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NONPROFIT AGENDAS

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Uniform Guidance compliance

Watch out for 3 danger zones

Federal funding in response to the COVID-19 pandemic has meant that more nonprofits have found themselves subject to the Uniform Guidance for Federal Awards — the rules and requirements for obtaining federal grants. If they spent $750,000 or more in federal awards in a fiscal year, they're also facing single audits, possibly for the first time.

Single audits combine an annual financial statement audit with an examination of an organization's compliance with its federal grant fund requirements. Even long-time recipients of federal awards can trip up when it comes to single audits. Here are three areas your nonprofit should watch closely to reduce the possibility of costly penalties and reputational harm.

1. Cost allocation

Nonprofits can struggle with the distinction between direct and indirect costs. Direct costs are those that can be:

1. Identified specifically with a particular "final cost objective" (that is, a particular award, project, service or other activity), or
2. Directly assigned to such activities relatively easily with a high degree of accuracy.

Indirect costs are those that are incurred for common or joint objectives and aren't readily identified with a particular final cost objective.

You must treat costs that you incur for the same purpose in like circumstances consistently as either direct or indirect. If a type of charge is direct for one federal contract, it can't be categorized as indirect for another. Developing and enforcing a clear cost allocation policy will help preempt this type of error (which can cause problems in single audits).

Another problem area relates to indirect cost rates, whether negotiated or the de minimis rate of 10% of modified total direct costs (MTDC). Think of that figure as a ceiling, not an allowance. You can't charge more than what you actually incurred in indirect costs, even if that amount falls below the assigned percentage of MTDC. If you overcharge, you may have to refund the difference.

Developing and enforcing a clear cost allocation policy will help preempt problems in single audits.

2. Time and effort reporting

Salaries, wages and benefits charged to a federal award must be supported by "time and effort" documentation that accurately reflects the work performed. Time and effort reporting often is a

fertile area for auditor findings because it's not nearly as simple as it seems.

For starters, you can't base it on budgeted amounts. Your reporting must reflect the actual time and effort expended. Moreover, you must record time and effort for specific cost objectives, rather than just the award. Some awards may have more than one cost objective — for example, a grant might cover both administrative and program costs.

Finally, 100% of an employee's time charges must equal the employee's compensated time. Even with overtime, an employee can't report 80% of time for one objective and 40% for another.

3. Subrecipient monitoring

If you're a "pass-through entity" (PTE) that relays part of a federal award to other entities, you're required to monitor those subrecipients. A PTE is a nonfederal entity that provides a subaward to a subrecipient to carry out part of a federal program. This obligation includes two potential pitfalls.

First is a pre-award assessment. Examine a subrecipient's risk of noncompliance with all the subaward's requirements to determine the appropriate monitoring procedures to ensure compliance. You'll need to individualize the assessment, as opposed to, for example, assigning risk level based solely on the amount of the subaward. Your assessment should consider factors such as:

- The location of the work,
- The subrecipient's internal controls, and
- Whether the subrecipient has an existing relationship with the PTE.

Second, the monitoring procedures should be commensurate with the level of risk. They shouldn't be the same for every subrecipient. And it's not enough to require regular reports from your subrecipients. You also must review them and ensure that the subrecipients remedy any issues.

Complex web

The Uniform Guidance contains a sprawling array of requirements — and they're regularly updated and revised. We can help your nonprofit stay on the right side of the rules and avoid adverse audit findings. ●

GET THE DOCUMENTATION RIGHT

The importance of maintaining and assembling adequate documentation in anticipation of a single audit can't be overstated. Not only will good preparation expedite the process, but it also will send the audit team a clear message about your commitment to transparency.

But just what is "adequate documentation"? It requires much more than your current financial statements and Schedule of Expenditures of Federal Awards (commonly known as the SEFA).

For purposes of a single audit, your documentation should include your written policies and procedures for the handling of federal awards (for example, procurement and subrecipient monitoring procedures). You'll also need to provide accounting records, along with supporting documentation to show that all payments, procurements, contracts and grants to subrecipients are necessary, reasonable and allocable.

Your auditors will want to see the award letter or grant agreement for each federal award, too. They'll use these to identify the specific deadlines, terms and other requirements they must check in addition to the general Uniform Guidance requirements.

Updating collective impact initiatives to include equity

Large-scale social change involving issues such as global warming, racial justice, economic development or education generally isn't possible for individual nonprofits. An approach known as "collective impact" coordinates organizations across multiple sectors to tackle these larger issues. Here's what you need to know before signing on to such an initiative.

What is it?

Collective impact is more than just collaboration. Its originators describe the phrase as the commitment of a group of important players from different sectors to a common agenda for solving a specific social problem. That includes the nonprofits themselves, government, businesses and constituent communities.

In the *Stanford Social Innovation Review* article that introduced the concept in 2011, the authors explicitly contrast collective impact with collaboration. Unlike most collaborations, they explain, collective impact initiatives involve a centralized infrastructure, dedicated staff and a structured process.

Adherents of collective impact have typically cited five prerequisites that together produce the alignment necessary for successful initiatives:

1. A common agenda in which all participants in the initiative have a shared vision for change, based on a common understanding of the problem and their goals.

2. Shared measurement systems in which each of the participants takes the same approach to data collection and metrics to ensure the continued alignment of efforts, foster accountability and facilitate the kind of information sharing that can make it easier to meet goals.

3. Mutually reinforcing activities where each participant is encouraged to pursue the activities at which it excels, in a way that both supports and coordinates with its fellow participants' activities.

4. Continuous communication that fosters trust among stakeholders, so that they work together to share information and solve problems.

5. A backbone support organization with its own infrastructure to provide the "backbone" for the project. The backbone entity needs its own dedicated staff to plan, manage and support the initiative.

For collective impact action to succeed, the approach requires "nonprofit management organizations" with the skills and resources to coordinate the necessary elements.

What's new?

In 2022, the authors of the original article updated the collective impact concept. In their new article,

they state that collective impact needs to be redefined to "center equity." What's equity? The authors have settled on a definition from research and advocacy organization Urban Strategies Council: "Equity is fairness and justice achieved through systematically assessing disparities in opportunities, outcomes, and representation and redressing [those] disparities through targeted actions."

Thus, the new definition of collective impact "is a network of community members, organizations, and institutions that advance equity by learning together, aligning, and integrating their actions to achieve population and systems-level change." So, to better center equity, the authors add five new strategies to the original five:

1. Ground the work in data and context, and target solutions.

2. Focus on systems change, in addition to programs and services.

3. Shift power within the collaborative.

4. Listen to and act with community.

5. Build equity leadership and accountability.

According to the authors, these aren't new strategies, but nonprofits will need to focus on them to achieve collective impact success.

Holistic approach

While the evaluation of a nonprofit project frequently focuses on a project's outcomes, you need to look at a collective impact initiative holistically and consider all parts of the "puzzle." Consider the effectiveness of an initiative's changemaking process, including its structure and operations. You'll also need to review ways influencers of the targeted issues are changing and the degree of progress made toward the ultimate goals.

If your nonprofit is involved with large-scale social change, participating in a collective impact initiative may be the next step. Remember, though, that each organization that joins such an initiative must give each project component the attention it warrants to meet collective goals. ●

IRS issues guidance on LLCs as 501(c)(3) entities

Nonprofits often use limited liability companies (LLCs) when they want to form subsidiaries to, for example, launch a new service or joint venture. However, federal regulations for tax-exempt organizations don't specifically address LLCs. This makes new guidance from the IRS on the requirements an LLC must satisfy to be deemed tax-exempt welcome news.

Guidance gap

The Internal Revenue Code's organizational test for Section 501(c)(3) organizations was established before the enactment of any state laws allowing LLCs. As a result, related regulations don't discuss LLCs, and the IRS has never issued any formal guidance on requirements for recognizing LLCs as tax-exempt under Sec. 501(c)(3). Generally, though, the IRS has required that each LLC member be a Sec. 501(c)(3) tax-exempt organization, a governmental unit, or a wholly-owned instrumentality of a state or political subdivision thereof.

When the IRS began considering requirements for LLCs to qualify as Sec. 501(c)(3) organizations, it reviewed state LLC laws and how they differ from laws covering nonprofits. Some laws, for example, don't allow LLCs to be organized and operated solely for charitable purposes. Moreover, most LLC laws include default provisions granting LLC members certain economic rights that may violate Sec. 501(c)(3) requirements. Confusion has sometimes ensued.

New rules of play

IRS Notice 2021-56 attempts to alleviate some of the uncertainty around LLCs in the nonprofit arena. The IRS says the notice's requirements are intended to ensure that a Sec. 501(c)(3) LLC is organized and operated exclusively for exempt purposes — including that its assets are dedicated to an exempt purpose and don't benefit private purposes.

According to the notice, the IRS will issue an LLC a tax-exempt determination letter if both its articles of organization and operating agreement include:

- Provisions requiring that each LLC member be a Sec. 501(c)(3) tax-exempt organization, a governmental unit or a wholly-owned instrumentality of a governmental unit,
- Explicit charitable purpose and charitable dissolution provisions that comply with existing regulations,
- Provisions for complying with the applicable rules (for example, minimum distribution requirements and a prohibition against self-dealing) if the LLC is a private foundation, and
- An acceptable contingency plan if a member ceases to be a Sec. 501(c)(3) organization or governmental unit (for example, suspending the member's rights).

The LLC also must represent to the IRS that all provisions in its articles of organization and operating agreement comply with applicable state LLC law and are legally enforceable.

Some states prohibit the inclusion of provisions in the articles of organization other than those specifically required by state law. LLCs formed in these states can meet the IRS requirements by including the above provisions in the operating agreement. The operating agreement and articles of organization must not include any inconsistent provisions, though.

Note that the new requirements don't affect LLCs already recognized as tax-exempt, whether as so-called disregarded entities (entities the IRS doesn't consider to be separate from their owners for tax purposes) or as exempt entities in their own right.

More to come?

When the IRS published the new guidance in the fall of 2021, it requested public comments on the requirements. It also solicited comments on several issues related to tax-exempt status for LLCs — including whether individuals or organizations other than Sec. 501(c)(3)s, governmental units and wholly-owned subsidiaries of governmental units should be allowed to be members of Sec. 501(c)(3) LLCs. This suggests that additional guidance may be on the horizon. We'll keep you updated on any important developments. ●

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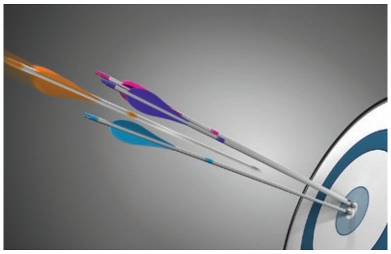
Is it time to reconsider Facebook?

Some organizations may be questioning their use of Facebook in the wake of whistleblower testimony in a Congressional hearing. That's according to a new paper from the Dorothy A. Johnson Center for Philanthropy at Grand Valley State University. A former Facebook employee testified that the company is well aware of the harm its products cause but continues to pursue questionable data collection practices and amplify the spread of misinformation.

Facebook's fee-free fundraising platform has appealed to many nonprofits. The company claims it has helped raise more than $5 billion for nonprofit and private causes since 2015. But, the paper notes, convenience and processing fee savings come at the high cost of donors' privacy and data. Some nonprofits have stopped using Facebook altogether, and a coalition of about 50 U.S. nonprofits has launched a campaign to highlight the dangers of such apps (HowtoStopFacebook.org). ●

Ranking direct marketing options



Direct marketing has long been a critical component of nonprofit fundraising, even as additional avenues, such as social media, have evolved dramatically. A new survey report from the Association of National Advertisers reveals that email "remains king" when it comes to advertisers' direct marketing strategies, with social media catching up. But direct mail is surprisingly effective.

The "Response Rate Report 2021: Performance and Cost Metrics Across Direct Media," found that email was the most used medium among survey respondents (82%). Social media was second, at 74%. But, when it came to return on investment (ROI), traditional methods posted impressive performances. For example, messages mailed in letter-sized envelopes had an ROI of 112%. The ROI for email was 93%, and SMS messaging scored an ROI of 102%. ●

Virtual events remain vital and valuable

Pandemic protocols may be loosening, but that doesn't mean nonprofits should shut the door on virtual events. A recent survey of 1,000 people who attended fundraising events between January 2020 and February 2022 suggests that the flexibility of multiple attendance options attracts supporters. Conducted by Classy, a San Diego-based fundraising platform (that was recently acquired by GoFundMe), the study found that virtual events earned higher satisfaction ratings than in-person events — 96% versus 87%.

The "2022 Fundraising Event Experience Report" found that 35% of respondents attended fundraising events that had the option to participate in-person or virtually, about evenly split between the choices. Limiting events to strictly one mode could deter a significant group of attendees who value having a choice. Importantly, the "sentiment to give" exists regardless of how people attend an event. More than 40% of both types of attendees were likely to donate more than $100 at the event. ●

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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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