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Nonprofits bracing for more disclosure

By: Claude Solnik September 27, 2016

The Financial Accounting Standards Board has issued new financial reporting rules for nonprofits that should provide more information to donors, benefiting some groups and leading to potential problems for others.

Lee Klumpp, director of BDO USA's Institute for Nonprofit Excellence, called this the "biggest change to nonprofit financial reporting in more than 20 years."

Manhattan and Melville-based accounting firm Marcum called the changes a "significant development for the industry," which last saw major changes in 1993.

The new format for reporting takes effect for nonprofits with fiscal years beginning after Dec. 15, 2017.

"They want to make more user-friendly financial statements," said Barry Wechsler, partner in charge of the nonprofit group at Raich Ende Malter & Co. in Melville and Manhattan. "I think it's going to make it more difficult for smaller nonprofits to report."

While the Securities and Exchange Commission increased reporting requirements on public companies, nonprofits continued to disclose very little.

"It wasn't providing the reader with enough meaning about what's really going on behind the organization," Brian Sackstein, a director in charge of not-for-profit and healthcare organizations at Marcum, said of nonprofits' financial statements. "This is supposed to help the clarity of that."

Groups of all sizes will now have to explain what portion of their budget is spent on programs, management and fundraising, much the way healthcare organizations must today.

"I think it will change where donors spend their money," Sackstein said. "It will break it down to a level comprehensible to someone who is an informed reader."

For the first time, donors will have a better sense of who's spending how much where, sending up red flags for some and leading to rewards for others.

"It will basically allow people to determine whether they are giving to a not-for profit spending all its money on programs compared to one spending more money on general administrative and fundraising," Wechsler said.

Sackstein said this could be "helpful and it can be painful for the organization" if it must spend a lot to raise a little more.

Groups also must show how they plan to meet their cash needs for their fiscal year, potentially leading some groups, facing uncertainty, into bigger trouble.

“Some organizations have already had enough information to respond to these,” Sackstein said. “For organizations that don’t really know where their next dollar is coming from, it will have an impact. They’re going to have to say how they’ll survive for the next year.”

Groups that can’t show where their money will come from could face a “going concern” issue, indicating they may not be able continue past that year.

Nonprofits also must disclose if any of their endowment funds are underwater, defined as having less than the principal that a donor asked the group to maintain.

“We weren’t really able to see that in the past,” Sackstein said. “This is going to be a required disclosure.”

This could lead to additional questions such as whether a group must replenish underwater funds.

“You may have donors saying, ‘I contributed $2 million. What’s it worth today?’ ” Sackstein said. “Some things can be helpful for an organization. They can also be hurtful.”

Nonprofits sometimes take money from donations to meet emergency or immediate needs after they face unanticipated expenses, potentially leaving some funds under water.

If the state finds money wasn’t spent appropriately, it may ask the nonprofit to return funds.

“If they give back that money, where do they get it from?” Sackstein said. “Most of the time they don’t have the arsenal of cash lying around. So they take it from donor-restricted dollars.”

He also talked about an organization that derived a great deal of income from invested donations. After the stock market tanked, that stopped flowing in, forcing the group to take funds from other sources.

“They didn’t have investments throwing off this income to support the losses,” Sackstein said. “That may be the discussion organizations have, that they have to look at these endowments.”

While some see more information as better, some nonprofits said it’s already possible to get a wide range of information from income tax returns and groups such as GuideStar.

“If you’re making large-scale grants, you have the tools you need,” said Darren Sandow, executive director of the Hagedorn Foundation in Roslyn. “We have tools like GuideStar. We can look at anybody’s 990s.”

And he questioned whether donors who make small gifts would even seek additional information.

“People give because they want to support something they believe in. It’s typically connected through their heart,” Sandow said. “If somebody wants to give money to a dog shelter because they like dogs and cats, do you think they’ll go through the Humane Society’s 990s to give a $25 check?”

Although the new regulations have just been approved, accountants said most nonprofits aren’t yet dealing with them.

Klumpp said, “Organizations should strongly consider acting early on the new guidance,” rather than waiting until the deadline nears.

“This is an education process,” Wechsler said. “It’s going to be my job to start educating our nonprofits about the changes in these rules.”

He plans to sit down with his clients and make presentations to their boards about what new financial statements should look like.

“The boards have to be involved in understanding what’s in the financials,” Wechsler said. “They need to be educated the way the clients need to be.”

Klumpp said, “Boards count on financial statements and absolutely need to be a part of the process” of implementing the new reporting.

“It may prove to be a test of how well they can educate readers of their financial statements on what has changed and why,” Klumpp said of groups.

Whether the new formats will provide more insight to donors depends, in part, on whether they look for it and use it in making decisions.

“My gut feeling is it’s useful information,” Wechsler said. “Even the individuals making the contributions have to be educated on this. It’s new for everybody.”

Sackstein said this is part one of a two-part implementation of changes with the next phase still in the works.

“It’s supposed to be simplifying the financials,” Sackstein said. “I would like to see them take things out that not-for-profit readers don’t understand.”

Nonprofits, for instance, must break down investments into various levels, which can be confusing, he added.