might want to do some budget modeling where you game out different scenarios. Consider your options if, for example, you lost a major grant or once again were unable to hold a big in-person fundraising event. Would you reduce staff, delay or cancel a capital project, or apply for a loan or line of credit?

2. Break your bad habits

Your nonprofit may not always approach its budget efficiently and productively. For example, budgeting may be done in separate silos, with little or no consultation among different departments. At the same time, goals are set by executives, individual departments come up with their own budgets, and accounting or finance is charged with crunching the numbers.

You'd be better off approaching the process holistically. This requires collaboration and communication. Rather than forecasting on their own, accounting and finance should gather information from the departments.

Another habit to break? Underbudgeting for reserves. If COVID-19 has proven anything for nonprofits, it's the necessity of rainy-day funds. If you don't already have a reserve fund, establish one, and, if you do, avoid the temptation to skip a budget period or two of funding for it.

3. Roll with it

Nonprofits have long created annual budgets, but you'd be wise to consider switching to the more flexible rolling budgets — at least temporarily. Instead of drafting a budget and setting it in stone for an entire year, you can set certain intervals during which you'll adjust the numbers as circumstances dictate. So, you would still budget for the following four quarters. But, as the end of each quarter nears, you'd update the budgets for the next three quarters and a new fourth quarter.

The rolling approach largely has been favored by nonprofits that have volatile financial and service environments. It empowers them to respond to developments on the ground, both crises and opportunities, in a timely manner. It also provides a more accurate picture of their current financial conditions and focuses on the horizon instead of the past.

Better budgeting going forward

Drafting and approving an organizational budget is a central tenet of good governance, but it doesn't have to be a dreaded chore. Adopting these three ideas, as well as documenting and referring back to the data, trends and assumptions that support each budget, can make for a better process in the future. ●

Strategic planning

Using a "real-time" approach to guide your future

As we move toward a post-COVID-19 economy, it's a great time to do some strategic planning. And the way nonprofits go about strategic planning may be ready for an update as well. By adopting a more fluid and ongoing approach known as "real-time strategic planning" (RTSP), nonprofits can quickly and efficiently identify, understand and act on challenges and opportunities to advance their missions.

Traditional planning

Under an old-school approach to strategic planning, nonprofits can spend months — or even years — to develop formal written plans that lay out specific goals for set periods of time. And those plans can have a downside.

Traditional strategic planning requires leaders to confront a future they can only guess at. Moreover, choosing a strategy under this approach requires an organization to explicitly shut down other options and possibilities.

4 building blocks

RTSP was first introduced in nonprofit consultant David La Piana's book *The Nonprofit Strategy Revolution: Real-Time Strategic Planning in a Rapid-Response World.* According to La Piana, RTSP is "a coordinated set of actions designed to create and sustain a competitive advantage in achieving a nonprofit's mission." A successful nonprofit plan requires three levels of strategy: organizational, programmatic and operational, using the following four building blocks of strategy formation:

1. Identity. RTSP is rooted in a firm and honest understanding of the organization's identity. What

is your nonprofit's mission and impact? What do you do (programs and services), where (geographic scope) and for whom (constituent, client or customer)? And how do you pay for it?

2. Competitive advantage. What strengths do you leverage to differentiate your nonprofit from others and compete effectively for resources and clients? This step requires analyzing other organizations in the same geographic area that offer the same or similar programs, to the same or similar constituents, with similar funding sources.

3. Decision making. Develop a "strategy screen" composed of the criteria you'll use to choose strategies or courses of actions. A strategy screen might consider, for example, if an option advances your organization's mission and enhances its competitive advantage. It also considers if you have the capacity to carry out the option and if you can pay for it.

4. Strategic questions. Many questions naturally arise when an organization is presented with an opportunity, but they aren't all strategic. You need to identify the strategic questions that must be answered now and differentiate operational questions (for example, "Will we be able to hire more employees to do this?") from strategic questions ("What are the implications for our mission?").

Competitive advantage elements

La Piana pegs an organization's competitive advantage as one of *the* most important components of its strategy — perhaps the most important. Your competitive advantage must be something clients and funders value. For purposes of RTSP, competitive advantage is the ability to advance your nonprofit's mission by:

Using a unique asset or strength. An asset advantage can be a better program design leading to better outcomes, including unique attributes of programs or services, great name recognition and reputation among funders and constituents, or powerful partnerships and a well-connected board of directors. It can also be that your nonprofit has accessible locations or specialized property that enhances program delivery, or a robust, diversified funding base that provides flexibility and stability.

Executing programs or services. Examples of execution advantages include lower costs to funders or customers, greater efficiency per dollar spent, faster delivery of programs or services, sound marketing and communications, or better accountability and public reporting.

To make comparative judgments, you also need to identify and understand your competitors and their strengths. As La Piana notes, though, "competitor" in this context isn't a negative term. In the nonprofit arena, "competitors" often are organizations you collaborate with. Nonetheless, you're likely competing for donors, media coverage, board members, employees, volunteers or clients.

Gaining a clear vision

Strategic planning is more than an agenda item in an annual meeting. By implementing RTSP, your nonprofit's long-term strategy will determine daily, weekly and monthly actions. This in turn will move your nonprofit forward toward meeting its goals. ●

News for Nonprofits

Survey finds mixed results on public trust

A new survey from Independent Sector reveals some worrisome trends regarding the public trust in nonprofit and philanthropic organizations. As the survey report highlights, trust is a necessary condition for many Americans' support. Examples of nonprofits for purposes of the survey include churches and religious organizations, health and human services organizations, and environmental groups. Philanthropies include corporate philanthropy, private foundations and high net-worth individuals engaged in philanthropic efforts.

The net trust (the percentage of those with high trust less the percentage with low trust) in "philanthropy to do what's right" decreased from 15% in 2020 to only 4% in 2021. Nonprofits saw a relatively minor decline, from 47% to 45%. But confidence in the ability of nonprofits (84%) and philanthropy (65%) to strengthen society remains high.

Statistical modeling, the report says, shows that the top factors contributing to trust in both nonprofits and philanthropy are an organization's purpose and integrity. Ability and dependability are secondary contributors. ●

Clawing back nonprofit employment levels

Following strong growth in July 2021, the Johns Hopkins Center for Civil Society Studies (CCSS) has predicted that the nonprofit industry should fully recover its pandemic-related job losses around July 2022. Through August 2021, the nonprofit workforce was down about 565,000 jobs compared to February 2020.

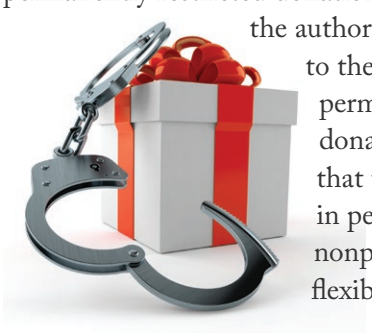
Before the pandemic, nonprofits accounted for at least 12.5 million jobs in the United States. CCSS

"conservatively" estimates that initial job losses (March through May 2020) due to the pandemic rang in at 1.64 million — a 13.2% reduction. The industry clawed back about 41% of the jobs in the summer of 2020, but the comeback slowed considerably in September 2020 through February 2021, recovering only 4.2%. Spring 2021 saw an acceleration, though, and summer 2021 continued the promising numbers. By the end of August 2021, nonprofits had recovered nearly 66% of the initial job losses. ●

Be wary of restricted gifts

Donor-imposed restrictions on gifts can handcuff a nonprofit, as many have learned during the COVID-19 pandemic. A new academic study of national arts and culture organizations, "Service Delivery Under Pressure: The Effect of Donor-Imposed Financial Restrictions," published in the journal *Public Performance & Management Review* in 2021, suggests how well-intended restrictions could backfire when it comes to service delivery.

Donors often believe restrictions help service delivery, while nonprofits generally assert they hinder it. According to the study, researchers found a negative relationship between financial restrictions and program outputs. The adverse effects are greater when financial restrictions are mostly derived from permanently restricted donations. According to the authors, this could be due to the relative size of permanently restricted donations and the fact that they're restricted in perpetuity, leaving nonprofits with little flexibility. ●



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- Budget and policy design
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- Tax form preparation (990, etc.)
- Strategic and management consulting
- Speaking on financial literacy and other topics
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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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