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Reporting Expenses Under the New Financial Statement Standards

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On August 18, 2016, the Financial Accounting Standards Board (FASB) released Accounting Standards Update (ASU) 2016-14 entitled Presentation of Financial Statements of Not-for-Profit Entities. The Update will change the way all nonprofit organizations present their financial statements and is intended to improve comparability between organizations, and provide more useful information for users. In our 2017 2nd Quarter Not-For-Profit Newsletter, we addressed the new requirements for disclosing liquidity and availability of resources.

We will now turn our attention to the updated requirements for presenting expenses by both their natural classifications, i.e., salaries, employee benefits, occupancy, etc., and their functional classifications, which are generally program services and supporting services such as management and general, fundraising, and membership development. In addition, an analysis of these expenses must be presented either on the face of the statement of activities, as a separate statement, or in the notes to the financial statements. Finally, a supplemental disclosure describing the organization's methodology in allocating expenses between functions will also be required.

Tracking expenses by natural category is usually simple and straightforward. Tracking expenses by functional classification is more subjective, and can be more challenging for organizations that operate multiple programs. Expenses that benefit more than one function should be allocated. For example, let's assume the executive director of an organization primarily runs program services, but also out of necessity must perform management and general duties, and devotes a fair amount of time to fundraising. Salary expense for the executive director should then be allocated between the functions that he or she performs based on the amount of time spent performing each function.

How do we allocate expenses between functions? Let's start with a reminder of what each function generally includes. Program services are those activities that fulfill the purpose or mission of the organization. The definition of management and general activities has been modified by the Update to include "supporting activities that are not directly identifiable with one or more program, fundraising, or membership development activities." Fundraising activities are those that induce potential donors to make financial contributions to support the organization's mission. Finally, membership development activities seek to increase and maintain membership.

Many organizations are already capturing most of this information for use on their Form 990, specifically for Part III, the Statement of Program Service Accomplishments, and Part IX, the Statement of Functional Expenses, but this may not be reflected on their financial statements. In addition to the enhanced reporting for expenses, the Update will now require supplemental disclosures regarding how allocations between functions were determined. Examples of disclosure notes for allocation of expenses can be found in the ASU at section 958-720-55-176.

Even though these changes will not become effective until calendar year 2018 or fiscal year 2019, management and the board of directors should start considering now how the Update will affect their particular organization. If additional disclosures will be required, you will want to consider how to best capture the information necessary to complete the disclosures. Early planning will ensure smooth and successful implementation of the Update. While the Update does present challenges, it also provides an opportunity for organizations to evaluate how resources are being allocated which may have a positive overall effect on the financial well-being of the organization.

How to Fund Your Newly Formed Nonprofit Organization

Whether you are passionate about a certain cause and would like to advocate for it or would like to be a facilitator of change in your community, there are many reasons for starting a nonprofit. Now, having the ambition and entrepreneurship is a fantastic first step but how do you tackle the real issue of obtaining funding to start operations? One possible solution is to find a fiscal sponsor.

A fiscal sponsor is an already established tax-exempt nonprofit that you enter into an agreement with in order to obtain donations while your own tax-exempt status is in the process of being granted by the IRS. This lends credibility to your organization, making it more attractive for people to donate and thus generating revenues you would have much more difficulty in obtaining as a new organization. The donors also benefit as their contribution is still considered tax-deductible since it was given to the fiscal sponsor.

If you decide this is a route you would like to take, it is best practice, as with all agreements, to formally and explicitly outline the responsibilities of both parties as well as other aspects in writing. The question now becomes, what are some of the responsibilities and who is ultimately accountable for those items?

As hinted earlier, the fiscal sponsor agrees to accept contributions on your behalf. This is often done in exchange for an administrative fee. Once the contributions are obtained, they are required to perform certain oversight actions to ensure their compliance as a fiscal sponsor. The first of which is the retention and control over how to use the donated contributions. This may seem counter-productive since your main goal is to fund your own operations. However, it serves the important purpose of upholding the donors' trust that their donation is being used appropriately. To this end, the second oversight item is that the sponsor will request records and reports to justify and confirm compliance.

Your responsibilities mirror the sponsor's. While they are accepting contributions, you are honing in on your mission and what projects will be the most impactful to meet it. The end goal should be to establish yourself to the point where you no longer need to rely on another to continue your operations. As you pay your administrative fee, you are also receiving "flow-through" funds from the sponsor. One of the major advantages of entering into this type of agreement is that these funds could also include grants from either a foundation or the federal government. In any case, the sponsor is responsible for how the contribution is used and will therefore require you to create and update recordkeeping reports to track that you are in compliance.

One of the final things to consider is that constant communication from both parties is key to retaining a healthy and advantageous relationship. Not just from an oversight and compliance standpoint but you could also utilize their experience in a "mentor" capacity and gain insight to what processes are most efficient while they could benefit from any new ideas you could bring to the table. How you handle the initial steps of your newly formed nonprofit organization could set the tone of its future and utilizing a fiscal sponsor is a great option to assist in laying that foundation.

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