NONPROFITS: THE NEW KIDS ON THE BLOCKCHAIN

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NONPROFITS ARE NOT IMMUNE TO MAINTAINING DATA PRIVACY

6 STRATEGIES UNDER $6 TO EXPONENTIALLY IMPROVE ORGANIZATIONAL PERFORMANCE
By Sanjay Marwaha

Nonprofit organizations constantly strive to appease many constituencies. From board members to donors to program participants, stakeholders are wide-ranging and, in healthy organizations, information is constantly flowing between them and the organization itself. But how can organizations ensure that this information is complete and accurate, measure the efficacy of their programs, convey impact metrics to donors and keep costs low?

That’s where blockchain comes in.

According to Harvard Business School professors Marco Iansiti and Karim Lakhani, blockchain is essentially “an open, distributed ledger that can record transactions between two parties efficiently and in a verifiable and permanent way.” The best-known use of blockchain to date is to support the transaction of cryptocurrencies such as bitcoin and, while the two are often conjoined—and confused—bitcoin is just one of many potential blockchain applications. Bitcoin is, in essence, a new form of currency; blockchain is the database that enables its secure transaction. While it has certainly enabled the meteoric rise of cryptocurrencies, blockchain has implications far outside of the financial sector.

The primary appeal of blockchain is the unprecedented level of trust it offers. Every transaction must be verified through a process known as “consensus,” requiring multiple-system participants to independently verify authenticity. Once a new entry has been made in the blockchain, it is “locked” or time-stamped, meaning it cannot be modified; it can only be updated by adding a new entry as an addendum. All entries can be viewed by the public.

Offering increased levels of accuracy and accessibility for sharing any asset of value, blockchain supports many different uses, from transacting cryptocurrencies, to verifying information and contractual processes between a nonprofit organization and a corporate partner or government agency. It also reduces transaction costs, meaning participants can avoid using expensive third-party services to facilitate transactions.

For nonprofits, the potential applications are far-ranging, and could help address a number of issues that have long plagued the sector.
Nonprofits: The New Kids... Continued

INCREASED TRUST ACROSS THE GIVING CHAIN

First, let’s start with the very beginning of the giving process—the donor.

The profile of the average donor is changing. Millennials now make up the largest portion of the overall population, and have begun to take on a key role in philanthropy around the globe. These donors differ significantly from their predecessors: Most expect that nonprofits will be transparent and able to back up the impact of their donations with concrete proof. As the role of millennials in the nonprofit world grows, so too will the demand for increased visibility and reporting around impact and outcomes.

Along with the shifting demographics of donors, public trust in nonprofits is shaky. According to the 2015 Money for Good study, 49 percent of donors don’t know how nonprofits use their money, while 20 percent are unsure who benefits from the work they’re funding. This is a clear breakdown in communication, and one that will continue to erode donor confidence and willingness to give.

Blockchain technology can record in detail how funds from donors are used, and the transparency and traceability it provides could drastically improve trust between an organization and its funders. This could also be a significant advantage for organizations that receive funds from governments or government agencies, cutting down on time spent monitoring and reporting by demonstrating in real time that funds have made it to their intended recipients.

Blockchain also offers insight into how employees, grantees, “boots on the ground” subcontractors or partner organizations are using funds—a boon in fighting fraudulent activity. Not only are all transactions auditable in real time, falsifying entries in the blockchain is nearly impossible. By allowing nonprofit management, be it the board, the executive director or another professional to easily confirm if funds are being used both correctly and efficiently, the opportunity for fraud to occur decreases greatly and any instances of financial mismanagement can quickly be identified. For the nonprofit sector to function effectively, there needs to be an established level of trust between the donors/funders, the organization itself and the recipients of those funds or program participants. Blockchain technology can take this trust to the next level—preventing fraudulent payments and validating that donations are being used as intended from the donor’s initial gift all the way through to the end beneficiary.

These qualities are already being demonstrated in pilot programs across the nonprofit sector. Bitgive, for example, maintains a blockchain donation tracking platform that lets donors “trace nonprofit transactions on a public platform in real time to see how funds are spent, ensure they reach their final destination and track the results generated from contributions.” The World Food Programme (WFP) also tested its “Building Blocks” blockchain in Pakistan by giving vulnerable families WFP food and cash assistance, and recording and authenticating the transactions on a blockchain ledger through smartphones. Program managers used these reports to double-check that distributions were occurring properly. The Grant Hero Foundation even created its own cryptocurrency for philanthropic endeavors, called GIVE Coins, that allow users to create and award personal grants, and hopes to raise $25 million this fall for future grantmaking.

REDUCE THE “COST OF DOING BUSINESS”

Another way blockchain could positively disrupt the sector is by enabling nonprofits to cut down on overhead and administrative costs.

Nonprofits rely heavily on intermediaries to help support their activities, ranging from credit card companies to process donations to financial institutions, to execute cross-border transactions and foreign exchange services. By eliminating these middlemen, organizations can execute transactions directly, increasing both efficiency and cost savings.

Reporting, a critical element of the trust equation, is another nonprofit expense that could be significantly streamlined by blockchain technology. Our recent benchmarking survey found that over a third of nonprofits struggle with not having enough human resources to gather data for reporting and an inability to compile statistics on the impact of programs. With blockchain, data is recorded in real time and easily accessed, reducing the time and manpower needed to compile comprehensive reports.

Blockchain could also improve several aspects of audit and compliance processes, both of which can be resource-intensive. These processes can trigger rounds of manual reconciliations, involve data that requires significant sampling or full testing, and demand hours of often-duplicative data analysis due to a lack of systems integration.

A blockchain transaction can be validated when it occurs and can be reviewed for completeness and accuracy using entities that exchange transactions through a common platform. The auditor should be able to more quickly and efficiently reconcile data, amounts, assets, ownership, transactions and other detailed information across the distributed general ledger. Compliance activities and filing with various agencies can also be automated. When facing different audit requirements across all 50 states, using blockchain to cut down on audit inefficiencies and limit their invasiveness can lead to significant savings for nonprofit organizations.

WHAT’S NEXT? THE FUTURE OF BLOCKCHAIN PHILANTHROPY

The potential for blockchain to increase nonprofits’ transparency and reduce overhead costs could disrupt the sector in the short term, and there are multiple ways that blockchain could truly revolutionize the future of giving as we know it:

- Blockchain has the capacity to help monitor and identify issues that need philanthropic assistance. For example, a foundation interested in reducing child labor can use the blockchain ledger to monitor supply chains to detect suspicious activity, and identify where resources should be deployed.

- Blockchains can also transact any type of asset, meaning there could be the
Nonprofits: The New Kids... Continued

potential for an explosion of new forms of donations like microdonations and transfers of physical or even intellectual property.

Smart contracts are self-executing contracts stored in the blockchain system and monitored by the network of computers that run the blockchain. Essentially, these contracts are immediately triggered when a set of agreed-upon conditions are met. Smart contracts can allow organizations to quickly open up new funding to program managers and subcontractors if key metrics are demonstrated, resulting in faster response times when dealing with unexpected events like natural disasters. A smart contract could also be set up to automatically redirect excess funds to another project if they’re not needed or if needs shift.

Initial Coin Offerings (ICOs) could be the next big thing when it comes to innovative fundraising. In an ICO, investors purchase tokens (similar to shares in a traditional initial public offering) to help crowdfund a project. While this has yet to be explored for philanthropic purposes, ICOs have been known to raise millions in just a few hours, which could be a game changer for philanthropic organizations.

Blockchain technology is still relatively new to the philanthropic world, but that’s likely to change in short order. While the impact of blockchain on nonprofit regulation, governance and management is unclear, this technology has the potential to forever alter the way people and organizations work for the greater good.

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IRS ISSUES 2018 WORK PLAN FOR TAX-EXEMPT ORGANIZATIONS

By Laura Kalick, JD, LLM in Taxation

The Tax Exempt and Government Entities (TE/GE) division of the IRS recently issued its FY 2018 Work Plan, which builds upon the agency’s ongoing mission to refine, realign and improve its education and examination methods. In 2017, the agency implemented data analytics and knowledge management strategies to target organizations with a high likelihood of noncompliance, and the 2018 plan continues this practice. Facing budget cuts and a declining workforce, the agency reiterated its mission, first stated in last year’s work plan, of transparency, efficiency and effectiveness.

For nonprofits preparing for 2018, now is the ideal time to review the work plan and develop a strategy in case of an IRS audit.

FISCAL YEAR 2018 INITIATIVES

For fiscal year 2018, the IRS has outlined the following compliance strategies:

Examine entities that state they are supporting organizations and filed the Form 990-N.

Examine organizations that have operated as for-profit entities in the past, but now operate as 501(c)(3) organizations.

Examine organizations that show signs of providing private benefit or inurement to individuals or private entities though contracts with individuals or other arrangements such as partnership agreements.

If any of these attributes apply to your organization, it is crucial to ensure your financial information is organized and correct to prepare for the possibility of an audit.

TAX GAP ISSUES IN THE SPOTLIGHT

In 2016 and 2017, the agency identified the tax gap as a key issue area. In 2016, the IRS conducted almost 5,000 examinations, with a large portion of these examinations encompassing tax gap issues, such as employment tax and unrelated business income tax. For 2018, these tax areas remain of concern. Organizations should be aware of the following:

Unrelated Business Income: Organizations should review materials as they relate to gaming, non-member income, expense allocations, net operating losses, rental activity, advertising, debt financed property rentals and investment income.

Employment Tax Issues: These include unreported compensation, account-
The IRS has focused on providing online guidance and knowledge materials with the expectation that this will improve compliance and increase the number of correctly submitted documents. Not only will this guidance aid organizations in the proper process for exemption filing, but it will also act as a training resource for agents, allowing for the quick resolution of issues.

**BEST PRACTICES FOR ORGANIZATIONS**

With the IRS work plan released, organizations can start preparing for the year ahead. If there are any uncertain tax positions, it is best to sort them out sooner rather than later. Preparation is key and with a trove of knowledge and guidance online, resources such as mini-courses, issue snapshots, podcasts and audit tools can help you sort out any questions or issues you may have. Another tip is to undergo a “mock” audit, so instances of non-compliance can be identified before a real IRS audit. Online tools and resources are a great place to help you get started on your organization’s “mock” audit.

After analyzing what to expect for the coming year and identifying any potential issues, organizations should ensure they have properly documented all financial activity. A routine audit means three years of documentation will be examined. However, in certain circumstances, documents from years prior may be requested. For example, if an organization is offsetting current income with a loss generated two decades ago, the IRS can request information from the year of the loss. In the event your organization must challenge an IRS outcome, documentation will be crucial. Without proper documentation, it will be difficult to make a strong case.

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**YEAR END ACCOUNTING UPDATE SUMMARY - WHAT IS ON THE HORIZON?**

*By Tammy Ricciardella, CPA*

All entities, including nonprofit organizations, are facing the daunting task of addressing a slew of changes as a result of numerous Accounting Standards Updates (ASU) being issued by the Financial Accounting Standards Board (FASB). We have discussed many of these forthcoming changes in prior editions of the Nonprofit Standard and provided updates through our Nonprofit Standard blog. This article provides a summary of the upcoming standards, as of this point in time, that entities need to be aware of and actively working to implement.

**ASU 2014-09, REVENUE FROM CONTRACTS WITH CUSTOMERS (TOPIC 606)**

Summary: In May 2014, the FASB issued ASU 2014-09 which is a comprehensive new revenue recognition standard that will supersede existing revenue recognition guidance. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To accomplish this objective, the standard requires five basic steps:

- Identify the contract with the customer.
- Identify the performance obligations in the contract.
- Determine the transaction price.
- Allocate the transaction price to the performance obligations in the contract.
- Recognize revenue when (or as) the entity satisfies a performance obligation.

Entities will generally be required to make more estimates and use more judgment than under current guidance, which will be highlighted for users through increased disclosure requirements.

Entities should evaluate whether the following contracts (and others they may have) are subject to the ASU: memberships, subscriptions, products and services, royalty agreements, sponsorships, conferences and seminars, tuition, advertising, licensing, and federal and state grants and contracts.

Contributions received from donors are not specifically scoped out of the ASU. However, the ASU defines revenue as “inflows
Year End Accounting... Continued

or other enhancement of assets of an entity or the settlement of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity’s ongoing and major activities.” In other words, revenue is a reciprocal transfer between parties in which the parties are expecting to exchange similar value. On the other hand, a contribution is defined as “an unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner.” Since a contribution is both voluntary and nonreciprocal, it is scoped out of the ASU by definition.

Effective Date: FASB issued ASU 2015-14 that deferred the effective date of ASU 2014-09 until annual periods beginning after Dec. 15, 2018 for the majority of nonprofit organizations.

For those organizations that have issued, or are a conduit bond obligor for, securities that are traded, listed or quoted on an exchange or an over-the-counter market qualify as a public entity under the standard and therefore the standard is effective for annual reporting periods beginning after Dec. 15, 2017, and interim reporting periods within annual reporting periods beginning after Dec. 15, 2018.

Steps That Should be in Process: Organizations should be reviewing all their business activities and contracts to ascertain the effect this new standard will have on the recognition of revenue. Each type of contract that the entity has will need to be subjected to the five-step process and the revenue treatment ascertained.

ASU 2015-03, INTEREST – IMPUTATION OF INTEREST: SIMPLIFYING THE PRESENTATION OF DEBT ISSUANCE COSTS (SUBTOPIC 835-30)
Summary: This ASU requires that debt issuance costs be presented in the statement of financial position as a direct reduction from the carrying amount of the debt liability, consistent with debt discounts and premiums.

Effective date: The ASU is effective for financial statements issued for fiscal years beginning after Dec. 15, 2015.

ASU 2015-07, FAIR VALUE DISCLOSURES FOR INVESTMENTS IN CERTAIN ENTITIES THAT CALCULATE NET ASSET VALUE PER SHARE (OR EQUIVALENT) (TOPIC 820)
Summary: In May 2015, the FASB issued ASU 2015-07, which allows for those entities that have elected the practical expedient to use the net asset value (NAV) as a measure of fair value and to no longer categorize these investments within the fair value hierarchy. The practical expedient criteria differ from the criteria used to categorize other fair value measurements within the hierarchy. A reporting entity should continue to disclose information on investments for which fair value is measured at NAV (or its equivalent) as a practical expedient to help users understand the nature and risks of the investments and whether the investments, if sold, are probable of being sold at amounts different from NAV.

Effective Date: The ASU is effective for fiscal years beginning after Dec. 15, 2016, with early application permitted and should be applied retrospectively. The retrospective approach requires that an investment for which fair value is measured using the NAV practical expedient be removed from the fair value hierarchy in all periods presented in an entity’s financial statements.

Steps That Should be in Process: Organizations that have not adopted this yet should be reviewing the valuation methodologies of their investments. For those investments that are measured at NAV using the practical expedient they should be removing these from the Level 1, 2 and 3 columns in their footnote disclosures and drafting the revised presentation to present those investments carried at NAV separately. This disclosure should reconcile to the total investments on the face of the financial statements for all years presented in the footnotes.

ASU 2015-11, INVENTORY (TOPIC 330)
Summary: Topic 330, Inventory, currently requires an entity to measure inventory at the lower of cost or market. Market could be replacement cost, net realizable value or net realizable value less an approximately normal profit margin. The amendments in this update require an entity to measure inventory currently being carried at first in, first out (FIFO) or average cost at the lower of cost or net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. Subsequent measurement is unchanged for inventory measured using last-in, first-out (LIFO) or the retail inventory method.

Effective Date: The ASU is effective for fiscal years beginning after Dec. 15, 2016. The amendments in the ASU should be applied prospectively with early application permitted.

Steps That Should be in Process: Organizations that hold inventory should be evaluating their valuation methods and determining if the change to net realizable value impacts the carrying amount of inventory and whether there are any adjustments that are necessary. In addition, footnote disclosures will need to be updated to reflect the current method of determining the carrying value.

ASU 2016-02, LEASES (TOPIC 842)
Summary: The new lease standard applies a right-of-use (ROU) model that requires a lessee to record, for all leases with a lease term of more than 12 months, an asset representing its right to use the underlying asset and a liability to make lease payments. For leases with a term of 12 months or less, a practical expedient is available whereby a lessee may elect, by class of underlying asset, not to recognize an ROU asset or lease liability. At inception, lessees must classify all leases as either finance or operating based on five criteria. Statement of financial position/balance sheet recognition of finance and operating leases is similar, but the pattern of expense recognition in the
Year End Accounting... Continued

statement of activities/income statement, as well as the effect on the statement of cash flows, differs depending on the lease classification.

The new lease standard requires a lessor to classify leases as either sales-type, direct financing or operating, similar to existing accounting principles generally accepted in the United States of America (U.S. GAAP). Classification depends on the same five criteria used by lessees plus certain additional factors. The subsequent accounting treatment for all three lease types is substantially equivalent to existing U.S. GAAP for sales-type leases, direct financing leases, and operating leases. However, the new standard updates certain aspects of the lessor accounting model to align it with the new lessee accounting model, as well as with the new revenue standard under Topic 606.

Effective Date: The ASU is effective for fiscal years beginning after Dec. 15, 2019. Early adoption is permitted. For those organizations that have issued, or are a conduit bond obligor for, securities that are traded, listed or quoted on an exchange or an over-the-counter market qualify as a public entity under the standard and therefore the standard is effective for annual reporting periods beginning after Dec. 15, 2018.

Steps That Should be in Process: Organizations that are lessees and/or lessors should be reviewing their leases and quantifying the asset and liability that will need to be reflected on the financial statements once this ASU is adopted. Organizations should also take the effect of the change in accounting for leases into account for calculating financial covenants per existing debt agreements in order to determine if they will still meet the covenant requirements. If this revised accounting will negatively impact the covenant calculations, organizations should be working with lenders to revise the covenant calculations.

ASU 2016-14, PRESENTATION OF FINANCIAL STATEMENTS OF NOT-FOR-PROFIT ENTITIES (TOPIC 958)

Summary: ASU 2016-14 improves the presentation of financial statements of not-for-profit entities. This is the first major change to the nonprofit financial statement model in over 20 years, which is intended to provide more useful information to donors, grantors and other users. The ASU impacts all not-for-profit entities in the scope of Topic 958. The ASU addresses the following key qualitative and quantitative matters:

- Net asset classes
- Investment return
- Expenses
- Liquidity and availability of resources
- Presentation of operating cash flows

In addition, the ASU includes illustrative financial statements of not-for-profit entities, which reflect changes made by the new standard.

Effective Date: The amendments in ASU 2016-14 are effective for annual financial statements issued for fiscal years beginning after Dec. 15, 2017, and for interim periods within fiscal years beginning after Dec. 15, 2018. Application to interim financial statements is permitted but not required in the initial year of application. Early adoption is permitted.

Steps That Should be in Process: Organizations should be reviewing the components of this ASU and working toward a resolution for presenting the new required items. There are numerous changes to the financial statements that will result from the adoption of this ASU that need to be addressed well in advance. In addition, there may be underlying accounting system changes that may be necessary if the entity determines that they need to change any of their expense allocations or if the current accounting system is not set up to track the new information that is required to be disclosed. See the BDO Institute for Nonprofit Excellence Resource Center for more information that can assist you with this endeavor.

ASU 2016-15, CLASSIFICATION OF CERTAIN CASH RECEIPTS AND CASH PAYMENTS (TOPIC 230)

Summary: This ASU was issued to address the diversity in practice with regard to how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The ASU addresses the following eight types of cash flow issues: (1) debt prepayment or debt extinguishment costs, (2) settlement of zero-coupon debt, (3) contingent consideration related to a business combination, (4) proceeds from the settlement of insurance claims, (5) proceeds from settlement of corporate-owned life insurance policies, (6) distributions received from equity method investments, (7) beneficial interests in securitization transactions, and (8) classification of cash receipts and payments that have aspects of more than one class of cash flows.

Effective Date: The ASU is effective for fiscal years beginning after Dec. 15, 2018. Early adoption is permitted but the entity must adopt all the amendments at that date. The amendments in this ASU should be applied using a retrospective transition method to each period presented. If it is impracticable to do so for certain of these items, the amendments for those issues would be applied prospectively as of the earliest date practicable.

Steps That Should be in Process: Organizations with these transactions should evaluate the revised retrospective presentation for these items in the statement of cash flows.

ASU 2016-18, STATEMENT OF CASH FLOWS: RESTRICTED CASH (TOPIC 230)

Summary: This ASU was issued to address diversity in practice with regard to the classification and presentation of changes in restricted cash on the statement of cash flows. The provisions of the ASU require that a statement of cash flows explain the change during the period in the total cash, cash equivalents, and amounts generally described as restricted cash and restricted cash equivalents. To meet this requirement amounts generally described as restricted cash or restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows.

Effective Date: The ASU is effective for fiscal years beginning after Dec. 15, 2018. Early adoption is permitted and should be applied on a retrospective transition method to each period presented.
Steps That Should be in Process: Organizations that have not previously presented restricted cash in this format will need to assess the changes that are needed for their prior financial statements.

PROPOSED ACCOUNTING STANDARDS UPDATE, CLARIFYING THE SCOPE AND THE ACCOUNTING GUIDANCE FOR CONTRIBUTIONS RECEIVED AND CONTRIBUTIONS MADE

Summary: The proposed amendments would assist entities in (1) evaluating whether transactions should be accounted for as contributions (nonreciprocal transactions) within the scope of Topic 958 or as exchange (reciprocal) transactions subject to other guidance and (2) distinguishing between conditional contributions and unconditional contributions.

Steps That Should be in Process: Organizations should stay abreast for the final issuance of this exposure draft. Once this is issued, organizations should review the final document and determine if the content of the final ASU affects their classification of items as a contribution or an exchange transaction. Once issued, this is projected to have the same effective date as ASU 2014-09 as amended.

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*For organizations that have issued, or are a conduit bond obligor for, securities that are traded, listed or quoted on an exchange or an over-the-counter market qualify as a public entity and the effective date noted above is not applicable. For the ASUs noted, they are effective earlier for these organizations and the earlier effective dates are indicated below.

Effective dates for organizations described above:

- ASU 2014-09 – Calendar year ending 2018/Fiscal year ending 2019
- ASU 2016-02 – Calendar year ending 2019/Fiscal year ending 2020

Year End Accounting.. Continued
WHAT ORGANIZATIONS SHOULD DO TO MAINTAIN EXEMPTION AND PUBLIC CHARITY STATUS

By Christina K. Pattern, EA

Tax-exempt status with the Internal Revenue Service (IRS) has its perks, the most beneficial being exemption from paying federal income taxes, allowing the net income of an organization to be used in furtherance of its tax-exempt purpose. Other beneficial perks include allowing the organization to receive charitable contributions and, if qualified, government funding.

Once an organization is established as tax-exempt under Internal Revenue Code (IRC) section 501(c)(3), the organization’s governing board members and officers must ensure that the organization maintains its tax-exempt status and meets its ongoing compliance responsibilities. A governing board should be composed of persons who are informed and active in overseeing the organization’s operations and finances, and ensure the organization’s tax-exempt status is properly maintained.

The following are a few ways a tax-exempt organization can maintain its exemption and public charity status:

COMPLY WITH FEDERAL TAX LAW
IRC section 501(c)(3) requires tax-exempt organizations to comply with federal tax law to maintain their tax-exempt status and avoid penalties. Under IRC section 501(c)(3), an organization must not be organized or operated for the benefit of private interests, and no part of the net earnings may inure to the benefit of any private shareholder or individual. If the organization engages in an excess benefit transaction with a person having substantial influence over the organization, an excise tax may be imposed on the person and any organization managers who knowingly participated in the transaction. Additionally, the organization may not attempt to influence legislation as a substantial part of its activities and it may not participate in any political campaign activity for or against political candidates.

PAY EMPLOYMENT TAXES
Although a tax-exempt organization is exempt from federal, state or local income taxes, it is responsible for employment taxes. The tax-exempt organization must withhold, deposit and pay employment tax, including federal income tax withholding and Social Security and Medicare (FICA) taxes. IRC section 501(c) (3) organizations do not pay federal unemployment (FUTA) tax. Employment taxes are reported on Form 941, Employer’s Quarterly Federal Tax Return. The organization is subject to penalties if it fails to withhold and pay employment tax.

The organization is responsible for determining whether individuals providing services are employees or independent contractors. The organization can be held liable for employment taxes, plus interest and penalties, if a worker is incorrectly classified as an independent contractor. Generally, the organization does not have to withhold or pay employment tax on payments to independent contractors but may have to file a Form 1099.

BE AWARE OF UNRELATED BUSINESS INCOME TAX
Unrelated Business Income (UBI) is income from a trade or business, regularly carried on that is not substantially related to an organization’s exempt purpose. If an organization has $1,000 or more of UBI during a tax year, Form 990-T must be filed. Excessive UBI, which the IRS has not specifically quantified, may result in the IRS taking the position that the organization is not operated exclusively for exempt purposes, thereby jeopardizing its tax-exempt status.

PASS THE PUBLIC SUPPORT TEST
Most organizations exempt under IRC section 501(c)(3) are required to pass an annual public support test in order to maintain their tax-exempt status. If the organization cannot meet the public support test for two consecutive years, it may be reclassified as a private foundation as of the start of the second consecutive year. Certain types of organizations are exempt from this test such as churches, schools and colleges, hospitals and supporting organizations.
**What Organizations Should... Continued**

An organization’s annual public support test is reported on its Federal Form 990, Schedule A, Part II or Part III. Part II applies to organizations that are described in IRC section 170(b)(1)(iv) and 509(a)(1) which normally receive a substantial part of support from a governmental unit or from the general public, in general, one third. Part III applies to organizations described in IRC section 509(a)(2) which normally receive (1) more than one-third of their support from contributions, membership fees and gross receipts related to exempt functions, and (2) no more than one-third of their support from gross investment income and unrelated business income. Each of the tests looks at the cumulative support for the year being reported plus the prior four years, so any one year is not definitive in terms of passing or failing the public support test.

Should an organization under IRC section 509(a)(1) receive less than one-third but more than 10 percent of its support from the general public or a governmental unit, it can qualify as a public charity if it can establish that, under a “facts and circumstances test,” it normally receives a substantial part of its support from the general public or a governmental unit. The “facts and circumstances test” is not available for organizations under IRC section 509(a)(2). The organization must establish on Federal Form 990, Schedule A, Part IV how the organization meets the “facts and circumstances test” in accordance with the criteria found in IRS Regulations section 1.170A-9(f)(3).

Newly formed organizations that would otherwise be subject to the annual support test are treated as meeting the test during their initial five years. After their first five years, they must meet the public support test, which is based on a five-year computation period that consists of the current year and the four years immediately preceding the current year.

When completing the annual public support test, either on Part II or III of Schedule A, unusual grants are excluded. Unusual grants are grants and bequests from disinterested persons or organizations that are (1) attracted because of the organization’s publicly supported nature, (2) unusual and unexpected because of the amount, and (3) large enough to endanger the organization’s status with regard to meeting the one-third public support test or the 10 percent facts and circumstances test. The most common unusual grants are typically large bequests from estates or large one-time “startup” grants received early in an organization’s life.

The organization should pay attention if public support percentages are decreasing and should consider ways to gain more public support in order to avoid ultimately failing the test. Projections can be made for future years to determine approximately what is going to be required to pass the test.

**FILE ANNUAL FORM 990**

Tax-exempt organizations that are required to file annually must file IRS Form 990-N, 990-EZ or 990 depending on the organization’s total annual receipts and total assets. Please be aware that supporting organizations, regardless of threshold amounts, are not allowed to file Form 990-N. Failure to file for three consecutive years results in automatic revocation of tax-exempt status (IRC section 6033(j)). The list of organizations whose tax-exempt status has been automatically revoked is available to the public on the IRS website. This Auto-Revocation List can be viewed and searched on Exempt Organizations Select Check.

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NONPROFITS ARE NOT IMMUNE TO MAINTAINING DATA PRIVACY

By Karen Schuler, CFE, IGP, IG²

It is 6 a.m. and you receive a call from your chief financial officer that your donor data has been stolen. What do you do? Whom do you call? How do you handle this situation? I find that a fair number of our nonprofit clients are unaware of where their data resides, who has access to it, and how it’s protected. So, let’s explore some methods that your organization can employ to better protect the privacy of your donor, employee and volunteer data. This is the first of two articles that will better prepare you to implement a data privacy program.

STEP ONE
UNDERSTAND REGULATORY STANDARDS
Due to the prevalence of data breaches, data privacy standards are popping up across the globe. Regardless of whether you operate in the United States or internationally, it is critical to understand which data privacy regulations apply to you. In the United States there are approximately 20 sector-specific national privacy or data security laws, and hundreds of them among the 50 states. From a global perspective, there are thousands of data privacy laws that have been in place or are coming into law in the next several months. Regardless of where you operate, you need to understand how your organization should comply.

STEP TWO
IDENTIFICATION
The next step is to ensure you understand what information you have and where it is. Certainly there are tools to assist with this, but if you do not have the budget to access those tools, start by conducting interviews of the individuals that manage certain types of applications and data. During these interviews, gain an understanding of what software applications or technology are used to conduct your business, identify where that data is stored, whether it’s managed internally or externally, and how long data is retained.

To prepare your data inventory, follow these steps:

1. Obtain application inventories that might already exist.
2. Update the application inventories.
3. Gain an understanding of who manages each application.
4. Identify what types of data are stored within each application.
5. Understand how long certain data types are retained.
6. Determine where your most sensitive types of information reside.
7. For those critical sets of data, map how the data flows through the organization, who manages it, who has access to it, and where security gaps might exist.

STEP THREE
CLASSIFY DATA
There will be certain types of data that you consider very sensitive while other types might be considered less critical or sensitive to the organization. To develop classification schemas, use a guide similar to the one outlined on the next page. Regardless of the size of your organization, classifying data is a critical step in protecting the privacy of your information.

STEP FOUR
ALIGN POLICIES WITH DATA CLASSIFICATIONS
Once you have classified your data, the next step in the process is to understand what data protection policies are currently in place and whether they are current or need updating. Often times an organization will find that its policies have not been updated for years. This can be more detrimental than not having policies at all. The key is, if you create policies, ensure there are good governance and management practices to maintain those policies. Typical policies that are essential to maintaining the privacy of data can include:

- Data classification
- Data retention
- Legal hold
- Data security
- Data handling
- Information lifecycle management
- Data privacy

As you are developing your policies, your technical or security teams should ensure that the information contained within each policy matches actual controls. In other words, it is critical to align your security practices with your policies.
Nonprofits Are Not Immune... Continued

STEP FIVE
IMPLEMENT AND TRAIN YOUR TEAM MEMBERS
Once you complete the above steps, it’s time to develop an implementation and change management strategy as well as a training program. Training and change management are critical to performing a successful roll out of any program. And, although implementation plans vary widely, standard steps that can be employed in any organization include:

► Pilot: Test the process, policies or procedures with a small group.
► Utilize Technology: Understand what technology can be utilized to better manage policies, procedures or processes over time.
► Roll-out: Once you conduct the pilot, begin to rollout the program to all team members.

► Training: Immediately following your roll-out or implementation step, ensure that each team member is trained in a timely manner.

Now that you have these steps under your belt, it is time to move on to establishing the privacy program. Stay tuned for our spring issue where we will provide you the steps needed to expand into a formal privacy program.

GUIDE TO CLASSIFICATION OF DATA

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<tr>
<th>Classification</th>
<th>Description</th>
<th>Examples</th>
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| Public               | This type of data may be disseminated to the public *without potential harm* to the organization or its constituents. | • Brochures
|                      |                                                                             | • Advertisements
|                      |                                                                             | • Job opening announcements
|                      |                                                                             | • Press releases
| Internal Use Only    | This category of data means that exposure to the public *could adversely* impact the organization or its constituents. | • Financial records
|                      |                                                                             | • Security documents
|                      |                                                                             | • Workflow
|                      |                                                                             | • Internal memos
| Confidential         | This category of data is to only be disseminated to those who *need to know*. | • Contracts
|                      |                                                                             | • Personnel matters
|                      |                                                                             | • Internal business plans
|                      |                                                                             | • Strategic plans
| Restricted           | This category of data *would cause irreparable harm* to the organization if it were to be disseminated to the public. | • Protected Health Information
|                      |                                                                             | • Personally Identifiable Information
|                      |                                                                             | • Intellectual Property
|                      |                                                                             | • Donor lists
|                      |                                                                             | • Dissolution documents

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The most thoughtful strategic plan, organizational structure, employee handbook or Standard Operating Procedure (SOP) is no match for an ineffective, disruptive workforce. Competence and culture can buoy or bankrupt an organization, no matter how fiscally strong it is initially.

4. KNOW YOUR ROLE

Do you have the correct individuals with the proper amount of responsibility and authority?

Does each employee, board member and volunteer have clearly defined roles?

Be sure all employees, board members and volunteers know what is expected of them and make sure these expectations are documented. Every person in the organization (staff, board, volunteers) should have a job description that is measurable, expectations that are attainable and consequences that are reasonable. Therefore, a successfully operated nonprofit is reliant on the right people in the right positions with the right approach to their individual and collective roles.

5. ADDRESS THE ICE CUBES BEFORE THEY BECOME ICEBERGS

Does your organization address issues immediately, or does it tend to leave them for later until they become so big that they are almost impossible to fix without a detrimental impact on the organization?
6 Strategies Under... Continued

▶ Do you and your stakeholders fear conflict or embrace it as a healthy part of the organizational culture?

Organizational Behavior 101 teaches us that human beings hate conflict, or even what they perceive as conflict—factor in that change is conflict’s sidekick, which only adds insult to injury for us humans—so we tend to ignore making a critical decision when it’s a simple problem, and then become paralyzed when it’s a crisis. Organizations need to have procedures in place to assist leaders in addressing difficult issues when they first appear. This strategic action can reduce the odds of the issue becoming a crisis of staggering proportions.

6. NEVER UNDERESTIMATE YOUR ORGANIZATION’S PLACE IN THE GLOBAL ECONOMY
▶ Who do you identify as your organization’s direct and indirect competition?
▶ What is the choice matrix your customers and stakeholders use to decide to invest in your organization and how can you persuade them?

Organizations can become insular in their decision-making without even realizing it. Driven by mission alone, nonprofits often make the mistake of not considering the local, national or global economy and its impact on their stakeholders’ choices. Today’s consumer has the internet and all of the world’s information just a few clicks away—this can be used to an organization’s advantage or be a detriment depending on how the organization positions itself in the global economy of options.

Implementing any of these six strategies can assist a nonprofit in reaching new operational and financial heights. However, incorporating all six into your organization’s daily focus should exponentially increase its sustainability for years to come.

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