Nonprofit Observer

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CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
Expert Advice | Strategic Solutions | Personalized Attention
111 Deer Lake Road, Suite 125, Deerfield, IL 60015-9578
Tel: 847.267.3400 Fax: 847.267.3401 www.mannweitz.com
info@mannweitz.com

Multiple income streams: The key to sustainability

When the so-called Great Recession hit the nation over a decade ago, many nonprofits found themselves struggling to stay afloat financially. Not all of them survived.

Organizations with only one or two sources of revenue were particularly vulnerable, yet, more than a decade later, some nonprofits continue to struggle. It's only a matter of time until the country enters another recessionary period, so now's the time to ensure your revenue streams are sufficiently diverse.

Varied revenue sources

As some organizations learned the hard way during the last recession, relying on a single source of revenue can leave you with empty coffers if that source dries up. For example, nonprofits that were dependent back then on state funding for their budgets had to scramble as states across the nation began reducing, suspending and even eliminating grants.

Of course, governmental funding isn't the only source that could unexpectedly disappear. Tough economic times can hurt major gifts, corporate giving, ticket sales for fundraising events, individual donations and foundation grants. If you sell goods or services, you might see sales dry up as people are forced to cut back on personal spending.

Road map to diversification

Financially stable nonprofits have a good mix of revenue sources, with no *one* source accounting for more than 25% or 30% of the budget. The following steps can help you get there.

Perform and present your initial evaluation. Nonprofit boards of directors sometimes are reluctant to add revenue streams, but a visual aid can help them understand the need. It's easy to generate a pie chart in Excel that will show each source as a percentage of the total revenue. You also might want to include benchmarking data that shows how your revenue mix compares to those of peer organizations.

The initial evaluation should include a review of future plans and anticipated expenses, too. Present the board with multiple scenarios where those costs are compared to revenues with and without the current revenue sources. Seeing how eliminating a revenue stream could jeopardize the mission may be the nudge reluctant directors need to embrace diversification.

Determine appropriate additional revenue sources. Keep everything on the table as you begin this part of the process. Consider a wide range of potential sources, weighing the pros and cons of each, including implications for staffing and other resources, accounting processes, unrelated business income taxes and your organization's exempt status.

MAJOR DONORS AREN'T JUST FOR THE BIG GUYS

For some nonprofits, the term "major donors" brings to mind Bill Gates or similar charitably inclined multimillionaires — the kind of donors who think big and probably wouldn't be interested in their small organizations. But every nonprofit should work to cultivate the kinds of donors who qualify as "major" to them.

While large organizations may define major gifts as those with six or more figures, you might regard a gift with four figures as major. Review the past 10 years of donations to identify your largest gifts and work from there to generate similar gifts. Look for philanthropic individuals with both the financial capacity and the interest in your specific mission. Highlight historically generous donors but also review lists for infrequent donors, event attendees and similar prospects.

A little extra research can uncover other organizations they've supported and personal information that can help you build a relationship with these prospects. If you lack the staff resources for such detective work, use volunteers. You also might invest in wealth-screening software, such as DonorSearch or WealthEngine.

In addition, assess how well aligned potential sources are with your mission. For example, has that foundation grant you're thinking about pursuing ever been awarded to another nonprofit serving your population? Does the company that has proposed a joint venture engage in practices counter to your values?

Financially stable nonprofits have a good mix of revenue sources, with no one source accounting for more than 25% or 30% of the budget.

Develop strategies for each new source. You don't want to put all your eggs in one basket, but you also don't want to depend on too many "baskets," because each new revenue stream will require its own strategy. Executing too many implementation plans can strain resources.

Each plan should include initial and ongoing budgets, as well as any new systems, procedures and marketing campaigns that will be needed. It also should have a timeline with milestones to facilitate monitoring.

Review and adjust as necessary. Take the time at the end of every month — don't wait until year end — to closely review each revenue source. Is it living up to expectations? Is it costing more than expected or falling short of revenue projections?

If a source fails to deliver over time, don't feel tied to it. Your financial advisor can help you figure out whether it's best to let it go and try another route.

Patience is crucial

You can't add significant revenue streams overnight — it takes time, especially if you've relied on one type of revenue for a long time. But that's more reason why organizations with only one or two revenue sources should start diversification plans now. ●

Keep these 5 points in mind when raising funds

Since the Tax Cuts and Jobs Act (TCJA) was enacted in late 2017, some aspects of charitable giving have changed, but not exactly in the way some nonprofit watchers predicted. Because the TCJA widely reduced the motivation for donating to charity, many observers forecast that annual donations might plummet. But so far that hasn't been the case.

For example, the Giving USA website reports that 2018 contributions declined only 1.7%, when the total dollar amount was adjusted for inflation. However, 2018 was only the first full post-TCJA year. The jury is still out for contribution totals in 2019. Nonetheless, in a post-TCJA world, there are certain "truths" we know for sure, and they may help you in upcoming fundraising efforts.

1. Microdonations make sense

Microdonations are a small but mighty tool. Some nonprofits have found it worthwhile to devote resources to securing gifts in increments so small that donors don't think twice about making them. A callout for $5 donations sent via text or an app, or an automatic $10 monthly donation from a checking account or credit card, can produce a nice chunk of revenue for minimal effort.

This method of donation has proven particularly popular with younger donors who appreciate the ease. Getting these donors invested in your organization when they're still in their early earning years can pay off in the future when they may have the potential to become major donors. And who, regardless of age, wouldn't be tempted to donate "loose change" to your organization?

2. Donor-advised funds have appeal

Donors can get an immediate tax deduction for contributions to a donor-advised fund (DAF). And they can keep the advisory privileges for fund distributions and asset investments.

By making significant contributions to a DAF in a single year, a donor can exceed the standard deduction threshold. This allows the taxpayer to itemize and obtain a tax benefit from charitable donations. The donor can advise the fund administrator to distribute the funds to your nonprofit *annually* in increments. This allows you to receive a steady stream of donations.

3. Donation "bunching" works

It's been estimated that the number of households claiming charitable deductions will dramatically drop because fewer taxpayers will itemize. But, if typical donors bunch their donations similarly to how those with DAFs do, they may accumulate enough charitable deductions to push them over the standard deduction in some years.

For example, a donor who typically contributes to your organization at year end can instead bunch donations in alternate years (for example, January and December of 2020 and January and December of 2022). Or a donor could make several years' worth of donations in one year. The donor still gives the same total amount as in the past, but without sacrificing the charitable deduction.

4. Retirees are a natural target

Donors age 70½ or older may qualify to transfer up to $100,000 to qualified charitable organizations (other than DAFs or private foundations) every year from their traditional or Roth IRA accounts. Married couples can distribute as much as $200,000 annually, if no more than $100,000 comes from each person's own IRA. There are some restrictions for 509(a)(3) supporting organizations.

Although no charitable deduction is allowed, the distribution isn't included in the taxpayer's adjusted gross income (AGI). That's because the IRA trustee makes it directly to the charity. This strategy reduces the donor's taxable income, possibly enabling him or her to qualify for deductions subject to AGI floors and avoid the net investment income tax. The distributions count toward the donor's required minimum distributions from IRAs.

5. Board members are vital

Traditionally, fundraising was considered a key responsibility of a nonprofit's board of directors. This obligation has fallen by the wayside at some organizations, as duties related to governance and ethics have gained in prominence. Now is the time to gently remind your board members of the vital fundraising role they play.

Ask them to reach out to their connections, and make it easy for them to do so. You can provide them talking points, statistics, outcome reporting and materials they can use to persuade potential donors of the value of your group's work. ●

Mandatory tax e-filings are right around the corner

Under the newly enacted Taxpayer First Act, all nonprofits will soon need to file their information returns electronically. Depending on the size of your organization, the requirement could take effect as soon as next year.

What's required?

The Taxpayer First Act requires nonprofits to file their report statements or returns in the Form 990 series or Form 8872 (political contributions and expenditures) electronically, effective for the 2020 tax year for calendar-year filers. For fiscal-year filers, this applies to returns covering tax years beginning on and after July 2, 2019. This newly includes Form 990-T. The act also directs the IRS to make nonprofits' annual tax returns available to the public in a machine-readable format as soon as practicable and at no charge.

The statute gives the IRS the option to delay implementation of the filing requirement for smaller organizations for two years. "Smaller organizations" are defined as those with annual gross receipts of less than $200,000 and aggregate gross assets of less than $500,000 at the end of the tax year. The IRS may similarly delay implementation related to Form 990-T filings.

The new law also requires the IRS to notify an organization that fails to file a Form 990-series return or e-postcard for two consecutive years. Nonprofits automatically lose their tax-exempt status if they don't file annual information returns for three consecutive years.

Sooner or later

Whether Congress opts to delay implementation of the e-filing requirement for smaller organizations or not, it's coming for every nonprofit at some point in the near future. Your CPA can help you stay in compliance on this and other tax-related matters. ●

FASB simplifies merger accounting for nonprofits

The Financial Accounting Standards Board (FASB) recently issued guidance that should ease the financial reporting burden on nonprofits that enter "business combinations," such as mergers and acquisitions. The title of the guidance is a mouthful, but it probably tells you everything you need to know: Accounting Standards Update (ASU) No. 2019-06, *Intangibles — Goodwill and Other (Topic 350), Business Combinations (Topic 805), and Not-for-Profit Entities (Topic 958): Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities.*

In other words, the guidance enables all nonprofits to take advantage of two simplified and cheaper alternatives to U.S. Generally Accepted Accounting Principles (GAAP) that have been available to for-profit businesses since 2014.

Accounting for goodwill

Under original standards, GAAP requires organizations that merge with or acquire another organization to identify and recognize the fair value (usually the current market price) of every asset and liability obtained in the deal, including goodwill. The value of goodwill is determined by deducting the value of all other assets and liabilities from the purchase price.

In the nonprofit context, goodwill might be found, for example, when an organization acquires a for-profit entity — think of a nonprofit hospital buying a physicians' practice. Or it might exist after the acquisition of a nonprofit that's in a loss position if the combined organization depends primarily on fee-for-service revenue. According to the FASB, the latter happens both in the health care industry and in other industries in which goodwill is less prevalent.

GAAP generally requires you to carry goodwill on your books at its initial fair value less any "impairment." It doesn't allow goodwill to be amortized, or gradually reduced in value, over multiple years.

Goodwill is impaired if its fair value falls to an amount less than its book value. GAAP requires impairment testing at least annually at a reporting unit level. That means that organizations with operating units that have their own discrete financial information, separate from the overall organization, must test for impairment for each separate

unit. The testing process can prove complicated and costly.

The goodwill GAAP alternative originated in ASU No. 2014-02, *Intangibles — Goodwill and Other (Topic 350): Accounting for Goodwill.* It generally allows an organization to amortize goodwill after its acquisition on a straight-line basis (reducing the value by the same amount each during a period of 10 years, or less if you establish that another useful life is more appropriate).

Making a policy decision

If you opt for the alternative, you must make an accounting policy decision to test goodwill for impairment at either the organization level or reporting-unit level. But the alternative requires testing only when a triggering event happens. Examples of triggering events include:

- A decline in general economic conditions,
- Increased costs,
- Negative or declining cash flows,
- A decline in actual or planned revenue,
- The loss of key personnel, and
- Litigation.

Nonprofits that choose to apply the alternative could see significant cost savings because amortization is allowed and the annual impairment testing requirement is eliminated. Amortization generally reduces the odds of impairments, and testing likely will be necessary less often. When testing is required, the ability to conduct a single test at the organization level should reduce the expense.

Recognizing intangible assets

Under original GAAP, organizations that acquire certain customer-related intangible assets or noncompete agreements in a merger or acquisition must recognize them on financial statements separately from goodwill. These intangible assets include such things as customer and donor lists and relationships.

The intangible assets alternative was issued in ASU No. 2014-18, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination.* It permits organizations that elect to adopt the goodwill alternative to also elect *not* to recognize customer-related intangible assets and noncompete agreements separately from goodwill. It doesn't apply, though, to noncustomer intangibles, such as patents, trade names, franchise rights and favorable leases.

Here's the appeal of this alternative: You can recognize fewer separate intangible assets and therefore have fewer assets to value individually. And you simply subsume covered intangibles and noncompetes into goodwill.

Note that this alternative isn't available unless you elect the goodwill alternative. You can, however, elect the goodwill alternative without electing the intangible assets alternative.

Effective immediately

This guidance has already taken effect. If you elect the goodwill alternative, you will apply it going forward to both existing goodwill and goodwill generated in future mergers or acquisitions. The intangible asset alternative would apply prospectively to future business combinations only. It wouldn't affect existing intangible assets. ●

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In keeping with our dedication to meeting the accounting and business needs of nonprofit organizations, MW&A established The Midwest Resource Group – a network of highly experienced advisors serving nonprofit organizations that we can draw upon to support our clients. Services available through the Midwest Resource Group range from insurance, HR, investment and IT consulting to executive search, training, research, website and marketing services.

We also participate in the Association Forum of Chicagoland and are active members of the Illinois CPA Society's Not-For-Profit Organizations Committee. In addition, we are members of the American Institute of Certified Public Accountants' (AICPA) Not-For-Profit Section and its Center for Governmental Audit Quality and Employee Benefit Plan Audit Quality Center.

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