AN OVERVIEW ON NON-PROFIT ORGANIZATION

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Overview

- Contribution Information
- Break Down of an Auditor's Report
- CHAR 500 Reporting
- FORM 990
- Revitalization Act of 2013
- Changes to Non-Profit Organization’s Financial Reporting
- Questions
Difference Between Profit and Non-Profit Entities

- No ownership
- Operating for a purpose of not generating income for owners
- Missions
- Funded by contributions and government grants and service contracts
Types of Contributions

- Types of a contribution
  - Voluntary
  - Nonreciprocal/Reciprocal
  - Unconditional/Conditional
Voluntary Contribution

- Unsolicited donation made by a donor
- It could be with restrictions or without restrictions
  - Accounting treatment may differ
Nonreciprocal Contribution

- Donor receives something of value in exchange for their contribution.
- Fair market value of the item received is less than the amount of the contribution itself.
- Disclosure on the thank you letter.
- Reciprocal?
Conditional Contributions

- When the donor specifies a future and uncertain event
  - Contribution depends on overcoming barriers

- Matching grants is an example of this
**Contribution vs. Exchange Transaction**

- A contribution is nonreciprocal
- An exchange transaction is reciprocal
  - Exchange of approximately equal value
- Membership dues
- Government contracts (grants)
Promises to Give

- Written or oral agreement
- Cash or some other asset
- Being transferred to another entity
- There must be sufficient evidence that can be verified that a promise to made (i.e. pledge card)
- Promises to be received within one year are recorded at net realizable value
- Promises to be received after one year are recorded at net present value
Contributed Services

- Recognize at fair value if the service
  - Creates or enhances nonfinancial assets or,
    - Meets all three of the requirements below
      - Requires a specialized skill
      - Provider must possess that skill
      - Service would be purchased if not donated
Restricted Contributions

- Only a donor may restrict the use of a contribution
- Temporary
  - Purpose- how the assets must be used
  - Time- when the asset must be used
  - Both
- Permanent
  - Perpetual endowment
  - Donated land which must be used as a park
  - Cannot be removed by organization
- Board Restricted Funds
Why is This Important

- Internal Controls
- Reporting for financial statement presentation
- Reporting for Form 990
As a board member, your role is to oversee the implementation of the not for profit organization’s mission and monitor.

- **The duty of good faith**
  - This duty requires that a board member act in good faith, in a manner that you reasonably believe to be in the best interests of the organization.

- **The duty of loyalty**
  - This duty requires that a board member act in a manner that furthers the interest of the organization.

- **The duty of care**
  - This duty requires that a board member exercise diligence in the oversight of corporate officers, seeking and reviewing all necessary information in order to make informed decisions.(Understand the Financial Statements)
Common Types:

- Budgets and financial projections
- Internal (unaudited) financials statements
- External (unaudited) financials statements
- Audited financials statements
- IRS Form 990

Common Users:

- Management team members
- Auditors
- Donors/Funders
- Lenders/Bankers
- IRS and other governmental and oversight agencies
- Board of Directors
Audit Report:
- a written opinion provided by an auditor regarding an entity's financial statements
- Discloses to the reader whether the financial statements are free of material misstatements

Types of Reports:
- Unqualified opinion – financial statements as a whole are fairly presented and do not contain any material misstatements.
- Qualified opinion – this is issued when there is a scope limitation and/or the financial statements or a section of the financial statements have not been prepared in accordance with GAAP
- Adverse opinion – financial statements do not fairly present the financial position or activities of the organization
- Disclaimer of opinion – this is issued when the auditor is not independent or there is a scope limitation that is significant enough that the auditor cannot issue an opinion

The typical audit report contains three paragraphs, which covers the following topics:
- The responsibilities of the auditor and the management of the entity.
- The scope of the audit.
- The auditor's opinion of the entity's financial statements.
The Statement of Financial Position:

- Summarizes the assets and liabilities of an organization as of a specific point in time
- Three sections: assets, liabilities, net assets

Net Assets

- Unrestricted:
  - These funds have no donor-imposed restrictions
- Temporarily restricted:
  - These are assets with time and/or purpose restrictions requested by a donor
- Permanently restricted:
  - The corpus of these gifts is maintained for a specific purpose based upon the donor’s stipulations
Board members should pay particular attention to these four issues relative to the Statement of Financial Position:

- **Trends:**
  - Review the year to year trends to determine the financial health or lack thereof of the organization

- **Liquidity:**
  - Refers to the organization’s ability to draw on cash required to satisfy immediate obligations

- **Debt:**
  - Should be familiar enough with the terms of loan agreements to assess the financial ability of the organization to cover the debt service

- **Unrestricted Net Assets:**
  - Plan for significant economic issues that may arise in the future
The Statement of Activities

- The Statement of Activities (or Income Statement) reports the results of the organization’s financial operations for a specific period of time.

- As a board member, you should review the Statement of Activities and consider these four critical areas:
  - **Budget versus Actual:** As you review the Statement of Activities, review the budget variances and ask the question “Why” so that members better understand both the cause and the effect.
  - **Revenue & Support:** Look for concentrations of income to determine if the organization has a concentration risk with a specific funding source.
  - **Trends:** When reviewing expenses, review those that are increasing at a faster rate than the corresponding support or revenue.
  - **Change in Net Assets:** A positive amount is just as important to a not-for-profit as it is to a for-profit organization.
The Statement of Cash Flows converts accrual-based activity into a cash basis format.

Cash flows are categorized into:

- The operations section which reports all of the day-to-day activities of your organization
- The investments section reports the purchases and sales of investments and capital assets such as property and equipment
- The financing section reports the flow of cash to and from debt or other funding sources, including support received for long-term purposes such as endowment gifts and capital project funding

The three net cash figures, when totaled, represent the change in cash from beginning to the end of the fiscal period represented in the Statement of Activities.
When a board member is reviewing the Statement of Cash Flows it would beneficial to review these areas:

- **Net Change in Cash:** Organizations that consistently show a decrease in cash over several periods risk having cash flow issues.

- **Trends:** As with the other statements, reviewing trends can indicate the start of financial issues.

- **Cash Flow from Operations:** The objective should be to secure a positive cash flow from operations, but this will not always be the case.

- **Days Operating Cash:** An indicator of how long an organization can operate on the current cash balances.
  
  To calculate your days operating cash, divide cash balances by the sum of all cash expenses (exclude depreciation and in-kind), divided by 365 days per year.
The Statement of Functional Expenses is currently only required for voluntary health and welfare organizations but is a good idea for all organizations.

The Statement of Functional Expenses classifies expenses according to their natural classification (payroll, rent, supplies, telephone, etc), and function/cost center (programs, management and general and fundraising).

Functional expenses can be allocated between programs and supporting service categories based upon a reasonable allocation that can involve a variety of denominators, such as hours worked or square footage.
Board member should review the notes to the financial statements to gain a further understanding of the amounts reported in the Statement of Financial Position and Statements of Activities.

Note are provided to give the reader additional information that is not apparent or provided in the various statements.
Material Weakness –

- Is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented or detected on a timely basis.

Example:
- Reconciliation of the bank accounts are not performed
- Ineffective oversight of the organization’s financial reporting and internal control by management or those charged with governance
- Lack of segregation of duties
- Management override of controls
- Employees or management who lack the qualifications and training to fulfill their assigned functions
Significant Deficiencies – a deficiency, or a combination of deficiencies, in internal control over financial reporting, that is less severe than a material weakness yet important enough to merit attention by those responsible for oversight of the company’s financial reporting.

- Lack of controls over nonroutine and nonsystematic transactions
- Lack of appropriate controls over the period end financial reporting
Tips on Selecting an Auditor

- Talk to fellow board members
- Talk to members of other not-for-profit organizations
- Ask for recommendations of auditors who have expertise with organizations similar to yours
- When selecting an auditor:
  - How many audits of nonprofit organizations have they performed
  - Can they complete the work within the time frame required
  - Do they possess the necessary knowledge required
  - Does the organization require a Yellow Book or Single Audit
  - Ask for a copy of their most recent peer review
Who Must Registrar to File CHAR 500

- **Article 7-A**: Article 7-A of the Executive Law (Article 7-A) requires registration of charitable and other nonprofit organizations that solicit contributions from New York State (including residents, foundations, corporations, government agencies and other entities).

- **EPTL**: Section 8-1.4 of the Estates, Powers and Trusts Law (EPTL) requires registration of charitable organizations that are incorporated, are formed or otherwise conduct activity in New York State.

- Based on these two registration statutes, there are three registration types for organizations registered with the Charities Bureau:
  - **Article 7-A**: Organizations registered pursuant to Article 7-A only and not registered under the EPTL.
  - **EPTL**: Organizations registered pursuant to the EPTL only and not registered under Article 7-A.
  - **Dual**: Organizations registered pursuant to both Article 7-A and the EPTL.

- Who exempt from filling
  - Government Agency
  - All libraries not subject to file.
The fee is $25 for all organizations that are not exempt from filing.

The fee is based on the organization’s net worth at the end of the reporting period. An organization's net worth may be found on Part I, line 22 of the 990 or Part I line 21 of the 990 EZ.

EPTL Registrants:
- Net Worth at End of Year EPTL Filing Fee
- Less than $50,000 $25
- $50,000 or more, but less than $250,000 $50
- $250,000 or more, but less than $1,000,000 $100
- $1,000,000 or more, but less than $10,000,000 $250
- $10,000,000 or more, but less than $50,000,000 $750
- $50,000,000 or more $1500

Make checks payable to the NYS Department of Law and submit with the complete annual filing. NYS Department of Law Charities Bureau, Registration Section 120 Broadway New York, New York 10271
Who Exempt from Filing Fee

- A 7-A registrant is exempt from paying the 7-A fee and filing attachments to Form CHAR500 if its contributions from New York were less than $25,000 AND it did not engage a fundraising professional. A Dual registrant exempt from 7-A requirements only must still file appropriate attachments to meet EPTL requirements and pay the EPTL fee.

- An EPTL registrant is exempt from paying the EPTL fee and filing attachments to Form CHAR500 if its revenue and assets did not exceed $25,000 at any time during the reporting year.
Attach to Form CHAR500 a complete copy of IRS Form 990, 990-EZ or 990-PF and all schedules, including Schedule B (the Charities Bureau does not disclose Schedule B to the Public)

A. If the organization's revenue was between $250,000 and $500,000, attach an independent Certified Public Accountants' review report and financial statements to Form CHAR500.

B. If the organization's revenue was over $500,000, attach an independent Certified Public Accountants' audit report and financial statements to Form CHAR500.

Form CHAR500 must be signed by two separate individuals, the president or another authorized individual AND the chief financial officer or treasurer unless it is a trust signed by a trustee or bank vice-president.
Form 990 is an annual reporting return that certain federally tax-exempt organizations must file with the IRS.

- It provides information on the filing organization's
  - Mission
  - Programs
  - Finances
- Most federally tax-exempt organizations, with the exception of churches and state institutions.
- All 501(c)(3) non-for-profit, regardless of income.
How many board members?
How many independent board members?
Who keeps the books
  - Name and address
Whistleblower policy?
Conflict of interest policy?
Are there conflict of interest, if so what are they?
Officer, board members and key employees, who were employed or served during the fiscal year.
  - Names and addresses
List of donors who have donated more than $5,000.00 or 2% of gross revenue
  - Names and addresses
Mission statement?
How many fundraising events does or Organization throw that gross over $5,000.00
Form 990 is due 4 and one-half months after the close of your fiscal year.
- Every organization can request an extension of 3 months.
- In situation where the organization needs additional time they can request an additional 3 months.
The law is aimed at improving governance and oversight at the board level.

The Attorney General Eric T. Schneiderman was the driving force behind the Act and was assisted by Senators, Assemblyman, and nonprofit leaders from across the state.

On December 19, 2013 New York Governor Andrew Cuomo signed the Act but many provisions of the Act take effect at various future dates.

Applies to almost all nonprofit organizations doing business in New York State.

First major change to the nonprofit sector in over 40 years.
Some of the key requirements of the Act are:

- A requirement that all non-profit organizations have a conflict of interest policy.

- A requirement that transactions between a non-profit organization and a related party be approved in accordance with procedures set forth in the Act.

- A prohibition against an employee of a non-profit corporation serving as the chair of the board of directors.

- A requirement that a non-profit organization with 20 or more employees and significant revenue have a whistleblower policy.

- Changes to the financial reporting requirements for certain non-profit organizations that solicit donations in New York.
Who is Subject to The Law

- The law applies to:
  - New York not for profit
  - New York educational corporations
  - New York religious corporations
  - Also nonprofit doing business in New York State.

- Certain provisions also apply to non-New York corporations and trusts registered with the AG to solicit charitable contributions in New York
The purposes of the Non-Profit Revitalization Act are:

- To reduce unnecessary and outdated burdens on non-profits.
- To enhance non-profit governance and oversight to prevent fraud and improve public trust.
- Increase the transparency with the public.
The Act requires non-profits to assign certain votes and responsibilities to “independent directors”

- Conflict of Interest matters
- Whistleblower Policy matters
- Certain audit matter
An “Independent Director” is defined as a director who:

- Is not, or has not been within three years, an employee of the organization or an affiliate, and does not have a relative who is, or has been within the last three years, a key employee of the organization.
- Has not received, and does not have a relative who has received in the last three years more than $ 10,000 in direct compensation from the organization.
- Is not a current employee of, or does not have a substantial financial interest in, and does not have a relative who is a current officer of, or has a substantial financial interest in, any entity that has made payments to, or has received payments from, the organization or property or services in the amount which, in any of the last three years, exceeds the lessor of $ 25,000 or 2% of such entity’s consolidated gross revenue.
Is this Director Independent?

- Individual X served as Director for the past 4 years for ABC Organization. Individual X’s job was as a branch manager at a local bank. ABC Organization has a checking account and a line of credit at that local bank. The checking account charges an annual fee of $100 and interest on the line of credit was $8,000. The bank’s gross annual revenue is $30,000,000.

- Is the Director independent? The answer is Yes

- $30,000,000 x 2% = $600,000
- $25,000 or $600,000
- $25,000 > $8,100
Conflict of Interest Policy

- Requires that the person with the conflict of interest not be present at or participate in Board or Audit Committee deliberations or vote on the matter giving rise to such conflict
- Prohibition of any attempt by the person with the conflict to improperly influence the deliberations or voting on the matter giving rise to such conflict
- Procedures for disclosing, addressing, and documenting related party transactions
- Requirement that the existence and resolution of the conflict be properly documented
The Conflict of Interest Policy must require that, prior to the initial election of any director, the director shall sign and submit to the Secretary a written statement identifying:

- Any entity of which the director is an officer, director, trustee, member, owner, or employee with which the nonprofit has a relationship.
- Any transaction in which the nonprofit participates in which the director might have a conflict of interest.

The Policy must require that each director annually submit such written statement (identifying the transactions above) to the Secretary.

The Secretary will provide a copy of the completed statements to the Chair of the Audit Committee or Board Chair, if they are not an Audit Committee member.
Any nonprofit that has 20 or more employees and over $1,000,000 in revenue must adopt a Whistleblower Policy:

- to protect from retaliation on people who report suspected improper conduct.

The policy must include the following:

- Procedures for reporting violations or suspected violations of law or nonprofit policies, including procedures for preserving the confidentiality of reported information.

- Requirement for an administrator (can be an employee, director, or officer) of the Whistleblower Policy be designated who will administer the policy and report directly to the Audit Committee, or other independent Committee of the Board.

- Requirement that a copy of the policy be distributed to all directors, officers, employees, and volunteers who provide substantial services to the nonprofit.
Related Party Transactions

- Related party transactions are prohibited unless the transaction is determined by the Board to be fair, reasonable, and in the nonprofit’s best interest at the time of the transaction.

- Any director, officer, or key employee who has an interest in a related party transaction must disclose to the Board/Committee the material facts of their interest.

- For any related party transactions involving the nonprofit and a related party, the Board/Committee is required to:
  - Consider alternative transactions (if available) prior to entering into the transaction.
  - Approve the transaction by a majority vote of the members at the meeting; and
  - Contemporaneously document in writing the basis for the approval including the alternatives considered.
No employee of the nonprofit can serve as the Chair of the Board or hold any other title with similar responsibilities.

Board members can participate in Board meetings via video conferencing, as long as everyone can hear each other at the same time and directors can participate in all matters before the Board, including voting upon an actions taken by the Board.

Clarifies that while it is reasonable for the nonprofit to pay reasonable compensation to members, directors, or officers for services rendered.

The Board can request background information on those individuals who are present and/or answer questions prior to deliberations and/or voting.
FASB’s Changes to the Nonprofit Financial Reporting Model

- Net Assets Classification
- Liquidity Information
- Reporting Expenses
- Cash Flow Statement
Why the Changes?

- Why is FASB proposing changes?
  - FASB is making these change to better serve the needs of the financial statement users.
  - The financial statements could better assess the financial health of the Organization.
Net asset classifications are redefined:

Current classification (GAAP):
  o Unrestricted
  o Temporarily restricted
  o Permanently restricted

Proposed classification (GAAP):
  o Net assets without donor restrictions
  o Net assets with donor restrictions
Liquidity

- Current (GAAP)
  - No requirement to disclose information about liquidity.

- Proposed (GAAP)
  - Require disclosure of quantitative and qualitative information about liquidity.
Liquidity (Continued)

- Quantitative information:
  - The total amount of financial assets
  - Amounts that are not available to meet cash needs
  - Total amount of financial liabilities that are due

- Qualitative information:
  - About how a non-profit entity manages its liquidity
    - Define policy
    - Define time horizon
Reporting of Expenses

- Current (GAAP):
  - Schedule of Functional Expenses is mandatory for health and welfare organizations and recommended for others.

- Prosed (GAAP):
  - Requires to report expenses by nature and by function in one location either in Statement of Activities or Schedule of Functional Expenses
Cash Flow Statement

- **Current (GAAP):**
  - Direct or indirect method acceptable

- **Proposed (GAAP):**
  - Requires direct method for operating cash flows
  - Re-categorize certain items to better align operating cash flows with operating measures
Cash Flow Statement (Continued)

- Cash Flow indirect method- which starts with the change in net assets for the respective reporting period and reconciles that number to the cash balance as of the end of the reporting period. (currently in place)

- Cash Flows direct method- This would detail more specifically the sources and uses of cash for the period in the operating section of the statement. (purposed change)
New proposed components of Operating Activities:

- Contributions restricted to acquire long-lived assets for operating purposes would be classified as operating cash flows.
- Payments to acquire long-lived assets for operating purposes would be classified as operating cash flows.
- Proceeds from the sale of long-lived assets would be classified as operating cash flows.
New proposed components of Investing Activities:
- Interest and dividends received

New proposed components of Financing Activities:
- Interest paid on long-term borrowings
Expected Project Timeline

- April 22, 2015
  - Exposure draft released

- August 20, 2015
  - Comment period (120 days from issuance)

- September 2015 – October 2015
  - Public roundtables

- Fall 2015
  - Begin board deliberations
How to Stay Updated

- [www.fasb.org](http://www.fasb.org)
  - FASB exposure draft
  - Project summaries
  - Webcast

- Sign up for FASB’s electronic action alert.
References


- www.fasb.org

- www.charitiesnys.com