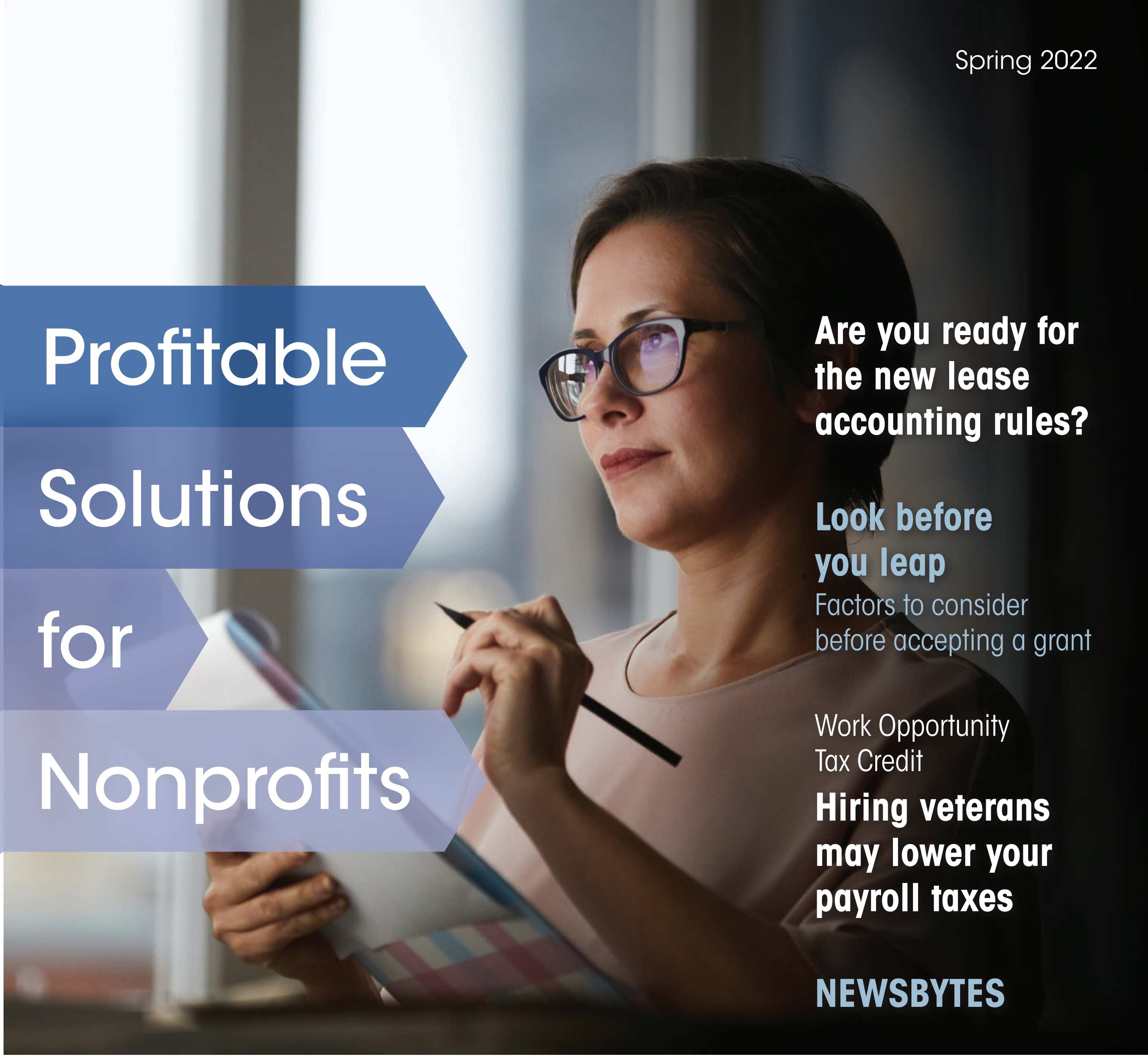
Spring 2022

Profitable Solutions for Nonprofits



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Are you ready for the new lease accounting rules?

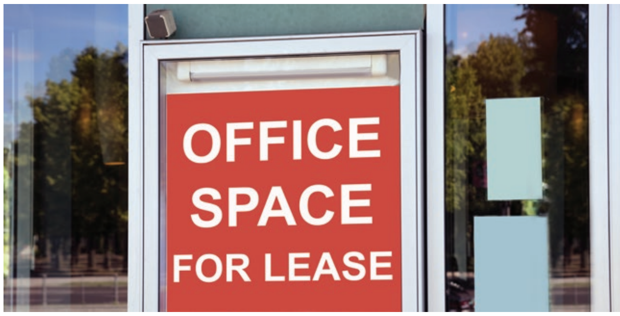
After a COVID-related delay, the new accounting standard for leases takes effect for all organizations (including nonprofits) that haven't yet adopted it for calendar year 2022 (and fiscal years thereafter). The Financial Accounting Standards Board's (FASB) Accounting Standards Update (ASU) 2016-02, *Leases* (*Topic 842*), applies to all entities (both lessees and lessors) that lease assets such as real estate, vehicles and equipment. The new rules are codified in FASB *Accounting Standards Codification* (ASC) 842. Here's an overview of what you need to know.

New accounting treatment

ASU 2016-02 is the first change to the accounting rules for leases in more than 30 years. Until now, the proper accounting for a lease depended on whether it was a capital lease (now known as a finance lease) or an operating lease.

Capital leases, such as a lease of a piece of equipment for most of its useful life, were reported as assets and liabilities on a nonprofit's statement of financial position. Operating leases, such as a lease of office space for a shorter term, were recognized on a lessee's financial statements as rent expense with required disclosures.

Under ASC 842, lessees must recognize assets and liabilities for all leases for terms of more than 12 months — whether the leases are finance or operating. You will need to report the right to use the leased asset as an asset on the statement of financial position, with the obligation to pay rent (reduced to its present value) to be reported as a liability.



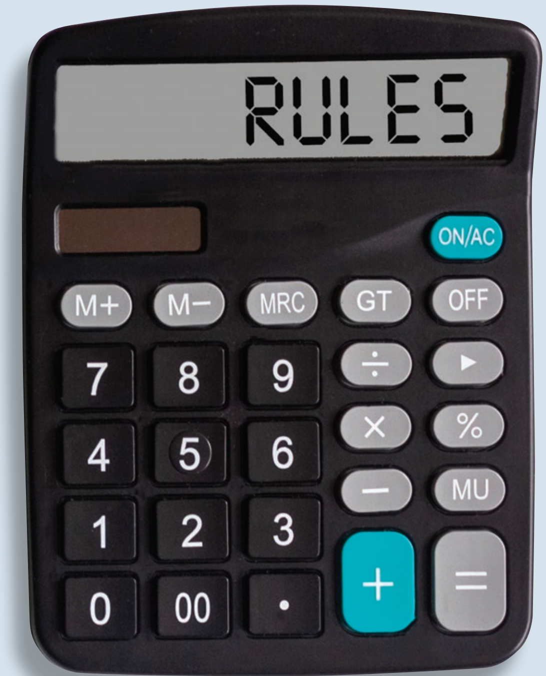
The category of lease comes into play when determining the proper way to recognize, measure and present a lessee's expenses and cash flows. For nonprofits:

Finance leases. On the statement of activities, amortize leased assets that you have the right to use separately from recording interest on the lease liability. For the statement of cash flows, classify repayments of the principal portion of the lease liability in financing activities. Classify payments of interest on the lease liability and variable lease payments in operating activities on the statement of cash flows.

Operating leases. Recognize a single total lease cost, allocating the cost across the lease term, typically on a straight-line basis. Classify cash payments made in operating activities on the statement of cash flows.

The new accounting rules also require additional disclosures about leases, including information about variable payments and options to renew or terminate. The accounting can become even more complicated with "embedded" contracts — or contracts with both lease and service or supply components (for example, a building lease that includes maintenance or security services). ASC 842 requires organizations to separate lease components from nonlease components. The portion of a contract payment that's related to nonlease components is excluded from the measurement of lease assets and liabilities, unless the available practical expedient is elected.

When your organization is the lessor



Although the new lease accounting standard (see main article) focuses primarily on lessees' accounting for leases, it also includes some provisions affecting lessors.

For example, the new standard incorporates certain "targeted improvements" for lessors intended to align their accounting with the lessee accounting model and the latest revenue recognition rules. As a result, a lessor might need to recognize some lease payments received as deposit liabilities if the collectability of lease payments is uncertain.

The new rules also require lessors to separate nonlease components that transfer a good or service to the lessor from the lease components. Such nonlease components might include common area maintenance or utilities. In some cases, though, lessors can opt not to separate lease and nonlease components, instead accounting for each separate lease component and its related nonlease components as a single lease component. We can help you determine the best approach.

Implications for your organization

The new standard could affect nonprofits in multiple ways. Most obviously, you'll need to adjust your accounting and financial reporting processes and procedures to ensure compliance. The first step is to identify all your leases so you can properly categorize them. You'll also need processes to collect the necessary information on new leases going forward.

It's important to understand the potential effects of changes in your accounting and financial statements. For example, you should reach out to any lenders and similar stakeholders to determine if the changes might affect debt covenants or other significant metrics that influence their decisions.

Under ASC 842, lessees must recognize assets and liabilities for all leases for terms of more than 12 months — regardless of whether the leases are finance or operating leases.

The new rules could affect your future lease negotiations, too. Your previous priorities may change in light of the new reporting requirements. You might, for instance, benefit from lower fixed rent and higher variable costs because you generally can exclude variable lease payments when measuring lease assets and lease liabilities.

Don't delay

With ASC 842 effective for most organizations in 2022, you need to prepare now. There are numerous expedients available to both lessees and lessors to ease the transition to the new standard. We will be happy to discuss the necessary processes and procedures needed to comply with the new requirements. ■

Look before you leap

Factors to consider before accepting a grant

Most nonprofits look to government and/or foundation grants to help finance their programs. These grants are fundamental in expanding an organization's reach. But you may find it difficult to quantify all the costs and benefits associated with a potential grant. If your nonprofit doesn't do its research before accepting grant funds, it could cause problems down the road.

What are the risks?

By its very nature, the nonprofit industry has long been resource-challenged. And the COVID-19 pandemic has increased financial uncertainty for many nonprofits. Under such ongoing financial pressures, you can't afford to ignore offers of support. Yet you also should avoid blindly accepting grants — doing so could leave you shouldering excessive administrative burdens, cost inefficiencies and lost opportunities.

Smaller or newer nonprofits aren't the only ones at risk of such unexpected consequences. You might think that larger, more mature organizations would have formal grant evaluation processes in place. But that's not always the case.

Further, as an organization grows, it has significantly more opportunities to expand the scope of its programming. This expansion can open the door to more grants, including some that are outside of the organization's expertise and experience. The organization could end up accepting a grant with requirements that need to be fulfilled and struggles that weren't anticipated.

What about administrative requirements?

Even small grants can bring sizable administrative burdens. For example, you could be caught off guard by the reporting requirements that come with a small grant. You might not have staff with the requisite reporting experience, or you may lack the processes and controls to collect necessary data. Government funds passed through to your nonprofit often carry the requirements that are associated with the original funding, which can be extensive.

Grants that go outside of your organization's original mission can pose problems, too. Not only might the grant not consider your learning curve and additional costs, you might also face IRS scrutiny regarding your exempt status. In addition, new grants from either federal or foundation sources may have explicit administrative requirements your organization must satisfy. This can create unforeseen inefficiencies that undermine the grant's face value.

What about costs?

As the saying goes, there's no such thing as free money. To start, your nonprofit might incur expenses to complete a program that may not be allowable or reimbursable under the grant. As part of your initial grant research, be sure to calculate all these costs against the original grant amount to determine its ultimate benefit to your organization.

Then if you decide to go ahead with the grant, analyze any lost opportunity considerations. For unreimbursed costs associated with new grants, consider how else your organization could spend that money. Also think about how the grant affects staffing. For example, do you have staff resources in place or will you need to hire additional staff? Could you get more mission-related bang for your buck if you spent funds on an existing program as opposed to a new program?

Quantifying the benefit of a new grant or program can be equally (or more) challenging than identifying its costs. You should evaluate *every* program to quantify its impact on your organization's mission. This will allow you to answer critical questions when evaluating a potential grant, such as: Are there existing programs that can be expanded using the same funds to yield a greater benefit to your organization's mission?

Avoid unpleasant surprises

Government agency and private foundation grants are among the most important funding sources for many nonprofits. But accepting grants without performing the necessary due diligence can backfire in costly and time-consuming ways. ■

Work Opportunity Tax Credit

Hiring veterans may lower your payroll taxes

Employers often overlook a federal tax break available to organizations that hire new employees from certain groups who have traditionally faced obstacles to hiring. While the Work Opportunity Tax Credit (WOTC) is more limited for nonprofits, it nonetheless presents payroll tax-saving opportunities that can prove especially valuable for organizations that are ramping up hiring.

Potential savings

To qualify for the WOTC, for-profit employers must hire people who belong to one or more of 10 "target groups." These groups include the formerly incarcerated and individuals with disabilities. Tax-exempt organizations, however, can claim the credit *only* for hiring "qualified veterans" who began work for their organization after 2020 and before 2026.

The amount of the WOTC generally equals 40% of up to $6,000 of wages paid to qualified new employees in their first year of employment who work at least 400 hours. But as much as $24,000 in wages can be taken into account when determining the credit for veterans with service-connected disabilities who have been unemployed more than six months. This means your organization could claim a credit of $9,600 for each qualified employee. Lower wage levels can be considered for other types of qualified veterans.

Nonprofit employers of all sizes can claim the credit, and there's no cap on the number of qualified veterans for whom you can claim the credit. The credit is limited only by the amount of employer Social Security tax owed on the wages paid to *all* employees for the tax period in which you claim the credit.

Nuts and bolts

Local job centers or state workforce agencies can help you find qualified veterans. American Job Centers, for example, host job fairs, perform skills assessments, help employers recruit employees and provide support to employees transitioning to new jobs. The Veterans Administration and related agencies are additional sources of qualified veteran job applicants.

Some applicants might be pre-certified as belonging to a qualified veteran group. Pre-certification can prove helpful, but it isn't required for an employer to hire or claim the WOTC. For new hires who aren't pre-certified, you must obtain certification that they're qualified veterans from the state workforce agency on or before the first day of work. You also have the option of completing a pre-screening notice (IRS Form 8850, "Pre-Screening Notice and Certification Request for Work Opportunity Credit") on or before the day you make the job offer.

Submit the notice to the state workforce agency to request certification within 28 days of when the employee begins work. New hires must work at least 120 hours before you can claim the WOTC. Once you have the certification, you can claim the credit against your Social Security tax liability by filing Form 5884-C, "Work Opportunity Credit for Qualified Tax-Exempt Organizations Hiring Qualified Veterans." You should file the form after you've filed the related employment tax return for the relevant tax period.

The IRS advises against reducing your required payroll tax deposits based on any anticipated WOTC (or any tax credits). The credit doesn't affect the Social Security tax liability you report on your employment tax return.

Bottom line

If your organization doesn't prioritize applicants who are veterans, you might want to consider it going forward. Not only can it help further your mission, but the potential tax savings could be significant. ■

NEWSBYTES

403(b) plan participation climbs

Participation in 403(b) retirement plans inched upward during the COVID-19 pandemic, from 76.6% in 2019 to 77.2% in 2020 — the highest level since tracking began in 2008. The bump is partly due to the spread of automatic enrollment, according to the annual *2021 403(b) Plan Survey* from the Plan Sponsor Council of America (PSCA). Automatic enrollment has jumped 50% over the past five years. Of the nearly 400 nonprofits surveyed, 29% now offer it. Also, more than half of those automatically escalate the default deferral percentage over time.

While 403(b) plans traditionally only offered annuity products, more than half continue to offer annuities as an option for guaranteed income in retirement, versus 17% of 401(k) plans. The survey also found that nonprofits are taking the lead on certain types of retirement plan features. For example, 38% of nonprofits provide access to environmental, social and governance (ESG) investment options, compared to almost 3% of 401(k) plans. ■

What to know about the growth of impact investing

The number of affluent households — those with a net worth of $1 million or more (excluding primary residence) and/or an annual income of $200,000 — where donors participated in impact investing nearly doubled in 2020 (13%) compared with 2017 (7%). Minorities and younger individuals were the most likely to participate in impact investing to help achieve various societal benefits.

These findings come from *The 2021 Bank of America Study of Philanthropy: Charitable Giving by Affluent Households.* The study, released in September 2021, is the eighth in the series of biennial studies conducted by the Indiana University Lilly Family School of Philanthropy.

About 60% of the donors said this form of investing was made on top of their existing charitable giving, while 36% indicated impact investing replaces some of their charitable giving. Only 5% of these donors said impact investing was in lieu of other charitable giving. ■

How the Great Recession affected household giving

The share of American households that donated to charity in 2018 dropped below 50% for the first time since the Philanthropy Panel Study (PPS) began tracking the figure. Only 49.6% of U.S. households donated that year, down from just over 66% when the PPS launched in 2000.

The Indiana University Lilly Family School of Philanthropy's *The Giving Environment: Understanding Pre-Pandemic Trends in Charitable Giving*, released in July 2021, reports that the giving rate in 2018 had fallen across most socio-demographic groups — including by age, income, race and level of education. Religious causes suffered the greatest reductions. The study notes that most of the decline in giving occurred after the Great Recession of 2008, but only about one-third of the drop in donating can be attributed to changes in income and wealth. Moreover, the trends didn't reverse or even slow when the economy recovered. ■

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Jones, Maresca & McElwaney, P.A., is a full-service accounting firm specializing in the unique tax and audit needs of nonprofit organizations. Our cornerstone is strong partner-client relationships. Every client has a dedicated firm partner and manager giving pro-active, consistent and ongoing attention to your organization — whether you have been with us for months or years. Our experienced support staff is equally responsive.

NON PROFIT & TAX EXEMPT AUDIT TEAM:

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FIRM PROFILE

Jones, Maresca & McElwaney, P.A. has been providing audit services to our clients for over thirty years. We have earned a reputation of providing a high quality of services through client satisfaction. In addition to proving audit, tax and management advisory services, we offer a broad range of related services including budget administration, organizational structure evaluation, cash flow and investment opportunity analysis, accounting system design and operation audits.

At Jones, Maresca & McElwaney, P.A., we're committed to keeping pace with the very-changing tax laws and regulations for nonprofits and how they affect your organization. And we're committed to providing superior, individualized accounting services — today, tomorrow and in the future.

Great News!
Jones, Maresca & McElwaney, P.A. is proud to announce, our newsletters are available electronically. If you wish to receive our next version electronically please send an email to ldixon@jmmcpafirm.com.