BROWNEDWARDS
certified public accountants

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Education and Not-for-Profit Update

Don't Forget to Update your Gift Acceptance Policy and Document Contributions

As we enter the fall season and the end of the calendar year, donors are preparing for the upcoming tax season and how they will be allocating donations to their charities of choice. Charities are working aggressively to get out in front of these donors to make one last fundraising push. It's a good time to remind your employees that they adequately document contributions and adhere to your gift acceptance policies. This may require sending a brief reminder to your accounting and development staff to make sure that your documentation standards and policies are adequately communicated.

First, here are a couple reminders for your gift acceptance policy. You want this in place before you start soliciting donations as it provides a roadmap to development staff. There are those that believe a charity should be happy with whatever donations it receives, but there are donations that a charity should thoroughly review prior to even considering accepting. It is the charity's responsibility to ensure that complex donations do not become overly burdensome. Below are items that should be addressed by a gift acceptance policy:

- Gifts that the organization will accept, will not accept, or will accept subject to certain requirements.
- Requirements may include additional review by legal counsel, approval of the board, or due diligence by management after consulting other specialized professionals. This also includes who is responsible for the costs of the due diligence.
- Minimum thresholds for the establishment of term or permanent endowments – While a donor may have great intentions, it may not be feasible for an organization to administer a $500 endowment. The policy should include a minimum amount required for the establishment of a new endowment. Anything below the threshold would have to designate an existing endowment.
- Overly restrictive gifts – if a gift has a purpose or time restriction that is overly restrictive and thus may prevent or unduly delay the organization from using the money, it may be in the organization's interest to not accept the gift.
- Gifts not managed by the charity – these usually include trusts or other estate planning gifts. The policy needs to be clear as to what information the charity will need on an ongoing basis in order to properly record and monitor these types of gifts.
- A description of how non-cash or illiquid gifts are treated – These types of gifts are usually real property, stock, equipment or other assets that may not be quickly or easily liquidated.





Don't Forget to Update your Gift Acceptance Policy and Document Contributions

(continued)

When soliciting and receiving donations it is the charity's responsibility to ensure it receives adequate documentation from the donor. Restrictions on donations come in all varieties and can be very complex. As such, it is important that the accounting and development departments keep in touch with each other to ensure that donations are recorded in the charity's financial statements appropriately. Charities at a minimum should include the following documentation for gifts received:

- Donor name
- Date of the gift
- Amount of the gift and payment terms
- Restriction or an indication that the gift is unrestricted

Charities should also provide donor acknowledgement letters. This acknowledgment letter should include the same information above and gives the donor the opportunity to correct any misunderstandings.

So why is this documentation so important? Practically speaking, charities are required by law to adhere to donor restrictions and your auditors will likely be taking a close look at the supporting documentation. Auditing standards require auditors to treat significant revenue streams as a higher risk audit area. Often contributions are a significant portion of a charity's revenue stream and therefore more scrutiny will be applied to that revenue stream. Having a through gift acceptance policy and following clear documentation standards can help protect you from accepting a gift that may not be in the best interest of your organization and will also ensure that you are adhering to the donors' wishes.

The Importance of IT General Controls in the Not-for-Profit World

At a recent not-for-profit (NFP) conference audience members were asked to stand up if they had received donations by cash on behalf of their organization. There was some murmuring, but only about 5% of the audience stood up. By check? About 40% of the room stood up. Credit card? More than half the room was now standing. Wire transfer? Some more stood, and when the speaker finally got to grants via an Automated Clearing House (ACH) system, the entire room was standing.

The speaker then asked the audience to sit down if they formally call out and test key systems that receive funding and donations as part of their IT general controls and application controls. Only about 10% in the room were able to sit down. In a perfect world, everyone should have been seated.

The need for greater transparency, cleaner reporting and electronic security are the key elements that build trust and integrity for those donating and using the services of your organization. The greater ability your organization has to promote a secure environment in terms of financial records and personally identifiable information (PII), the more confidence people will have in using and donating to your organization.

Now more than ever, the overwhelming trends for receiving donations and funding is via electronic means. Campaigns are run via social media, donations are received via apps on smart phones, and donor registration information supplied over webpages. Being confident in your electronic security is essential. However, many NFP organizations are still focused purely on the manual element of reporting on their accounting records, grant approval and distribution procedures.

The Importance of IT General Controls in the Not-for-Profit World
(continued)

The Control Environment component embodies the mission statement and vision your organization has spent time defining and promoting. It sets the tone and should have factors that reflect ethical values, integrity, management's philosophy and operating style.

The Risk Assessment component is an essential annual process to keep you and your organization abreast of the ever- changing risk landscape within which you operate. If your organization doesn't perform an annual risk assessment, then you have an immediate action item. This process doesn't take long, it can provide a voice to areas within your organization that you may not be familiar with, and, most importantly, the process should collectively define your identified risks into risk definitions.

By gaining consensus of the definition of each individual risk to the organization, you by default educate all the key participants and, in many cases, break down any silos within the organization. The better your people understand the risks your organization faces, the better chance you have at preventing, detecting and mitigating those risks.

Control Activities are where the COSO frame work gets slightly more prescriptive. The whole narrative from COSO follows:

> *Control Activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.*

One can look at control activities as they fall across the organization as control types. These can be broken down in to five groups:

1) Entity level controls
2) Manual controls
3) IT dependent manual controls
4) Application (or system) controls
5) IT general controls (ITGCs)

Of these control types, the last two – application controls and ITGCs – are where there is a great need to have these called out, documented, and tested to give you a complete suite of internal controls to cover the operations of the entire entity. At an even more detailed level, you can further classify application controls into two types: embedded and configurable. And, at the IT general controls level, break these into three categories: security – logical access, change management and operation controls.

In this day and age, where the velocity of negative social media or the leak of a data breach or publication of fraud can cripple the brand and trust of your organization, it is essential to have strong security practices in place. Support this by understanding how system changes and reports are formatted and ultimately backed up, and it puts your organization at a distinct advantage over organizations not embracing this need.

Uniform Guidance: The De Minimis Indirect Cost Rate

The lack of indirect cost recovery from Federal grants is nothing new for Not-for Profits (NFPs). This has been especially true for those NFPs who do not have a federally negotiated indirect cost rate, as they receive all, or predominant amounts, of Federal grants from pass-through entities. The Office of Management and Budget's (OMB) Uniform Guidance now recognizes that NFPs do indeed incur indirect costs and has made available use of the *de minimis rate*.

In accordance with 2 CFR 200.414(f), NFPs who have not received a negotiated indirect cost rate previously can now utilize the de minimis rate.

The Calculation

The de minimis rate can be charged at 10% of Modified Total Direct Costs (MTDC). MTDC is defined at 2 CFR 200.68 as being:

> *"all direct salaries and wages, applicable fringe benefits, materials and supplies, services, travel, and up to the first $25,000 of each subaward (regardless of the period of performance of the subawards under the award). MTDC excludes equipment, capital expenditures, charges for patient care, rental costs, tuition remission, scholarships and fellowships, participant support costs and the portion of each subaward in excess of $25,000."*

The first $25,000 of subawards can be taken when each subaward is initially issued, separately negotiated, or renegotiated over the Federal grant's period of performance (i.e. not $25,000 for each entity's fiscal year). Some NFPs have found it helpful to have two separate subaward general ledger accounts: one account that tracks the first $25,000 of subawards and another account that records costs in excess of the first $25,000.

The NFP will want to ensure that direct costs of the Federal grant do not already include recovery of indirect costs (double charging) when using the de minimis rate. This type of issue is most prevalent when the NFP's Federal grant supports a large majority, if not all, of the activities of the NFP. It could also occur, however, if the NFP has historically recovered indirect costs from Federal grants by means of direct allocations. The NFP must also be consistent in how direct and indirect costs are charged to Federal grants.

Internal Controls

Should the NFP enter into Federal grants that allow for use of the de minimis rate, it is important that the NFP establish a system of internal controls over the calculation of the de minimis rate. It is also important that the NFP monitor the calculation when invoicing the grant. Miscalculation will most often occur when those costs identified in the above definition (rental costs, subawards, etc.) are not properly deducted from total direct costs for purposes of calculating the de minimis recovery.

NFPs may be able to automate calculation of the de minimis recovery in their accounting systems to reduce the risk of error. Alternatively, the NFP could develop a form to document the calculation of the de minimis recovery. This form would ensure that the grant billing preparer takes all deductions that arrive at the MTDC into consideration. It would also allow for easy review of the de minimis calculation prior to grant billing submission.

Auditing the De Minimis Recovery

It is not surprising that indirect costs recovered from a Federal grant would be subject to audit as part of the Single Audit (if required). The OMB has outlined the following suggested audit procedures, as noted in OMB's 2015 Compliance Supplement, be performed over the de minimis recovery:

1) *Determine that the non-Federal entity has not previously claimed indirect costs on the basis of a negotiated rate. Auditors are required to test only for the three fiscal years immediately prior to the current audit period.*

2) *Test a sample of transactions for conformance with 2 CFR section 200.414(f).*

    a. *Select a sample of claims for reimbursement of indirect costs. Verify that the de minimis rate was used consistently, the rate was applied to the appropriate base, and the amounts claimed were the product of applying the rate to a modified total direct costs base.*

    b. *Verify that the costs included in the base are consistent with the costs that were included in the base year, i.e., verify that current year modified total direct costs do not include costs items that were treated as indirect costs in the base year.*

3) *For a non-Federal entity conducting a single function, which is predominately funded by Federal awards, determine whether use of the de minimis indirect cost rate resulted in the* non -Federal entity double-charging or inconsistently charging costs as both direct and indirect.

Auditors will be performing these audit procedures, or a version of these procedures, so be prepared. A miscalculation could easily result in an over recovery of indirect costs and questioned costs being reported as a Single Audit finding.

Other Options for Indirect Recovery

The de minimis rate is just one of several options for recovering indirect costs. In addition to the de minimis option, NFPs may negotiate a Federal indirect cost rate or negotiate an indirect cost rate with the pass-through entity in accordance with Appendix IV to Part 200.

For a NFP to negotiate a Federal indirect cost rate, it typically takes a direct relationship (direct award) with a Federal awarding agency and where that Federal awarding agency believes it to be worthwhile to negotiate a rate. Often times, a NFP has a federally negotiated indirect cost rate because it was required by a Federal funding agency, either currently or in the past.

Pass-through entities have the option of negotiating indirect cost rates greater than the de minimis rate with subrecipients, but are not required to do so. However, pass-through entities are not allowed to force or bribe a subrecipient into accepting an indirect cost recovery below the de minimis rate unless it is limited by the Federal program's statute.

A Step Forward

The de minimis rate can be a good start for NFPs to get paid for at least a portion of indirect costs incurred on Federal grants. In cases of limited Federal funding, NFPs may want to evaluate what is easier to fundraise and find other sources for – a shortfall in direct costs, or a shortfall in the recovery of indirect costs.

The de minimis rate is a bright spot within the Uniform Guidance and deserves careful consideration by NFPs, though appropriate internal controls must be in place when the de minimis rate is being used.

JUST ASK US

Dear Just Ask Us,

We are an arts organization exempt as a public charity under 501(c)(3). Our purpose is to promote art, artists, and education. A small organization has approached us asking if we can accept donations on its behalf. The organization provides art classes to seniors and children but has not been recognized as exempt by the IRS, nor has it applied for exemption. It wants to accept donations, but some donors do not want to give unless the organization is a 501(c)(3) charity so they can take a charitable deduction. Can we accept the donations on its behalf and then turn them over to the small organization?

Go-Between

Dear Go,

Go for it, but be careful. Certain requirements must be met to be a "fiscal sponsor" for this small organization. One major requirement of a "fiscal sponsorship" is that it furthers your exempt purpose. The information in your letter sounds like providing art classes does indeed further your exempt purpose. If you are unsure of this, please seek professional advice.

You also said you are a public charity. If you were a private foundation, there are more considerations and requirements. In either case be careful that your organization is not merely an agent for the small organization. As an agent, the donations are treated as if given directly to the small organization, resulting in no tax deduction and defeating the purpose of the arrangement. In drafting the agreement, make sure your attorney makes clear that your organization is not a fiscal agent.

There are many ways to be a fiscal sponsor. If the small organization is not a corporation or other separate legal entity, you may treat this small organization's program as your own. Your organization will have all the legal responsibilities and liabilities for this program as it has for all of its programs. If the organization is a separate legal entity, two fiscal sponsorship arrangements are:

A contractual agreement where the program belongs to your organization, but is contracted out to be performed by the small organization.

A grantor-grantee relationship with the small organization. The small organization's program is separate from your programs, the small organization applies to your organization for grants, and your organization provides grants to that program to the extent that donations for it are received.

It is not uncommon to charge a small fee to administer the donations. Consult other organizations to see what is standard for your location and type of arrangement. As you see, this can get rather complex and requires carefully written agreements. Therefore, your tax and legal counsel should be involved.

Your Just Ask Us Team

Dear Just Ask Us,

Every year at the end of December, we receive a flurry of contributions from donors. Our office is closed for the last week of the month, and our bookkeeper deposits all of the gifts when we reopen in early January. This year, our bookkeeper was also out the first week of January. The first deposit made in January was rather large. Our auditors are asking us how we handle cut-off of these gifts to make sure we have recorded them as revenue in the proper period. Shouldn't we use the date on the check? Or do we have to recognize the revenue only when we deposit them into our bank account?

Thanks,

Checks and Balances

Dear Checks,

That's great that you have a pool of supporters who include your organization in their year-end giving!

Keep in mind that the donor can backdate the check; for this reason, using the date on the donor's check is not recommended. For contributions that were not previously pledged to your organization, the trigger for recording revenue is typically receiving the payment. This is a constructive receipt, meaning that you shouldn't wait until your office is open and your bookkeeper is back to make the deposit in order to recognize revenue.

A common and recommended practice is to use the postmark date on the envelope as the date of receipt. As long as the donor dropped their gift in the mail prior to year-end, you can recognize that as a December contribution. But if the donor forgot to mail it until January, even if they put a December date on the check, the contribution wasn't yours until January. Similarly, if a donor drops off the check in person on January 3, with a December 31 check date, that's a January contribution.

Maintaining adequate (and contemporaneous) documentation is key here. Keep a scan or photocopy of the envelope to prove the postmark date for mailed gifts. For in-person gifts, require a donor contribution form to be filled out indicating the date of receipt. If the donor isn't willing to fill this out, have your staff fill it out to keep on file. A copy of the check alone will not be enough to support proper cut-off for year-end gifts.

It's also important to figure out what your process should be, and apply it consistently. It sounds like you don't have a written accounting policy for how to handle cut-off of receipts. Having a written policy will help ensure that everyone involved applies the same guidelines every time.

Your Just Ask Us Team

Dear Just Ask Us,

Our organization has many volunteers listed on Form 990, Part VII, as officers, directors, or key employees that are paid by related and unrelated organizations to work for our organization. Whose compensation do I need to report? I don't have access to compensation information for some of them.

Private Volunteers

Dear Private Volunteers,

Provided they must be listed in Part VII, report their compensation as follows:

1) Compensation from unrelated organizations -
   a. If a taxable entity takes a deduction for the compensation paid to your volunteer for services to your organization - disclose the compensation.
   b. If a taxable entity provides the volunteer but doesn't take a deduction – don't disclose.
   c. If a management company pays the volunteer – don't report compensation in Part VII Section A. If you pay more than $100,000 to the company, report it in Section B for independent contractors.
2) Compensation from related orgs that are listed on Schedule R of the Form 990 -
   a. If the taxable entity is not owned or controlled directly or indirectly by your organization or a related organization and does not provide management services - compensation is not disclosable.
   b. If such entity is owned or controlled as described above - compensation is disclosable.
   c. If such entity provides management services or is a management company - disclose the compensation.
   d. If each related organization paid less than $10,000 – don't disclose except if it is paid to a former director or trustee for services as such to the organization.

If you cannot get the information after making a reasonable effort and you cannot reasonably estimate the compensation, then you don't have to disclose it. An example of reasonable efforts is distributing a questionnaire that asks for the information and includes all the pertinent instructions and definitions.

Your Just Ask Us Team

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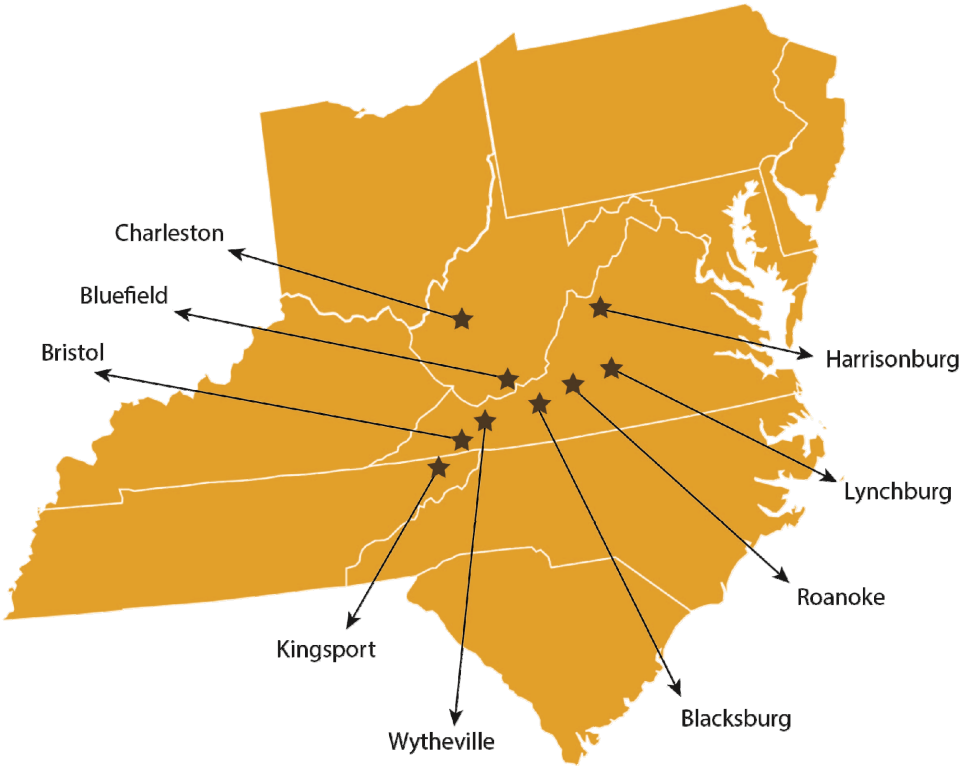
Education and Not-for-Profit Update

presented by the

Brown Edwards Education & Not-for-Profit Service Team



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