SCIARABBA WALKER &CO LLP
CERTIFIED PUBLIC ACCOUNTANTS
BUSINESS CONSULTANTS

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The Nonprofit Edge

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How Can We Help?

Our firm provides a broad range of services for nonprofits, including:

- Attestation services
- Corporate governance
- Tax compliance and consulting
- Cash-flow planning
- Budgeting
- Human resources assistance

Our News Briefs are going electronic!

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Ways to Lose Tax-Exempt Status

By Will Sheavly

There are multiple ways that nonprofit organizations can lose their tax-exempt status, and it's important for directors, employees, and volunteers to stay informed about what actions could potentially jeopardize the status. With a bit of increased awareness and employee training, it is easy for organizations to remain compliant.

For-Profit Activities/Generating UBTI - Under IRS rules, a nonprofit that generates $1,000 or more in unrelated business income must file a 990-T and pay tax on the income (UBTI or unrelated business tax income). This income comes from a regularly carried-on trade or business not substantially related to the organization's exempt purpose. However, there are some modifications, exclusions, and exceptions. Selling food and beverages to nonmembers, advertising income, and selling timber cut from the organization's land are all examples of UBTI-generating activities.

Tax-exempt public charities under the 501c3 classification with dividends, interest, certain other investment income, certain income from research activities, and gains or losses from the disposition of property do not need to have the same worries; these activities are all excluded. Other types of tax-exempt organizations, such as social clubs under the 501c7 classification, do not have this exemption.

Rental income can fall into either category, though it is usually exempt. The IRS lists the reasons rental income will be considered unrelated business income as: "If substantial personal services are provided to lessees, if more than 50% of the rent is for the use of personal property, if the property is debt-financed income or leased to a controlled entity, or if the organization is exempt under Sections 501(c)(7), 501(c)(9) or IRS 501(c)(17)".

Failure to Comply with Annual Reporting Requirements - Nonprofits must keep up to date with their required filings, including financial statements, form 990, and other required documents. Failure to submit a Form 990 for three consecutive reporting periods automatically causes nonprofits to lose their tax-exempt status, per IRS rules.

For the organization's state returns, penalties and eventual dissolution of the nonprofit are likely to result if they are not filed on time.

Failure to Operate Exclusively for Exempt Purposes - The purpose of the tax-exempt status is to support organizations with missions motivated by charitable, educational, religious, or scientific pursuits. Any form of profit-generating activity defeats the purpose of the tax-exempt status and could result in an IRS determination to take it away.

Organizations should be mindful of "mission creep," or when their activities drift away from their stated mission towards direct or indirect involvement with for-profit organizations or activities. Though direct instances of engaging in such activities may be more obvious, subtler instances include shifting the organization's mission for the sake of receiving a particular grant, shifting to a different geographical location or demographic of people than stated in the company's mission, or taking on too many activities at once to be able to retain a clear focus.

Private Inurement/Benefits to Insiders - The IRS considers any form of personal enrichment through nonprofit resources as a violation of the organization's responsibility to use its assets and income solely to support its mission. This can include contracts to board members or family members of the board at higher than market prices, excessive compensation for officers, or engaging in any activity that disproportionately serves the interests of an inside member.

Political Activity - Nonprofits are prohibited from any direct or indirect involvement in support or opposition to a candidate in a political campaign at all levels: federal, state, and local. Endorsing candidates, campaign donations, or any use of the organization's resources towards influencing the outcome of an election are included in the definition of support. In addition to the loss of tax-exempt status, fines and penalties can result.

In addition to political campaign involvement, any form of lobbying is limited. While a 501(c)(3) organization is allowed to do some lobbying, too much can hurt its tax-exempt status. Its lobbying activities cannot be more than an insubstantial part of its overall activities.

If you have questions about activities your organization is considering launching or is currently involved in, please contact Sciarabba Walker.

The Essentials of Nonprofit Accounting

By Svetlana Svetlichnaya, CPA

Nonprofit accounting has distinct features compared to for-profit accounting due to the nature and goals of nonprofit organizations. Nonprofits focus more on the accountability aspect of accounting. There is a specific set of rules and procedures regulated by Generally Accepted Accounting Principles (GAAP) set by the Financial Accounting Standard Board (FASB) that help them stay accountable to their donors and contributors.

Nonprofit Budget - Creating and managing a budget is crucial for any nonprofit organization. It helps ensure that resources are allocated effectively, financial goals are met, and the organization's mission is supported.

Components of a Nonprofit Budget

- Revenue sources including grants, donations, fundraising events, program fees, membership dues, and investment income.
- Expenses including salaries of program staff, materials, direct services, salaries for administrative staff, office supplies, utilities, occupancy costs, depreciation, miscellaneous expenses, event costs, marketing, and donor outreach.
- Cash Flow Projection allows for the estimates of cash inflows and outflows to ensure the organization has enough liquidity to meet its obligations.
- Variance Analysis allows for comparison of actual financial performance against the budgeted amounts to identify discrepancies and make adjustments as needed.

Statement of Financial Position - The Statement of Financial Position, also known as the Balance Sheet in for-profit organizations, is a critical financial statement for nonprofits. It provides a snapshot of the organization's financial health at a specific time. This statement details the organization's assets, liabilities, and net assets (equity) and helps viewers understand its financial stability and liquidity.

Components of the Statement of Financial Position

Assets:

- Current Assets are assets that are expected to be converted into cash or used up within one year, including cash and cash equivalents, accounts receivable, prepaid expenses, and inventory.
- Non-Current Assets: Assets that are not expected to be converted into cash or used up within one year, including plant, property, equipment, long-term investments, and intangible assets

Liabilities:

- Current Liabilities are obligations expected to be settled within one year. Examples include:

1. Accounts Payable: Amounts the organization owes to suppliers or vendors.
2. Accrued Liabilities: Expenses that have been incurred but not yet paid
3. Deferred Revenue: Funds received in advance for services or programs to be provided in the future.

- Non-Current Liabilities: Obligations that are due beyond one year. Examples include loans or bonds that are due after one year and any other long-term obligations not classified elsewhere, such as pension liabilities.

Net Assets:

- Unrestricted Net Assets are funds available for any purpose not restricted by donors. They include the net assets that can be used at the organization's discretion.
- Temporarily Restricted Net Assets are funds donated with restrictions on their use that will expire over time or through the accomplishment of specific activities.
- Permanently Restricted Net Assets are endowment funds where the where the principal amount is to be maintained permanently, with only the income available for use.

The statement of financial position for a nonprofit follows the equation:
Assets - Liabilities = Net Assets

This equation ensures that the nonprofit's total assets are always balanced against its obligations and net assets, providing a clear view of its financial standing at a specific point in time.

Statement of Activities - The Statement of Activities, also known as the Income Statement or Statement of Revenues and Expenses in for-profit organizations, is a critical financial report for nonprofits. It provides a detailed account of the organization's financial performance over a specific period, showing how revenues are transformed into net assets through various activities and expenses.

Components of the Statement of Activities

Revenues:

- Unrestricted Revenues: Funds received without restrictions on their use, including:
- Donations and Contributions: Gifts from individuals, businesses, and other entities.
- Grants: Financial support from foundations or government agencies that are not restricted.
- Program Fees: Income earned from providing services or goods.
- Investment Income: Earnings from investments, such as interest, dividends, or gains from investments.
- Restricted Revenues: Funds that come with specific restrictions on their use, including:
- Temporarily Restricted Contributions: Donations earmarked for specific purposes or time periods.
- Permanently Restricted Contributions: Donations that must be maintained in perpetuity, with only the income available for use (e.g., endowments).

Functional Expenses:

- Program Expenses are expenses directly related to the nonprofit's mission and specific programs or services. Program expenses can include compensation for staff working directly on program activities; materials and resources used to deliver services or conduct activities; expenses directly tied to the implementation of program activities, such as outreach costs or service delivery expenses; fees paid to consultants or service providers who contribute directly to program goals.
- Program Expenses are expenses directly related to the nonprofit's mission and specific programs or services. Program expenses can include compensation for staff working directly on program activities; materials and resources used to deliver services or conduct activities; expenses directly tied to the implementation of program activities, such as outreach costs or service delivery expenses; fees paid to consultants or service providers who contribute directly to program goals.
- Management and General Expenses are costs associated with the general operation and management of the organization, which support its overall functioning but are not directly tied to specific programs.

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Hacking & Nonprofit Security

By Alaric Saufley

In any online environment, there are risks of computer systems being hacked, data being stolen or manipulated, and privacy breaches occurring. Unfortunately, many not-for-profit organizations are woefully underequipped to protect themselves from these attacks due to financial, technical, or other restraints. While there is no single solution that will work for all organizations, there are many simple steps that any organization can take to improve their online security and minimize risks from both internal and external threats.

- **Individual user accounts** – Funds are limited in many organizations, resulting in multiple users sharing a single computer. It's crucial that when the sharing of computers occurs, each user has their own separate account, with only the programs they need access to installed on their account. For example, users not part of the accounting team should not have QuickBooks installed on their profile. Additionally, only Information Technology users should have administrative privileges, ensuring that non-IT administrative users cannot install or modify any programs.
- **Secure passwords** – Safe passwords are one of the most fundamental parts of online security for an organization, and the best part is they don't need to be ever-changing, complex passwords. Microsoft has recommended that organizations get out of the habit of complex passwords that are updated on a schedule and instead focus on ensuring each user creates a password that is easy to remember because it should never be written down. These passwords should be at least eight characters, but be sure to avoid commonly used words and phrases. Microsoft's "Password policy recommendations for Microsoft 365 passwords" may be a beneficial guideline for your organization.
- **Phishing and malware** – E-mail-based attacks are a common way for bad actors to attempt to access an organization's systems through different means. Users should never open emails or files from untrusted and unverified sources, as these files may automatically allow a hacker access to the organization's systems. Additionally, emails and email addresses should be reviewed to ensure the contact's request is legitimate and not an attempt to trick the user into giving out information that they should not. This can be especially important in a not-for-profit environment, where users may not have an email address directly associated with your organization
- **Networks** – Wireless networks are available in most businesses and organizations, and this may be an easy way for an individual with ill intent to access your business's private records and information. Wireless passwords should be secure and not shared outside the organization's employees or volunteers. If guests are provided access to a network, the network for these guests should be separate from the main network, and secure business information should never be transferred over the guest network. Employee devices (personal computers, phones, tablets, etc.) should not have access to the main network.
- **Multi-factor authentication** – More organizations are using multi-factor authentication (MFA) to ensure that only authorized users are accessing organization systems and information. This is useful if a hacker or other non-approved person gains access to a user's password. If the password is entered correctly, the program will "push" an additional verification to the user's phone or other device. The user can then deny access to the system or program. While MFA can incur extra costs, it's a great way to help keep your systems secure.

While the tools above are great starting points toward securing your systems, an IT professional can help you evaluate and navigate the needs ofyour organization. Policies and procedures to protect the systems in place and react in case of a data breach should be in place and reviewed to ensure that they're up to date. Taking these simple steps seriously will help improve your organization's security and minimize the likelihood of hackers accessing your systems.

Essentials of Nonprofit Accounting

(Continued)

- Management and general expenses can include compensation for administrative staff, including executive leadership and finance personnel; costs related to leasing or owning an office space; expenses for electricity, water, and other essential services; and costs for items such as computers, software, and general office materials.
- Fundraising Expenses are costs incurred in the process of raising funds to support the organization's mission, including expenses related to organizing fundraising events, including venue rental, catering, and event promotion; costs for promoting fundraising campaigns or donor appeals; expenses related to communication with potential and current donors, including mailings and telephone solicitations; and compensation for employees involved in fundraising activities.

The budget, Statement of Financial Position, and Statement of Activities provide a detailed view of the organization's revenues and expenses, highlighting how effectively it uses its resources to achieve its mission. This format helps donors and funders understand how funds are used, ensuring the organization is accountable for its financial activities. It assists management and the board in assessing financial performance, making informed decisions about future activities, and planning for sustainability. It also allows for comparison of financial performance over different periods and with similar organizations, helping identify trends and areas for improvement.

Sciarabba Walker & Co., LLP has a dedicated nonprofit team that can help with various challenges and assist with preparation and analysis. Any questions can be directed to info@swcllp.com.

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Donor-Advised Funds: What The Research Tells Us

By David Jacobson, CPA

Donor-Advised Funds (DAFs) are investment vehicles designed to allow individuals to contribute to the Funds and recognize the contribution to the fund as a charitable donation in the year it was contributed. The funds are then managed by advisors and eventually contributed to charitable organizations of the contributor's choice.

Research - The DAF Research Collaborative recently conducted a study which found that using DAFs is a growing trend, as 81% of the funds have been opened since 2010. A separate study showed that grants made from these funds have more than doubled in the past five years. The DAF Research Collaborative also found that most of the funds are advised by individuals and families (97%), with the baby boomer generation accounting for nearly half of those funds (49%). The majority of the contributions to these funds fall within the range of $10,000 and $49,999 (40%), with 49% of funds having a year-end balance of less than $50,000 by 2021. These trends show that donor-advised funds are not just for the ultra-wealthy but are becoming commonly used among the general population. To that effect, only 7% of funds had year-end balances over $1 million, and only 1% had balances over $10 million.

Connecting - Donor-advised funds also can keep the original donor anonymous. This can make it difficult for charitable organizations to connect to specific donors, though not impossible, and connecting the donors through these DAFs will be key to helping a nonprofit sustain growth.

Communication - Communication is crucial in developing donor relationships, even within DAFs. If the donor wants to remain anonymous, reaching out to the DAF to see if they can reveal their identity or contact information may help an organization stay connected. If not, the DAF may be willing to accept a thank you note on the original donor's behalf and pass it on to them. Thanking donors, if possible, encourages them to remain involved. Communication with donors allows them to stay connected and know the value of the services the nonprofit provides. Additionally, it's essential to be honest in communication and to share the organization's financial position and the impact of the donor's funds.

Holistic Approach - Donoradvisedfunds.com is a resource available for nonprofit organizations that provides information on donor-advised funds. On that site, users can search for various funds, and what they can provide for receiving contributions and distributing grants. This information might help organizations determine which DAF could be a good partner with which to develop a relationship. Other key players are employers who might provide the benefit of matching contributions to charitable organizations of their employees or allow their employees to make charitable contributions through payroll. Finally, investigating pools of donors could be helpful in noticing trends, both with patterns of donations and donation vehicles.

IRS Hearings held in May of 2024 discussed whether additional restrictions should be placed on donor-advised funds. The three key proposed changes are below:

1. Changing the definition of donor-advised funds, in the hopes of opening the benefits of the funds to more of the general public by being able to classify other investment vehicles as DAFs.
2. Imposing penalties, with a proposed excise tax of 20% on donations that significantly benefit the donors.
3. Broadening the definition of donor advisers to include personal advisors that manage assets in DAFs.

Concerns of these proposals include the following:

1. Changing the definition of donor-advised funds could impact other investment vehicles or entities, including certain investment funds held by public charities.
2. Broadening the definition of donor advisers to include personal advisers could provide more restrictions, particularly on earnings, from personal advisers and have an overall negative impact on the industry.
3. The excise tax would disincentivize individuals from contributing to these funds, which have recently provided more funds for charitable purposes even when philanthropic contributions are constricted due to economic difficulties.

At this point, nothing is finalized regarding definitional changes in law and their impact on the industry. However, it is essential to monitor. Nonprofit organizations can benefit from taking a DAF-focused approach to securing donors.