

More Than Money

New OMB rules allow more direct costs

Funding from the federal government can be a significant source of support for nonprofit programs and services. Applying for the money and then handling it once it's awarded, however, is often a complex proposition.

The U.S. Office of Management and Budget (OMB) is responsible for grant and contract oversight. The office publishes two key publications that provide information to nonprofits seeking federal funding. Both have been affected by new guidance.

OMB Circular A-133 refers to audit standards. Circular A-122 discusses which expenses qualify – and when – as direct expenses charged to a grant and how indirect costs – overhead – can be charged.

In response to long-standing concerns, the OMB in 2013 issued new grant reform rules titled "Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards at CFR 200" (OMB Uniform Guidance) effective for federal awards made after Dec. 26, 2014.

Paying for indirect costs has long been a problem area for nonprofits. They include administrative salaries, rent, utilities, insurance and any other support that isn't identified as directly related to the service provision.

There are also stringent rules about what can be considered direct, especially regarding administrative staff members who might perform related tasks.

Nonprofits that rarely access federal funds often don't bother to include indirect costs in applications. To justify charging indirect costs, extra paperwork showing the calculation is required during the application process.

Organizations receiving grants on a regular basis, especially from the same agencies each year, have the option of seeking a federally approved indirect rate. This reimbursement can be significant for institutions like universities, where the indirect rate can be upwards of 40 percent.

Small organizations often struggle with the complex accounting calculations to determine indirect costs and set a rate that will work for years forward.

Organizations with unrestricted funding streams like donations or memberships often don't separate direct and indirect costs fully

during the bookkeeping process. Preparing the annual 990 return is probably the closest organizations get to carving out administrative expenses. The next step required is calculating the percent of direct program costs they represent.

See **New OMB rules** on back



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Financial news & notes for nonprofit organizations from:

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Nonprofits need stronger bonds with foundations

The Great Recession caused a perfect storm for nonprofits by raising client need at the same time dollars from individuals, government and foundations declined.

Stretched resources and poor portfolio performance resulted in fewer dollars to give. The situation is gradually easing, but there are still improvements to be made.

Grantmakers for Effective Organizations (GEO) annually studies trends in grant making, including foundation requirements and nonprofit needs. According to GEO, the recession magnified the impact of grantmaking practices already straining organizations.

GEO identified a major area of nonprofit struggle as the inability to finance ongoing operating expenses through grants, in studies done during the recession. Without recognition by funders that a stable infrastructure is needed to support service delivery, nonprofits fall into the “services trap.”

Organizations continue to ramp up client numbers without investing in capacity building, long-term planning and reserve funds. The result is a balloon that will collapse as soon as the grants for programs dry up. That in turn leads to money-chasing – shifting services and mission to grab funding. Overhead has become a dirty word and, in response, organizations tend to self-restrict reporting their true costs and needs.

Building relationships between nonprofits and foundations is an area GEO believes is essential for continued nonprofit sustainability and success.

GEO took a look at this issue in the 2014 study, “Is Grantmaking Getting Smarter?” Encouragingly, GEO learned operating support increased in 2014 from about 20 percent of foundation giving to 25 percent.

In tandem, 74 percent of grant-makers participating said it was important to support infrastructure so grantees can increase impact. GEO feels this reflects a positive shift in this important issue.

Another area of nonprofit uncertainty and resource drain is being forced to raise funding annually because of short-term grants. Already in short supply, multi-year commitments took a hit during the recession. The GEO 2009 study found that a majority of funders preferred one-year commitments. This insecurity regarding future ability to continue services creates even more financial stress and scrambling.

A related issue is the push for revenue diversification. Believing that it’s safer to have multiple funding streams, organizations find themselves with unwieldy grant-seeking and reporting requirements.

In addition, unless required outcomes from the grants line up, program delivery has to be adjusted. This is where mission creep can wreak havoc on staff and organizations. If organizations create new programs or services when adding revenue sources, the impact is magnified. The true cost to the organization includes investments in skills, systems and capacity.

GEO found that organizations with fewer but higher quality revenue sources perform the best financially. Of course, the more unrestricted funding they have, the better the organization will fare. Examples of flexible funding include endowments, memberships and contributions.

The 2014 survey found that multi-year commitments are again on the rise after a severe dip in 2011. In 2008, 60 percent of foundations often or almost always gave multi-year grants.



In 2011, only 29 percent did. Now the percentage has risen to close to 2008 levels, clocking in at 58 percent. This is good news for grantees who can focus on service delivery and capacity building rather than seeking replacement funding.

About a quarter of foundations are also increasing dollars allocated to three key areas for nonprofits: multi-year funding, general operating support and capacity building. GEO believes that as giving rebounds, additional foundations will expand giving in these critical areas.

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Many organizations don’t feel funders understand their issues or how onerous the grantmaking process is.

Many grants take about 20 hours to prepare – and this burden isn’t necessarily related to the size of the award. In fact, foundations and other funders tend to raise the bar each year by requiring new information of applicants, in part because of the sheer difficulty of deciding who gets scarce funding.

Other requirements, such as information about sustainability or in-depth evaluation processes, are added to meet foundation goals of funding the organizations with the best performance or those most likely to survive.

If foundations truly want to lessen grantees dependence, GEO asserts, they need to help those organizations build the necessary capacity and infrastructure for long-term success.

GEO found that 53 percent of foundations now ask for grantee feedback, a significant increase over 2008, when only 36 percent did. Foundations are also seeking input on policies, strategic direction and program areas.

A gap still exists when it comes to discussing financial issues, with foundations most reluctant to talk about grantee long-term needs for working capital, physical capital and capacity building.

In turn, organizations fear to broach these topics because they feel pressure to reassure funders that they are good financial risks for grant funding. Not surprisingly, GEO found a correlation between strong grantmaker-grantee relationships and the likelihood the foundation would support operating and capital needs.

Another area for possible growth is funding collaborations between nonprofits, a strategy that organizations are already using to leverage scarce resources. Perhaps it is time for foundations to do the same. –Elizabeth Penney, M.B.A. ■

Expected changes in nonprofit reporting requirements

The Financial Accounting Standards Board embarked on a project back in November 2011 to review the standards for financial reporting of not-for-profit entities and determine ways to promote best practices for other means of financial communications used by these entities.

The Financial Accounting Standards Board (FASB) held multiple educational sessions to discuss current reporting standards and to establish a project plan. With the plan in place, the presentation of financial information, disclosure of activities and clarification of other matters were discussed in a series of meetings.

As a result of these discussions, certain changes were proposed that could have a significant impact on the current presentation of not-for-profit financial statements. Below is an overview of the core changes expected to be released in a first draft of the proposed FASB update to not-for-profit reporting requirements.

Net Assets

Under the current guidance, not-for-profit entities are required to classify net assets into three classifications: unrestricted, temporarily restricted and permanently restricted net assets. In an effort to simplify the presentation, the proposed standards would have only two categories: without donor-imposed restrictions and with donor-imposed restrictions.

FASB would require disclosures that focus on describing differences in the nature of the net assets with an emphasis on both how and when the resources can be used. The intention of the changes is to provide the users of the financial statements with a clearer picture of the net assets of the organization.

Statement of Activities

Similar to the proposed changes to net assets, the statement of activities would also undergo major changes to implement an intermediate measure of operations, reporting of expenses and investment return.

Intermediate Measure of Operations

The presentation of an intermediate measure of operations would be based on two key dimensions: a mission dimension and an availability dimension. The implementation of these dimensions is intended to provide the users of the financial statements a clearer picture of a not-for-profit's operations.

The mission dimension would be based on whether resources are (result) from, or are directed at, carrying out a not-for-profit's purpose. The availability dimension would be based on whether the resources are available for current-period activities and reflect both external and internal limitations.

Reporting of Expenses

Voluntary health and welfare organizations have been required to present a separate statement of functional expenses. However, the proposed standards would incorporate this concept into the overall statement of activities and permit, but no longer require, it to be presented as a separate statement.

This change would apply to all not-for-profit entities and would require an analysis of expenses by function and nature in one central location. Furthermore, additional disclosures regarding the method of cost allocation would be required.

Investment Return

Presentation of investment returns would be simplified to show the investment revenue net of expenses. Additionally, the requirement to disclose the amount of netted investment expenses would be removed.

Statement of Cash Flows

Building on the changes to the statements of activities and presentation of net assets, use of the direct method of reporting cash flows provided or used by operating activities would be required. This change increases the focus on operating activities and removes the requirement to reconcile the change in net assets to net cash flow from operating activities using the indirect method.

In addition, the proposed changes would reclassify the presentation of certain cash inflows and outflows to better align the categories used in the cash flow statement with those proposed for the statement of activities.

Other Proposed Changes

Other changes proposed relate to additional note disclosures on liquidity and underwater endowments that are not specifically tied to one of the core statements. FASB also plans to develop more streamlined examples of certain note disclosures. The proposed changes are tentative and don't change the current presentation. The FASB issued an exposure draft of changes April 22, 2015, with a comment period through Aug. 20, 2015. — John Waters, CPA ■

Charitable giving hit record numbers in 2014

Charitable giving is up — way up, according to the new Giving USA yearly report released in June.

Giving increased 7 percent to nearly \$358 billion in 2014, more than any year in the 60-year history of the organization's *Annual Report on Philanthropy*. The total surpassed the previous high of \$355 billion in the pre-recession year of 2007.

There were four major sources of total giving:

- ❖ Individuals — 72 percent (\$258 billion)
- ❖ Foundations — 15 percent (\$54 billion)
- ❖ Bequests — 8 percent (\$28 billion)
- ❖ Corporations — 5 percent (\$18 billion)

Bequests had the biggest increase in giving, 15.5 percent, followed by corporate (13.7 percent), foundations (8.2 percent) and individual giving (5.7 percent).

A number of gifts of \$200 million or more were made last year, many by young tech entrepreneurs, which impacted the

total considerably. Many of those gifts were to foundations.

Individual giving is impacted by disposable income, wealth and growth in the stock market, according to the report. Corporate giving is driven more by pretax profits and gross domestic product.

The recipients of charitable gifts in 2014, according to the study, were led by religious giving, which reached a new high of nearly \$115 billion. Despite that high number, the percentage of giving that goes to religious organizations has decreased dramatically during the past three decades, from 53 percent of all donations in 1987 to just 32 percent today.

The nine categories of organizations receiving the most gifts in 2014 are: religion (\$114.9 billion); education (\$54.6 billion); human services (\$42.1 billion); health (\$30.3 billion); arts/culture/humanities (\$17.2 billion); environment/animals (\$10.5 billion); public/society (\$26.3 billion); foundations (\$41.6 billion); international affairs (\$15.1 billion). ■



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New OMB rules *continued from front*

The rules in the uniform guidance document apply to local and state governments as well as federal agencies.

The major changes to OMB rules are:

More costs now considered direct – As noted above, support staff salaries have long been considered 100 percent indirect. The new guidance allows a portion of all staff salaries to be charged to a grant as long as they meet the requirements. These requirements include the following:

1. The activity performed must be integral to the federally funded project or activities.
2. Individuals can be specifically identified as working on the project.
3. Their costs are specifically included in the grant or contract budget and have received approval.
4. These costs are not also included in indirect cost calculations or reimbursement.

This ruling will allow organizations to better pay for necessary support staff members who otherwise would require unrestricted funding sources. Other expenses that can be shifted as direct costs include cost of materials, related extraordinary utility cost and certain services provided to the grant activities. Accurate cost accounting is essential for federal grants. The more accurately a relationship between expense and activity can be proven, the more likely it is that costs will be covered.

New indirect reimbursement rules – Perhaps one of the most beneficial changes to the OMB rules is the provision of a 10 percent indirect rate that can be charged without pre-approval. For small organizations, those who rarely tap federal grants and those without sophisticated bookkeeping systems in place, this provision can be a simple way of covering some overhead. Negotiating a higher rate in the future is allowed. Those with rates in place are not affected by the ruling.

Another major change is a requirement for state and local governments to reimburse reasonable overhead costs in the case of pass-through grants. If a nonprofit has a negotiated rate, that must be used.

Single audit threshold – The new OMB Uniform Guidance also raises the audit threshold for single audits to \$750,000 of expenditures of federal funding per year from \$500,000. Single audits are rigorous audits performed by CPAs of an organization's financial statements and records. The federal government is seeking to ensure that costs were properly charged to grants. Upon triggering this threshold, many small organizations then have a standard audit performed as well.

The new provision will save many organizations from incurring the expense of a single audit, which must be performed annually. – *Elizabeth Penney, M.B.A.* ■

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The technical information in this newsletter is necessarily brief. No final conclusion on these topics should be drawn without further review and consultation.