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NONPROFIT NEWSLETTER

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From Idea to Impact: 4 Fundamental Elements for Sustainability

By Laurie De Armond, CPA, and Adam Cole, CPA

The world needs nonprofits to continue striving for meaningful impact on a wide range of social, economic and human rights issues, and it needs them to remain financially healthy. To do so, organizations need to balance a nonprofit heart with a business mindset.

Your mission is the heartbeat of your nonprofit. Just as the human heart sustains a body, your mission is the driving force of your organization's work. But the heart can't do it on its own. One clogged artery puts stress on another element of the system—and while it may go undetected for some time, eventually that stress starts to show. A healthy heart and a strong organization rely on fully functioning support systems.

Like the four chambers of the heart, following are four critical elements for sustainability that can take your mission from idea to impact:

1. **People:** From the Governing Board to the C-suite team to employees and volunteers, supporting the people behind the nonprofit is vital. While the typical nonprofit professional is highly motivated and engaged, it's critical for the organization's leadership team to ensure the skills of its people align with the present and future needs of the organization. If you don't have the right people or maintain proper engagement and focus on the organization's mission—or don't treat your people well—it could ultimately harm your ability to fulfill your mission.
   - **Retention:** Nonprofits who take a business mindset to their recruitment and retention policies will work with their best assets—highly impactful and rewarding work—to promote internally and externally the holistic value of a nonprofit career.
   - **Succession Planning:** Successful organizations have strong leaders at the helm, but they also plan ahead for the inevitable day when a change in leadership must occur. Unfortunately, leadership succession planning can be neglected in the nonprofit world, where devoted leaders often stay for long tenures and can be hesitant to pass the reins to a new leader.
   - **CFO/Financial Leaders:** While the CEO and executive director are critical leaders who set the tone and mission of the organization, nonprofits cannot overlook the importance of their financial leadership.
2. **Operational & Financial Management:** Nonprofits must look at their operations with a more critical business mindset to find the appropriate balance between programmatic spending and the investments (both capital and programmatic) required for continued growth and stability. Prioritizing programmatic spending is a given, but nonprofits that place equal focus on long-term scalability and sustainability will maximize their impact.
   - **Tackling the Overhead Myth:** Charity rating sites have put additional pressure on organizations to minimize their overhead spending. The unfortunate consequence is that many donors now assume, incorrectly, that low overhead costs are a good measure of a nonprofit's performance—what is commonly referred to as the "overhead myth." Low overhead may serve as a nice, short-term talking point for donors, but it's an unsustainable strategy.
   - **Avoid the Starvation Cycle:** In reality, high ratios of programmatic spending could mean the organization is underfunding critical areas necessary for long-term growth—a phenomenon known as the "starvation cycle," which creates an unhealthy environment for the organization. Failing to invest in infrastructure, such as new technology, security, employee training and fundraising capabilities, can be detrimental to organizational growth.

3. **Transparency & Communication:** Prospective donors are increasingly thinking like discerning shoppers—researching organizations as they would a major purchase. They are seeking convenience, and fewer clicks to donate. Meeting these demands requires new skill sets, enhanced training and education, and creates opportunities for automation to improve and streamline processes.
   - **Digitizing Donor Relations:** It's not enough to create an annual report and share it online, or to send regular email and mail communications on impact and outcomes. Donors expect near real-time reporting, with frequent updates. A large number of nonprofits already use social media to communicate with external stakeholders and that is only likely to increase.
   - **Communicating Clearly & Often:** It's no secret that budgets have been constrained by economic and donor and funding shifts. To mitigate surprises down the line, start the budgeting process early and make projections to give a realistic picture of how the organization's financial situation could shake out. By planning ahead and communicating early and often, stakeholders will be better prepared to advise and respond.
4. **Governance & Compliance:** Lack of compliance with a regulation or insufficient board oversight on a key risk like cybersecurity can erase great mission-driven outcomes, sever trust with stakeholders and put the entire organization in jeopardy. The professionals in and outside of a nonprofit organization who proactively plan for risk, digest and implement new regulations, and prepare for compliance changes are unsung heroes who do behind-the-scenes, labor-intensive work to ensure the broader organization can focus on its mission without the worry of hitting costly roadblocks.
   - **Staying Cyber Secure:** Nonprofits can't maximize their impact if they are constantly responding to data privacy breaches or cyberattacks. A hack can take down a great organization by erasing trust and diverting resources from the mission. Nonprofits should think of these efforts as their secret weapon, not a financial anchor weighing them down. Even with limited resources, nonprofits must take a proactive approach to regulatory compliance and risk mitigation because the alternative could mean betraying donor and public trust and resulting in financial ruin.
   - **Managing Your Data Plan:** Consider a holistic data privacy strategy as part of your data governance program. A Privacy Operational Life Cycle that helps keep employees apprised of new privacy requirements, embraces recordkeeping and sound data protection practices, and offers enhanced data privacy for stakeholders is crucial with the General Data Protection Regulation in effect and other state and national laws in motion.
   - **Tax-Exempt, Not Tax-Blind:** Nonprofits also know that tax-exempt doesn't mean they can ignore taxes. Tax reform provided another significant shift in rules for nonprofits to address. Major changes to unrelated business income, executive compensation, endowment taxes for higher education institutions and changes to charitable giving deductions, among other items, impacted nonprofits and created significant compliance work for internal and external teams. Assessing guidance and understanding total tax liability is critical to strategic tax planning and maintaining operations. With changes to the tax code still a possibility in the future (including the release of additional guidance), this may be a moving target of sorts for nonprofit leaders, but it's one that can't be ignored.

When each of these elements, like the four chambers of the heart, are considered and given priority in setting and executing strategy, nonprofits are poised for greater success and long-term impact.

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Adapted from article in the Nonprofit Standard blog.

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Top 10 Trends in the Nonprofit Industry

By Laurie De Armond, CPA and Adam Cole, CPA

The nonprofit industry is anything but static. Many outside factors impact their daily operations. Following is a list of what we see as the top 10 trends that are currently impacting nonprofit organizations.

Protecting Nonprofit Nonpartisanship

The current political environment has created a lot of uncertainty. This impacts everything from legislation, such as tax reform, federal funding and government shutdown that in turn impact nonprofits. This is a struggle that nonprofits are trying to navigate. Nonprofits are focused on providing their services and focusing on their missions and are hopeful that the current political environment does not impact their missions.

Budget Cuts – Federal, State and Local Governments

Over the course of several years many nonprofit organizations have been faced with budget cuts that impact their programs at all levels of government. These budget cuts have put many organizations in financial hardship, particularly in the social services subsegment. The uncertainty of future budget cuts makes it difficult to prepare budgets and cash flow projections for the future. Many organizations are faced with more demand for their services and increased cash requirements for infrastructure while facing uncertainty in their funding sources from government entities. As a result, many are looking to expand their revenue streams to rely less on government funding.

Mergers, Partnerships and Joint Ventures

Many organizations are looking at the potential for a merger, or establishing a partnership or joint venture to accomplish their missions. Many organizations have historically tried to conduct all of the programs on their own. This has caused them to expand their operations into areas that are not their core strengths. Demographic and technology shifts have made it more expensive and more difficult to be successful. As a result many are looking to form partnerships or joint ventures to continue this work successfully. Other organizations are finding that mergers with either another nonprofit or a for-profit may be the best way to continue to serve their constituents.

Technology – Augmented Reality, Automation, Crowdfunding

There is a large push to increase technology used by organizations. The use of these technologies can save the organization money and resources in the long run but do require investment up front. Organizations are trying to implement these technologies but are faced with balancing this with potential decreases in funding.

Cybersecurity

This is a continued focus for all organizations – both large and small. The increasing complexity in the world of cybersecurity and the increased sophistication of cybersecurity breaches challenges many entities. The need to protect data, especially for health and human services organizations who maintain large amounts of personal data is critical.

It's All About Engagement

How nonprofits engage their constituents and donors is more important than ever. Changes in technology and the way in which individuals absorb information are requiring nonprofits to be creative in the way that they use social media. Many organizations struggle to develop a constant stream of content to engage constituents and donors. With the proliferation of crowdfunding, engaging constituents on a regular basis and creating a sense of community are critical.

Changes in Charitable Giving Paradigm

With so many worthy nonprofits and the proliferation of crowdfunding platforms there are a lot of demands for donor dollars. As the charitable giving paradigm continues to evolve, nonprofits must monitor how their core donor base is changing and how they might be affected by these shifts. The good news for now is that the change in the tax law did not seem to have a large impact in 2018 as some had predicted, but some believe the major impact may occur in the coming year once people see the impact of the tax law changes on their tax situation and the charitable contributions they made.

Employee Engagement – as Retention Tool

Nonprofits find that employees are very interested in making an impact in the world. They have joined the organization to specifically make an impact. Employees who don't see this coming to fruition are likely to leave. Organizations who regularly link employee performance

to mission impact may well be more successful at employee retention.

Board Members as Advocates/Developers

An age long debate – should your board members be fundraisers? The Board should be comprised of various members who bring different skill sets to the Board. If board members are only selected because they can provide funds or act as fundraisers this can cause issues. However, it is important for many organizations that Board members be contributors and assist with fundraising efforts.

Not-For-Profit Sustainability in the Social Services Space

Demand for services provided by social service organizations continues to increase. In addition, the evolution and sophistication of services is greater such as the ability to see a health care provider electronically. These evolutions in how services are provided are demanding more resources, making organizations look closely at how they can fund these changes to keep pace with these changes.

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FASB Issues ASU 2019-03, Updating the Definition of Collections

By Lee Klumpp, CPA, CGMA

The Financial Accounting Standards Board (FASB or the Board) issued Accounting Standards Update (ASU) 2019-03, Updating the Definition of Collections, to address the issue that the definition of the term collections in the Master Glossary of the FASB Accounting Standards Codification (ASC) was not fully aligned with the definition used in the American Alliance of Museums' (AAM) Code of Ethics for Museums (the Code).

This ASU was issued to improve the definition of collections in the Master Glossary by realigning it with the definition in the Code. The ASU also makes a technical correction to ASC Topic 360, *Property, Plant and Equipment*, to clarify that the accounting and disclosure guidance for collections applies to business entities, as well as nonprofit entities, that maintain collections.

The differences in the two definitions is outlined in the excerpts from the full definitions below:

ASC Master Glossary:

Works of art, historical treasures, or similar assets that are subject to an organizational policy that requires the proceeds of items that are sold to be used to acquire other items for collections.

AAM Definition:

Disposal of collections through sale, trade or research activities is solely for the advancement of the museum's mission. Proceeds from the sale of nonliving collections are to be used consistent with the established standards of the museum's discipline, but in no event shall they be used for anything other than acquisition or direct care of collections.

The ASC criterion requiring that collection sales proceeds be used to buy other items for the collection, did not reflect the AAM's guideline that the proceeds from a sale of a collection can also be used for the direct care of current collections. As a result, museums have been confused about what is in the AAM's policy guidelines against the FASB's definition of a collection under ASC Topic 958.

The ASU modifies the ASC definition of collections to permit that the proceeds from sales of collection items can be used to support the direct care of existing collections in addition to the current requirement that proceeds from sales of collection items be used to acquire other items for the collection.

In addition, an entity that holds collections should disclose its organizational policy for the use of proceeds from deaccessioned collection items. The disclosure should include whether the proceeds can be used for acquisitions of new collection items, the direct care of existing collections or both. If an entity that holds collections permits the proceeds to be utilized for direct care, the entity shall disclose its definition of direct care.

The changes, as a result of adopting the provisions of the ASU, will provide readers with more information about how an entity defines collections as well as provide information on what an entity deems to be direct care.

In addition, as a result of this ASU, there will no longer be disparity between the Code and generally accepted accounting principles. The ASU resolves the difficulties that museums have been encountering in determining the value of their collections, which include collections, artwork, artifacts and historical treasures in complying with the Code in order to receive their accreditations from AAM.

The ASU is effective for annual financial statements issued for fiscal years beginning after Dec. 15 2019, and for interim periods within fiscal years beginning after Dec. 15, 2020. Early application of the ASU is permitted. The provisions of the ASU should be applied on a prospective basis.

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Presentation of Restricted Cash and Cash Equivalents in the Statement of Cash Flows

By Amy Guerra, CPA

Historically there has been diversity in practice among nonprofits with regard to presentation of restricted cash and cash equivalents in the statement of cash flows.

To address this diversity, the Financial Accounting Standards Board (FASB) issued *Accounting Standards Update (ASU) No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash*. As a result of this ASU, a nonprofit will be required to present the total change in cash, cash equivalents, restricted cash and restricted cash equivalents for the period covered by the statement of cash flows. Thus, cash flows that directly affect restricted cash will be presented in the body of the statement of cash flows regardless of how they are classified in the statement of financial position and the timing of the establishment and release of the restrictions.

The ASU does not define restricted cash and restricted cash equivalents, so how a nonprofit defines these will not be impacted. What will be impacted is how these amounts are presented in the statement of cash flows. Oftentimes, a nonprofit will have these items presented in separate lines throughout its statement of financial position and may not even have them labeled as restricted cash or restricted cash equivalents.

Under the ASU, a nonprofit will show the net cash provided by or used in the operating, investing and financing activities of the nonprofit and the total increase or decrease as a result of these activities on the total of cash, cash equivalents and amounts considered restricted cash and restricted cash equivalents.

Internal transfers between cash and cash equivalents and amounts considered restricted cash and restricted cash equivalents are not deemed to be operating, investing or financing activities and thus the details of any transfers would not be presented in the statement of cash flows.

If a nonprofit identifies cash, cash equivalents, restricted cash and restricted cash equivalents in separate lines in the statement of financial position, these amounts should reconcile to the statement of cash flows. The nonprofit needs to present a reconciliation of the various cash and cash equivalents line items presented in the statement of financial position that shows the total that is presented in the statement of cash flows for each year presented. This reconciliation can be presented either on the face of the statement of cash flows or in the notes to the financial statements. The disclosure may be either in narrative or tabular format. The requirement to provide this reconciliation will allow users of the financial statements to identify where the restricted cash and restricted cash equivalents are included in the statement of financial position and how much is included in these line items.

In addition, a nonprofit must disclose information about the nature of the restrictions on its cash and cash equivalents.

For those nonprofits considered public business entities because they 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, the ASU is effective for fiscal years beginning after Dec. 15, 2017, and interim periods within those fiscal years. For all other entities, the ASU is effective for financial statements issued for fiscal years beginning after Dec. 15, 2018, and interim periods within fiscal years beginning after Dec. 15, 2019. The adoption of the ASU should be done on a retrospective basis. A nonprofit may opt to adopt the provisions of the ASU early.

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Don't be a CF-No: How Nonprofit CFOs Can Collaborate With Senior Leadership

By Laurie De Armond, CPA, and Adam Cole, CPA

The concept of "Nonprofit Heart, Business Mindset" – which, put simply, is the belief that nonprofit organizations must pursue business-oriented management practices to thrive long-term, without losing sight of their core mission. Nonprofit chief financial officers (CFO) are uniquely positioned to embody this philosophy and bring it to life.

As you've likely heard before, there's a misconception that the role of a nonprofit CFO is somehow less intense than the equivalent in the corporate world. We know that couldn't be further from the truth – nonprofit CFOs have the unique challenge of ensuring financial well-being, while simultaneously making sure the organization is advancing its mission.

Sometimes, it's not just those outside the nonprofit sector that view things differently from nonprofit CFOs; it's often their colleagues and peers who have differing opinions and conflicting perspectives. We have observed this firsthand with clients throughout the years.

Here are the four key areas where we see a divergence in opinions between CFOs and other executives in the nonprofit sector:

- **Views on Financial Challenges:** Nonprofit CFOs and other leaders often express differing sentiments around liquidity. The majority of finance chiefs we work with characterized it as a high or moderate challenge. But among other executives, fewer felt this way. We are firmly in the finance chiefs' corner and believe liquidity can be the one key performance indicator that makes or breaks a nonprofit's success. Generally, establishing at least six months of operating reserves is a prudent target for the sector. In our experience, about half of organizations surpass that six-month target, while the other half fall short. Unfortunately, some nonprofits have no operating reserves at all, meaning they are incredibly vulnerable if there are funding interruptions and/or reductions.

- **Views on Overhead:** Rising overhead costs is another area of greater concern for nonprofit finance chiefs, compared to their other executive colleagues. Given these differing perceptions, now may be the time for CFOs to educate other stakeholders about the importance of communicating mission outcomes and impact to outside stakeholders, particularly donors. CFOs understand all too well the risks of the "starvation cycle"–a situation in which an organization prioritizes high programmatic spending over necessary infrastructure like new technology, employee training and fundraising expenses. CFOs understand that spending on infrastructure is necessary, but outside stakeholders and donors may not.
- **Views on Regulation:** CFOs are often also much more attuned to the difficulty of dealing with regulatory and legislative changes. While it's likely that CFOs could bear the brunt of new regulatory and legislative changes, these issues will ultimately impact the entire organization's future strategy:
  - When federal tax reform passed more than a year ago, many nonprofits were left wondering how to handle changes like the new excise tax on executive compensation, taxes on fringe benefits and personal tax changes that impact charitable giving.
  - New regulations around how nonprofits recognize revenue mean organizations need to review and assess all their revenue streams to determine how to record them in annual financial statements.
- **Views on Cybersecurity:** CFOs are often somewhat less concerned about cybersecurity than other nonprofit executives. While IT is often not under nonprofit CFOs' immediate purview, the security of financial technology systems—including donor databases—is a crucial element of a nonprofit's long-term sustainability, meaning more and more CFOs will get involved in cybersecurity strategy as they understand the risks. Alternatively, when information technology does fall under CFOs' responsibilities, they are often more secure in the risk mitigation tactics they are taking to protect the organization.

It's clear from our experience in working with our clients that there is often a mismatch between the priorities of CFOs and other senior leaders, but it's critical they work together to make decisions and develop strategies that balance the organization's mission with its financial health. As the financial leader, the CFO has to make a convincing business case. Sometimes that means employing a little–or a lot–of style, to go along with substance.

For example, our co-presenter in our January webinar, Susan Pikitch, CFO at the United States Golf Association, said her biggest advice to nonprofit CFOs is to view their role as part-educator, part-fact-bearer. Like all other relationships, it's all about cultivating a creative business partnership where ultimately your guidance is a value-add. She cautioned against being viewed as a "CF-No." Those perceived to be CF-Nos can be thought of as roadblocks and left out of important conversations to the detriment of their organization. Unfortunately, that's how some brilliant CFOs get cut out of the decision-making process.

On a tactical level, CFOs should go beyond presenting facts and figures, and tell their organization's financial story using visuals to communicate insights. It's important to address the audience as clearly and simply as possible, being aware that not everyone has the same understanding of finance. The most important best practice to achieving that goal is ensuring constant, open communication between the CFO and other stakeholders.

The most effective nonprofit CFOs will look past the differences with other key leaders. By prioritizing working together, they can ensure their organizations maintain a nonprofit heart and business mindset, and set them up for long-term success.

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Adapted from article in the Nonprofit Standard blog.

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IRS Expands Self-Correction and Determination Letter Programs for Retirement Plans

By Norma Sharara, JD, and Joan Vines, CPA

The IRS recently expanded two existing programs for tax-qualified retirement plans—the Employee Plans Compliance Resolution System (EPCRS) and the determination letter (DL) program for individually designed plans. Generally, an individually designed plan is a retirement plan drafted to be used by only one employer. A DL expresses the IRS's opinion on the tax-qualified status of the plan document. These new changes to the EPCRS and DL programs could be a great help to employers, since they offer opportunities to increase compliance while reducing costs and burdens.

EPCRS

EPCRS is an IRS correction program that has existed since 1992. Its purpose is to give employers a path to voluntarily correct plan mistakes at a cost that is less than it would be if the failure were caught by the IRS on audit. For some errors, employers can simply self-correct and keep documentation in their files under the Self-Correction Program (SCP) component of EPCRS. But other (more serious) types of failures require a formal Voluntary Correction Program (VCP) application seeking IRS approval, which also requires paying a user fee of up to $3,500.

With each new iteration of EPCRS, the IRS has expanded the types of errors that qualify for self-correction. Rev. Proc. 2019-19 significantly expands SCP. The current iteration responds to requests from the retirement plan community for self-correction of a greater number of more common missteps without having to file a VCP application and pay a user fee (where the cost of the filing often outweighed the cost of correction). Beginning April 19, 2019, employers with tax-qualified retirement plans and 403(b) plans can now self-correct more plan document and loan failures and retroactively amend plans to fix more operational failures without filing anything with the IRS. Employers can use the new SCP features immediately.

Plan Document Failures

For many years, the SCP allowed employers to correct certain significant operational failures (if the plan had a DL) and most insignificant operational failures without paying any user fees or penalties. But until now, the SCP was generally not available to self-correct plan document failures (instead, employers had to submit a VCP application to the IRS and pay a user fee to correct such failures). A plan document failure is a plan provision (or the absence of a provision) that causes a plan to violate the qualified plan or 403(b) plan rules. Plan document failures are considered "significant" failures. So employers using SCP to fix plan documents must have a DL and complete the correction by the end of the second plan year after the failure occurred.

The new and improved EPCRS now allows these types of failures to be self-corrected if certain requirements are met:

- The plan document must have a favorable IRS letter covering the most recent mandatory restatement.
- The error is not a failure to timely adopt the plan's initial document.
- The failure is corrected before the end of the correction period, which is generally no later than end of the second plan year following the year in which the plan document failure occurred.

Retroactive Plan Amendments

Although prior versions of EPCRS allowed employers to retroactively amend their plans to fix a very limited number of operational failures,[1] the new program adds other types of failures that may be corrected in this way, including (under certain conditions), correcting operational failures with retroactive plan amendments. SCP now provides that the following errors may be corrected through retroactive plan amendment:

- Defined contribution plan allocations that were based on compensation in excess of the Internal Revenue Code (IRC) Section 401(a)(17) annual compensation limit.
- Early inclusion of employees who had not yet satisfied the plan's eligibility requirements.
- Loans and hardship distributions under plans that don't provide for them.
- Loans exceeding the number of loans that are permitted under the plan.

Besides those situations, under the new SCP, employers may now also retroactively amend their plans to correct other operational failures, but only if: (i) the plan amendment would increase a benefit, right or feature; (ii) the increased benefit, right, or feature is available to all eligible employees; and (iii) increasing the benefit, right or feature is permitted under the IRC and satisfies EPCRS's general correction principles. If those conditions are not satisfied, the error may still be corrected by filing a VCP application with the IRS and paying a user fee.

Plan Loan Failures

Making loans to plan participants seems like it should be simple, but there are a lot of ways to make mistakes. Even though loan failures are pretty common, correction has always been quite burdensome and costly, requiring a lengthy application for IRS approval for what is often a very small dollar amount. Plan loan rules fall under both IRS and U.S. Department of Labor (DOL) authority. The DOL does not recognize self-correction, so in the past the IRS required even the simplest and smallest loan failures to be formally submitted for approval.

Insight

The IRS has always been very hesitant to allow correction by retroactive plan amendment (for example, to align the plan document with the plan's operation). When it has been allowed, the IRS generally required a VCP filing. So expanding EPCRS to allow retroactive plan amendments is perhaps the greatest area of relief for employers.

The initial failure to adopt a qualified plan or the failure to adopt a written 403(b) plan document timely cannot be corrected by SCP.

Demographic and employer eligibility failures still cannot be corrected under SCP.

Also, the SCP expansion does not apply to Simplified Employee Pensions (SEP) and SIMPLE IRAs. Rather, as under Rev. Proc. 2018-52, SCP is available to correct only insignificant operational failures for SEPs and SIMPLE IRAs.

Although Rev. Proc. 2019-19 replaces Rev. Proc. 2018-52, it does not make any changes to the recently updated filing methods under EPCRS. Keep in mind that only electronic VCP filings will be accepted on or after April 1, 2019.

Employers may now use SCP to correct plan loan failures if the participant defaults or the loan is administered incorrectly. But, employers still cannot use SCP to correct plan loan terms that violate the maximum permissible loan amount and repayment period and level amortization repayment rules (since those are statutory violations, so sponsors must use VCP to correct those failures).

Until now, employers could voluntarily correct loan defaults by filing a VCP application and paying a user fee. Now employers can also use SCP. Under both programs, the default can be corrected by a single-sum repayment (including interest on missed repayments), re-amortization of the outstanding loan balance or a combination of the two. But employers that want the protection of a no-action letter under the DOL's Voluntary Fiduciary Correction Program (VFCP)[2] will still need to use the IRS's VCP program to correct the error. DOL will not issue a no-action letter for a loan default unless the VFCP application includes proof of payment of the loan and an IRS VCP compliance statement approving the correction.

Employers can now use SCP to correct failures to obtain spousal consent for a plan loan when the plan requires such consent. (For example, if distribution of a participant's benefit requires spousal consent under the qualified joint and survivor annuity (QJSA) rules, spousal consent is also required for a plan loan.) The sponsor must notify the participant and the spouse and give the spouse an opportunity to consent. If the spouse doesn't consent, the sponsor can still correct the error under VCP (which generally requires the employer to make a QJSA available to the spouse for the full amount of the participant's plan benefit, as if the loan had not been made to the participant).

Prior versions of EPCRS generally required employers to report deemed distributions resulting from loan failures on IRS Form 1099-R in the year of failure. However, depending on the type of loan failure, employers could request the following relief:

- No reporting of deemed distributions caused by loan defaults and violations of the maximum permissible loan amount, maximum repayment period and requirement to repay loans over a level amortization period.
- Reporting of deemed distributions caused by other loan failures in the year of the correction (instead of the year of the failure).

Under the new EPCRS, sponsors no longer have to request this relief; rather, they can simply self-correct and use such relief without an IRS filing.

Determination Letter (DL) Program

Rev. Proc. 2019-20 opens the IRS's DL program for one year (starting Sept. 1, 2019) for individually designed "hybrid" retirement plans (like cash balance or pension equity plans). It also opens the DL program to merged plans, so long as the DL is requested within a proscribed timeline. The guidance also extends the remedial amendment periods for these plans[3] and offers penalty relief for plan document failures discovered during the DL review. Since 2017, the IRS has accepted DL applications only from new or terminating individually designed plans, but reserved the right to open the DL program for other circumstances. This is the first time the IRS has opened the program for such "other circumstances."

Hybrid Plans

Fortunately, since IRS curtailed the DL program in 2017, there have been very few changes in the law that would require plan amendments. But there have been required amendments for cash balance and other hybrid plans based on final regulations, so the IRS is allowing a one-year review period for those plans. As part of this process, the IRS will review the entire plan for compliance with the 2016 and 2017 Required Amendments Lists and all Cumulative Lists issued before 2016.[4]

The IRS will not impose any sanctions for document failures it discovers during the DL review that are related to plan provisions required to meet the hybrid plan regulations. For plan document failures that IRS discovers during the DL process that are unrelated to the hybrid plan regulations (but that satisfy certain conditions), the IRS will impose a reduced sanction equal to either the amount the employer would have paid under EPCRS if the plan sponsor had self-identified the error or 150 percent or 250 percent of the EPCRS user fee (depending on the duration of the failure). So employers should correct any failures under EPCRS before filing under the DL program to avoid having to pay more than the regular EPCRS user fee.

Even if an employer is confident that the hybrid plan does not have any document failures, obtaining a new DL provides important protection if the IRS audits a plan and could reduce some of the complications that could arise with aging DLs.

Merged Plans

Beginning on Sept. 1, 2019, the IRS will accept DL applications for individually designed "merged plans" — i.e., single-employer, individually designed plans that result from consolidating two or more plans maintained by unrelated entities in connection with a corporate merger, acquisition or other similar transaction. An employer can request a DL on the merged plan if:

- The plan merger occurs no later than the last day of the first plan year that begins after the effective date of the corporate transaction.
- The DL application is filed with the IRS by the last day of the merged plan's first plan year that begins after the effective date of the plan merger.

The IRS will review a merged plan for compliance with the Required Amendments List issued during the second full calendar year before the DL application and all earlier Required Amendment and Cumulative Lists.

Plan mergers typically require amendments related to eligibility, vesting and maintaining protected benefits, etc. If an employer does not submit a merged plan for a DL under the expanded program, the employer could not rely on the plan's prior DL for changes made to the plan to effectuate the merger.

Although it is not clear, it appears that the expanded DL program would be available when a preapproved prototype or volume submitter plan is merged into an individually designed plan. Often larger employers have individually designed plans while smaller employers have preapproved plans, and larger employers often acquire smaller employers and merge the smaller employer's preapproved plan into the larger employer's individually designed plan. But employers should keep in mind that the merged preapproved plan can cause a plan document failure for the individually designed plan (for example, if signed and dated plan documents and amendments for the acquired plan cannot be located).

The IRS will not impose any sanctions for document failures related to plan provisions intended to effectuate the plan merger. For plan document failures unrelated to the plan merger that satisfy certain conditions, the IRS will impose a reduced sanction equal to either the amount the employer would have paid under EPCRS if the plan sponsor had self-identified the error or 150 percent or 250 percent of the EPCRS user fee (depending on the duration of the failure). As noted above, employers should correct any failures under EPCRS before filing under the DL program.

Insight

Plan mergers before July 2018 may not be eligible for the expanded DL program, since the DL application for the merged plan must be submitted within one year after the plan merger. Since IRS curtailed the DL program in 2017, such plans may be left without access to a DL on a merged plan even under the expanded program.

Employers who merged plans in July 2018 (or later) should consider hurrying to file a DL application before the one-year filing window permanently closes. But keep in mind that a Notice to Interested Parties must be given in advance of a DL filing.

The new guidance does not restrict the number of times that employers could request a DL on a merged plan, so presumably, an employer could file a new DL request for every plan merger.

Key Takeaways

Employers considering whether to use the expanded SCP or DL program should consult with their tax advisers to ensure that the plan is eligible for the program (and that any other potential qualification issues are considered before requesting a DL).

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Article adapted from the Nonprofit Standard blog.

For more information, contract Norma Sharara, Managing Director, National Tax – Compensation and Benefits, at nshrara@bdo.com or Joan Vines, Managing Director, National Tax – Compensation and Benefits, at jvines@bdo.com.

[1] See Section 2.07 of Appendix B of Rev. Proc. 2018-52 (prior EPCRS).

[2] DOL's Voluntary Fiduciary Correction Program is described here.

[3] Rev. Proc. 2019-20 extends any remedial amendment period that is still open on the date an employer becomes eligible to submit a DL until the later of: (i) the last day the employer can submit a DL application under Rev. Proc. 2019-20; or (ii) 91 days after the IRS issues a DL (in accordance with Treas. Reg. § 1.401(b)-1(e)(3).

[4] Notice 2017-72; Notice 2016-80; and the Cumulative Lists issued prior to 2016.

ASU 2016-14 – Liquidity and Availability Disclosure Issues

By Tammy Ricciardella, CPA

As calendar-year-end nonprofits have worked through the implementation of Accounting Standards Update (ASU) 2016-14, Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities, we have seen quite a bit of diversity in the preparation of the liquidity and availability disclosure required by the ASU.

To improve the ability of financial statement users to assess a nonprofit entity's available financial resources and the methods by which it manages liquidity and liquidity risk, the ASU requires specific disclosures including:

- Qualitative information that communicates how a nonprofit entity manages its liquid available resources to meet cash needs for general expenditures within one year of the statement of financial position (balance sheet) date
- Quantitative information that communicates the availability of a nonprofit's financial assets to meet cash needs for general expenditures within one year of the statement of financial position date. Items that should be taken into consideration in this analysis are whether the availability of a financial asset is affected by its (1) nature, (2) external limits imposed by grantors, donors, laws and contracts with others, and (3) internal limits imposed by governing board decisions

The following information can be displayed either on the face of the statement of financial position, or in the notes to the financial statements, unless otherwise required to be on the face of the statement of financial position:

- Relevant information about the nature and amount of limitations on the use of cash and cash equivalents (such as cash held on deposit as a compensating balance)
- Contractual limitations on the use of particular assets. These include, for example, restricted cash or other assets set aside under debt agreements, assets set aside under collateral arrangements or assets set aside to satisfy reserve requirements that states may impose under charitable gift annuity arrangements
- Quantitative information and additional qualitative information in the notes, as necessary, about the availability of a nonprofit's financial assets at the statement of financial position date

An entity can provide additional information about liquidity in any of the following ways:

- Sequencing assets according to their nearness of conversion to cash and sequencing liabilities according to the nearness of their maturity and resulting use of cash
- Classifying assets and liabilities as current and noncurrent
- Disclosing in the notes to financial statements any additional relevant information about the liquidity or maturity of assets or liabilities, including restrictions on the use of particular assets

Liquidity is defined in the Accounting Standards Codification (ASC) Master Glossary as "an asset's or liability's nearness to cash. Donor-imposed restrictions may influence the liquidity or cash flow patterns of certain assets. For example, a donor stipulation that donated cash be used to acquire land and buildings limits an entity's ability to take effective actions to respond to unexpected opportunities or needs, such as emergency disaster relief. On the other hand, some donor-imposed restrictions have little or no influence on cash flow patterns or an entity's financial flexibility. For example, a gift of cash with a donor stipulation that it be used for emergency-relief efforts has a negligible impact on an entity if emergency relief is one of its major programs."

Based on this definition, an entity will have to carefully look at its assets and consider any donor-imposed restrictions that may exist when determining the presentation of liquidity.

A simple measure of liquidity per the ASU is the availability of resources to meet cash needs for general expenditures within one year of the date of the statement of financial position. The ASU does not define general expenditures but does provide some suggestions regarding limitations that would preclude financial assets from being available for general expenditures. Some of these items noted in the ASU include:

- Donor restrictions on the use of assets for particular programs or activities
- Donor restrictions on the time period in which assets are used
- Board designations that commit certain assets to a particular purpose
- Loan covenants that require certain reserves or collateralized assets to be kept on hand
- Compensating deposit balances required by financial institutions

To provide the liquidity and availability disclosure, entities should likely consider combining both a narrative description of their method for managing revenue with donor restrictions and a table that lists the dollar amounts expected to be released from various sources. Entities should develop a liquidity management program that allows them to determine what portions of donor restricted funds will be released from restriction and available for both direct program costs as well as shared expenses that support those programs.

In addition, entities should have a program in place to assess what resources are available. These should only include the portion of funding commitments that are expected to be received in the next year. To assist in this determination, as well as the overall liquidity management, entities should consider utilizing a rolling cash flow projection that covers at least a 12-month period.

Entities should also provide, in the qualitative component of the disclosure, information about other methods they use to manage liquidity and maintain financial flexibility. Examples of these could include:

- The use of lines of credit
- Established operating reserve policies
- Cash management process

It is important to develop this disclosure to present an accurate picture of the liquidity and availability of resources utilizing both financial information and supporting narrative to fully explain the financial health of the organization.

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Audit Committee Self-Assessment

By Laurie De Armond, CPA

What is the audit committee self-assessment?

This is a tool designed to assist the audit committee in evaluating how well the audit committee is executing their responsibilities.

Why should audit committees perform a self-assessment?

As there is always room for improving quality and performance, we recommend that this document be used in conjunction with your organization's Audit Committee Charter (or similar document) to ensure that governance responsibilities are adequately aligned with the charter and are being fulfilled appropriately. You may choose to customize this self-assessment further to reflect specific attributes of your organization and develop specific action steps and estimated completion dates to enhance your audit committee's performance.

Who should use this self-assessment?

This Audit Committee Self-Assessment may be used by those charged with governance (in particular, audit committees) in performing an annual self-assessment. The audit committee chair would generally compile the results, which may be obtained from individual committee members on a confidential basis, but should also contemplate feedback from other key stakeholders such as the board, internal and external audit, and management.

When should the audit committee use this self-assessment?

The audit committee should perform a self-assessment at least annually with areas identified for improvement to be assessed throughout the year.

How should the audit committee use this self-assessment?

This self-assessment tool is to be used as a guide and in correlation with the responsibilities laid out within the audit committee charter approved by the full board. Thus, organizations may feel the need to tailor the self-assessment to their specific needs. At the discretion of the audit committee chair and members, an additional free-form commentary box could be included to allow for specific recommendations or observations to be captured for further consideration.

Areas of Assessment

1. Composition and Character
2. Chairman
3. Independence
4. Continuing Education
5. Setting Tone at the Top
6. Oversight of Internal Control Over Financial Reporting
7. Evaluation of and Communication with Management
8. Evaluation of and Communication with Internal Audit, if applicable
9. Evaluation of and Communication with External Auditors
10. Financial Statements and Other Information
11. Ethics and Code of Conduct
12. Authority and Funding
13. Overall Assessment

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For more information, contact Laurie De Armond, Partner, at ldearmond@bdo.com.

Other Items to Note

2019 OMB Compliance Supplement Status

Each year the Office of Management and Budget (OMB) Compliance Supplement (2019 Supplement) is updated to reflect changes to compliance requirements applicable to federal programs and required programmatic changes outlined by the federal agencies. The changes to the 2019 Supplement are more extensive than usual due to the mandate by OMB that federal agencies identify the six most significant compliance requirements as applicable to a program. In addition, the OMB's request to thoroughly review federal programs has also led to more changes in the programmatic section of the 2019 Supplement. There are significant changes to the Student Financial Assistance cluster in the Supplement as well.

The 2019 Supplement was issued July 1, 2019 as a stand-alone document as was the case prior to the 2018 format and can be accessed here.

The mandate by OMB for each federal agency to limit the number of compliance requirements to six has resulted in significant changes. The Research and Development cluster has seven compliance requirements that are subject to audit.

For determination of the six compliance requirements, A. Activities Allowed and Unallowed and B. Allowable Costs and Cost Principles will be treated as one compliance requirement. Therefore, allowability will be treated as one requirement for this purpose even though in the 2019 Supplement they are listed as two separate compliance requirements.

To meet this mandate, some federal agencies are having to mark "N" in the Part 2 matrix for compliance requirements that have historically been tested as direct and material requirements.

It is important to note that this six-requirement mandate does not apply to programs that are not included in the 2019 Supplement.

The 2019 Supplement is effective for Single Audits of fiscal years beginning after June 30, 2018.

2019 Data Collection Form Issued

The OMB Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) Section 512 requires auditees to submit a completed Form SF-SAC, referred to as the Data Collection Form (DCF), along with one complete reporting package, to the Federal Audit Clearinghouse (FAC). The only approved DCF format is created using the Internet Data Entry System (IDES) option on the FAC website. The FAC IDES website contains submission instructions to assist auditees with the preparation and certification of the DCF.

The FAC has updated the DCF that should be used for all audits covering fiscal periods ending in 2019, 2020 or 2021. The new form is dated 3/25/19. The revised DCF and instructions can be accessed here.

The key changes to the form are the requirement to include the full text from the notes to the schedule of expenditures of federal awards (SEFA), any audit findings and management's corrective action plan (CAP) within the form itself. The system will not allow for the transfer of charts or tables embedded within the original documents so a notation will have to be utilized within the transferred text referring readers to the actual underlying note, audit finding or CAP for the relevant charts and tables.

Auditees will have an option to generate a customizable schedule of expenditures of federal awards (SEFA). Auditees will be able to enter the Federal awards and notes to the SEFA prior to the end of their fiscal period and the audit work being conducted. Once they have entered this information, the auditees can generate a customizable SEFA and the notes from the system to include in their reporting package.

The IDES will offer an optional worksheet-type function to assist in the transferring of text from audit findings and CAPs using an Excel template document that will be able to be downloaded, completed and then updated.

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