



## Limited Partnerships—To Consolidate or Not to Consolidate, That is the Question

*By Lee Klumpp CPA, CGMA*

**The Financial Accounting Standards Board (FASB)** has added a project entitled Clarifying When a Not-For-Profit Entity That Is a General Partner Should Consolidate a For-Profit Limited Partnership (or Similar Entity), to its agenda. Its objective is to clarify when a nonprofit entity that is a general partner should consolidate a for-profit limited partnership into its financial statements.

This project was added to the agenda because the FASB issued its Accounting Standards Update (ASU) 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis, in February 2015. Since the issuance of that ASU, FASB staff have received feedback from various stakeholders indicating that the guidance fails to make clear when a nonprofit that is a general partner should consolidate a for-profit limited partnership or similar entity.

Prior to the issuance of ASU 2015-02, Accounting Standards Codification (ASC) Subtopic 958-810, Not-for-Profit Entities—Consolidation, provided that a nonprofit entity that is a general partner of a for-profit limited partnership or a similar entity should apply the consolidation guidance in Subtopic 810-20, Consolidation: Control of Partnerships and Similar Entities, unless that partnership interest is reported at fair value in conformity with certain other guidance. The problem is that ASU 2015-02 eliminated Subtopic 810-20 and instead referred a nonprofit that is a general partner of a for-profit limited partnership or a similar entity to the consolidation guidance in ASC Subtopic 810-10.

In subsequent feedback from stakeholders, the FASB learned the guidance in the General Subsections of ASC Subtopic 810-10, as amended, is written only in the context of when a limited partner should consolidate. Specifically, paragraph 810-10-15-8A states that “the usual condition for a controlling financial interest, as a general rule, is ownership by one limited partner, directly or indirectly, of more than 50 percent of the limited partnership’s kick-out rights through voting interests.” To use the guidance in that paragraph, it is appropriate for the nonprofit first to navigate through the Variable Interest Entities (VIE) Subsections of Subtopic 810-10 before applying the General Subsections. However,



that is a problem because nonprofits are scoped out of the VIE guidance, unless the guidance is being used to circumvent those subsections. As a result, when a nonprofit that is a general partner navigates directly to the General Subsections of Subtopic 810-10, the guidance fails to make clear when the general partner should consolidate.

At the March 30, 2016 FASB meeting, the staff presented and the board discussed outreach performed on alternatives that would address when a nonprofit general partner should consolidate a for-profit limited partnership (or similar entity).

The board decided to maintain current practice for nonprofits that are general partners by reinstating the consolidation guidance that previously existed in ASC Subtopic 810-20, Consolidation: Control of Partnerships and Similar Entities, and including it in ASC Subtopic 958-810. Because the board decided to reinstate the consolidation guidance that previously existed in Subtopic 810-20, the board decided not to supersede the guidance related to special-purpose-entity (SPE) lessors



from Subtopic 958-810 and agreed not to perform further outreach on the SPE guidance.

Additionally, the board decided to provide transition guidance because some entities may have early-adopted the amendments in ASU 2015-02. Those nonprofits that have adopted the amendments in ASU 2015-02 should apply the proposed amendments using a modified retrospective approach by recording a cumulative-effect adjustment to net assets (equity) as of the beginning

of the fiscal year of adoption, or they would apply the amendments retrospectively. Nonprofits that have not yet adopted the amendments in ASU 2015-02 would apply the proposed amendments using the same effective date and transition provisions in ASU 2015-02.

The FASB directed the staff to draft a proposed ASU with a comment period of 60 days. At the time of this article, the exposure draft had not yet been released by the FASB.

## How to Retain, Recruit and Engage Great Board Members

*By Laurie De Armond, CPA*

**The nonprofit world has already seen** a number of board shakeups this year—from board members resigning en masse from the Frost Science Museum following fundraising and cash-management woes, to the issues at the Northwest Museum of Arts and Culture in Spokane, in which a spiraling relationship with the board led to the firing of the CEO.

The right qualifications, a good cultural fit, dedication to the mission and a solid dynamic among nonprofit leaders are critical for a healthy organization.

A crucial challenge for both new and long-standing nonprofit organizations is how to find and keep the right leadership group in place. Board members can make or break a nonprofit, depending on their abilities, decisions and group dynamic. Let's address how you can locate the right mix of board members and set them up for success.

### **The Big Question: Where Do You Find Potential Board Members?**

Even if you already have a solid board of directors in place, it won't remain the same forever. The board must engage in an ongoing process to use its current connections and to establish new relationships to draw from an expanding and increasingly diverse pool of potential candidates.

When you are identifying potential candidates, it is better to make your criteria as specific as possible to ensure



you are only considering the candidates who prove to be a good fit for the organization. One way to find candidates who fit your culture and mission is to look to people who have already shown an interest in the work of the organization. If no one qualified has already shown an interest, you can bolster your recruiting efforts by holding events designed to introduce the work of your organization to a key pool of qualified people.

Finding the right board members is not a simple task; one or more leaders, or possibly a committee of the board, should be tasked with this role to ensure someone is accountable for advancing the effort. Determine who will be responsible for contacting candidates with materials and developing the messaging to use when approaching potential candidates. However, nonprofit organizations don't have to take on this task alone. There are various consultants and programs that assist with everything



from establishing board recruitment plans to seeking out board members.

### Determining the Right Skill Sets Needed on the Board

A nonprofit board should be composed of a diverse group of individuals with various skill sets in order to carry out its fiduciary responsibilities most effectively. Depending upon the mission of an organization, the skill sets needed vary. In addition to individuals who are passionate and knowledgeable about the mission of the organization, it might be beneficial to have individuals with legal, financial, development or technical backgrounds on the board. Demographic diversity is also very important, as the most effective boards represent individuals of diverse backgrounds.

### Integrating New Board Members

Like your organization, the board is a community in itself. New members must be welcomed and oriented

to its culture. Develop a board manual for new board members that includes standard documents, including the mission, bylaws and other important literature, as well as job descriptions for the positions to be filled. In addition, the organization should provide an orientation to walk through the expectations for new board members, the code of conduct and interactive training on the organization's code of ethics.

To help new members get acclimated and actively participating, provide them with a clear role on the board, including committee assignments. From the very beginning, new board members should be brought into board conversations. It's also helpful to provide new members with a mentor who can address their questions and check in on them periodically.

An ineffective board of directors can severely hurt an entity's financial health and reputation, so it's crucial for leadership to put the right recruiting and onboarding processes in place, and to seek assistance if necessary to ensure it can secure collaborative and qualified new board members.

*Article reprinted from the BDO Nonprofit Standard blog.*

## 10 Common Self-Dealing Mistakes Private Foundations Make

*By Rebekuh Eley, CPA, MST*

**What may seem like a simple transaction** could pose a big problem for private foundations. The self-dealing rules unique to private foundations prohibit any transactions between the foundation and insiders of the organization or other disqualified persons, such as an officer, a trustee or a relative of one of those persons. Simply put, if a person has influence over the decisions of the private foundation, it's likely that he or she is a disqualified person.

### There are six types of prohibited transactions affected by these rules:

- Sale, exchange or leasing of property
- Lending of money or other extension of credit
- Furnishing of goods, services or facilities

- Payment of compensation or payment or reimbursement of expenses
- Transfer to, use by, or for the benefit of a disqualified person, any income or assets of the private foundation
- Agreement to pay a government official

The prohibited transaction rules are all-encompassing and are strictly interpreted by the Internal Revenue Service (IRS). As a result, private foundations have been surprised when they are faced with the consequences—including severe excise taxes and correction requirements—of a transaction they didn't think was subjected to these rules.

With such broad coverage of transactions, how can organizations ensure they do not inadvertently become exposed to these rules and their potential consequences? Below are 10 common examples of how



private foundations can go wrong and how they can stay on the straight and narrow to avoid penalties.

1. When accepting non-cash gifts such as property, there should be no mortgage or lien on the property; otherwise it may be considered a sale from a disqualified person.
2. Grants should not satisfy the pledge of the founder or other disqualified person, as that would be considered payment of an obligation or debt of the disqualified person.
3. Private foundations should not advance foundation managers more than \$500 for private foundation expenses that are reasonable in relation to the duties of the manager to ensure the transaction is not an act of self-dealing.
4. Document any operating arrangement the private foundation has alongside the founder's family office or corporation to ensure there are no direct or indirect benefits to the family office (such as a reduced rental rate).
5. Expense payments for use of a disqualified person's property should be made to a third-party vendor when appropriate, not directly to a disqualified person.
6. Do not arrange for the foundation and a disqualified person to jointly pay for a ticket to a benefit event. Disqualified persons should only attend as representatives of the foundation if appropriate for their role and if they would not otherwise have attended the event; otherwise, the disqualified persons should pay their way in full.
7. Unless there is a business reason for the spouse of a disqualified person to attend an event, the spouse should pay his or her own way.
8. If a grantee provides special privileges to the foundation in exchange for its grant, adopt a conservative policy of disclaiming membership privileges, requiring that disqualified persons pay for their own memberships or pass along the privileges to employees who are not disqualified persons.
9. As government officials are considered disqualified persons, avoid any payment to a government official that does not clearly qualify as one of a few exceptions, such as an employment payment after the official's term ends.

10. Vet vendors to avoid indirect self-dealing with an entity controlled by the private foundation or by a disqualified person.

Aside from these basic preventive measures, private foundations should take steps to be well versed in complex self-dealing regulations to identify other transactions that could trigger penalties such as an excise tax. All proposed transactions with anyone who is considered a disqualified person, as well as a disqualified person's relatives and related entities, should be carefully scrutinized prior to making any arrangement. To ensure this happens on a continuous basis, private foundations should develop and maintain policies and procedures to avoid any potential self-dealing transactions.

*Article reprinted from the BDO Nonprofit Standard blog.*





# Revenue Recognition of Grants and Contracts by Nonprofits—Is it Time for a Change?

By Lee Klumpp, CPA, CGMA

**At its April 20, 2016 meeting,** the Financial Accounting Standards Board (FASB) voted to add a project to its agenda to improve and clarify existing guidance on revenue recognition of grants and contracts by nonprofits. The FASB directed its staff to perform additional research on the identified issues to best address stakeholder concerns and to develop an approach for clarifying and improving the existing guidance. The FASB began its initial deliberations at its board meeting on June 1, 2016.

The issues that have been raised by stakeholders (including the Not-for-Profit Advisory Committee [NAC], the American Institute of Certified Public Accountants [AICPA] Expert Panels, the AICPA NFP Revenue Recognition Task Force and others) indicate that there are difficulties and diverse practices among nonprofits related to the following issues:

- Issue 1: Characterizing grants and similar contracts with government agencies and others as (i) reciprocal transactions (exchanges) or (ii) nonreciprocal transactions (contributions).
- Issue 2: Distinguishing between conditions and restrictions for nonreciprocal transactions.

Stakeholders have conveyed to the FASB that despite the existing guidance, there is significant diversity in practice among nonprofits related to these issues for many grants and contracts. In some instances, similar grants and contracts are accounted for as nonreciprocal transactions (generally conditional) by some nonprofits and as reciprocal transactions (exchanges) by other nonprofits. The diversity in practice related to this issue can lead to two different nonprofits recording the same transaction with totally different revenue recognition and measurements that result in differing presentations on each of their financial statements.

These two issues have been an implementation problem for many nonprofits for some time. However, with the issuance of the FASB Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606), they have been brought to the forefront and have received new focus due to the elimination of limited exchange transaction guidance in Accounting



Standards Codification (ASC) Subtopic 958-605. The additional disclosure requirements that will be required under Topic 606 going forward have some stakeholders expressing that they do not think these disclosures are relevant for these transactions.

In various meetings with the FASB, stakeholders have expressed that there has historically been difficulty related to these transactions that have been identified as contributions. These grants and contracts often carry specific terms, and issues arise in distinguishing whether these terms are a condition or a restriction. This is particularly the case when funds are provided to a nonprofit with the stipulation that certain outcomes must be met, but the contract has no return of funds language specified.

Additionally, there is also diversity in practice in determining whether the likelihood of failing to meet a condition is remote, which can impact the determination of when a contribution is recognized. While these issues occur for grants and contracts from various types of funders (federal and state governments, private foundations, international non-governmental organizations, other nonprofits and individuals), government grants and contracts cause the most concern among stakeholders. Overall, the conclusions reached by the nonprofit on these issues can affect the timing and net asset classification of the revenue recognized in such transactions, as well as the presentation of this revenue in its financial statements. Consensus in the industry is critical so that these transactions are treated uniformly by all nonprofits.



# Pending Nonprofit Tax Legislation: What's on the Way?

By Laura Kalick, JD, LL.M.

**Although tax legislation will likely wait** until after the presidential election, Congress continues to introduce bills for when that day comes. Previous bills and budget proposals have attempted to reduce the benefits of the charitable deduction for taxpayers. The charitable sector demonstrated in numerous hearings that such a reduction would have a significant adverse impact on organizations' ability to provide needed services. And now, Congress is exploring actions that could help protect the charitable deduction.

Senator John Thune (R-S.D.) introduced S. 2750 CHARITY Act (Charities Helping Americans Regularly Throughout the Year). This bill conveys that the goal of tax reform should be to encourage charitable giving, and Congress should ensure that the charitable deduction endures through a comprehensive rewrite of the tax code. The bill includes the following provisions:

- The Individual Retirement Account rollover from charities would be available for a rollover from a donor advised fund;
- The excise tax on private foundations' investment income would be reduced to 1 percent;
- In order to enhance transparency, all Forms 990 would be filed electronically;
- The mileage rate for charitable volunteer services using an automobile would match the rate for medical expenses; and
- An exception to the excess business holding rules would allow a business received by a private foundation through a will or trust to be held by the charity if the business's profits go to the charity.

Senator Tom Udall (D-N.M.) introduced S. 2648, Create Act of 2016, which includes a special rule allowing a donor who makes a qualified artistic charitable contribution (i.e., literary, musical, artistic or scholarly work, or contributes the copyright to a charitable organization) to deduct the fair market value of the contribution from gross income.

On the House side, "Preventing IRS Abuse and Protecting Free Speech Act" (HR 5053), introduced by Peter Roskam (R-Ill.-6), was passed. This bill prohibits



the Internal Revenue Service from requiring a tax-exempt organization to include in annual returns the name, address or other identifying information of any contributor. The bill includes exceptions for:

- Required disclosures regarding prohibited tax shelter transactions; and
- Contributions by the organization's officers, directors or five highest compensated employees (including compensation paid by related organizations).

As the sector stands by during the final months of election season, we'll be watching and waiting for more developments in tax legislation.

*Article adapted from the Nonprofit Standard blog.*



## Other Items to Note

### Changes to Charity Navigator's Rating System

Influential assessment organization Charity Navigator unveiled a new rating system June 1, which it claims gives donors a better picture of organizations' long-term performance. The nonprofit updated seven metrics used for evaluating charities' financial health, which comprises half of the rating. Metrics for accountability and transparency, which make up the other half, are unchanged.

Charity Navigator CEO Michael Thatcher said that user experience will remain largely the same, and organizations will still be rated on a scale of zero to four stars. Many nonprofit organizations consider their Charity Navigator star rating a critical metric that can help them obtain resources and attract new donors, [according to The New York Times](#).

### Key measures being adjusted include:

#### ■ Expenses for program, administration and fundraising costs

**Then:** Calculated using data from the most recent fiscal year.

**Now:** Averages data from the three most recent fiscal years.

#### ■ Liabilities to assets ratio

**Then:** Not included in rating criteria.

**Now:** Used as a measure to detect potentially excessive debt.

#### ■ Administrative expenses and overhead

**Then:** Only organizations with zero administrative expenses could receive 10 out of 10 points.

**Now:** Organizations that score within a given range for their type of organization can receive 10 out of 10 points. (See our previous insights on the overhead myth [here](#)).

#### ■ Program spending

**Then:** Organizations spending less than 33 percent of budget on programs automatically receive zero points for their full financial score (which makes up

half their Charity Navigator rating). This remains unchanged.

**Now:** Criteria expanded such that organizations spending more than 85 percent of budget on programs receive 10 out of 10 points for program expense. Those spending between 33 and 50 percent of budget on programs will receive 0 out of a possible 10 for the program spending criteria.

[Nonprofit Times](#) reported that more than 2,100 of the 8,000 organizations Charity Navigator rates, (approximately 27 percent) will experience a change in their ratings as a result of the new system implemented June 1. Ratings improved by one star for 19 percent of charities examined, and dropped by one star for 8 percent. Fourteen charities saw their rating increase by two stars and just two saw their rating decrease by two stars.

We recommend organizations evaluate the new criteria to determine the impact it will have on your rating and prepare development and program personnel with the information necessary to respond to stakeholder inquiries.

### 2016 Office of Management and Budget (OMB) Compliance Supplement

As of the date this newsletter was prepared, OMB had not issued the final 2016 Compliance Supplement. The expectation is that the 2016 Compliance Supplement (CS) will be issued by mid-July. The 2016 CS is effective for fiscal years beginning after June 30, 2015, and will supersede the 2015 OMB CS.

Appendix V of the CS, *List of Changes in the 2016 Compliance Supplement*, identifies all changes in the 2016 CS and should be reviewed to begin your process of assessing the changes in the 2016 CS.

Based on the draft version of the 2016 CS, one change that was made to the 2016 CS is the addition of the applicable row from Part 2, *Matrix of Compliance Requirements*, to each program/cluster included in Parts 4, *Agency Program Requirements* and Part 5, *Cluster of Programs*. This has been added to assist auditees and auditors in identifying the applicable compliance requirements and put this in one location.



The 2016 CS will include Part 6, Internal Control, whereas the 2015 CS Part 6 was blank. Part 6 provides an overview and the objectives of internal control. Part 6 describes the characteristics of internal control relating to each of the five components of internal control that should reasonably assure compliance and highlights the relationship between those characteristics and the 17 principles of internal control.

Once the 2016 CS is issued, organizations should review the document for changes to compliance requirements to their programs and ensure they have the proper controls and processes in place.

### New Overtimes Rules Issues: What It Means for You

On May 18, the Department of Labor (DOL) issued its final overtime rules which take effect on Dec. 1, 2016. The rules will significantly raise the salary level used to determine whether employees are eligible for overtime and will affect more than 4 million salaried employees. The DOL has more than doubled the current salary threshold for the overtime exemption from \$455 per week (\$23,660 per year) to \$913 per week (\$47,476 per year). In addition, it increased the total annual compensation amount required to exempt highly compensated employees from \$100,000 to \$134,000. These thresholds will automatically increase every three years.

Organizations should review their employee classifications and determine what steps need to be taken to address these new rules. The impact of these new rules on nonprofits needs to be carefully examined as the new regulations will result in higher salary costs for employers.

### Update on FASB's Not-for-Profit Financial Reporting Exposure Draft

The FASB is expected to vote on the final Accounting Standards Update on this topic by the end of June. If this occurs as expected, a final ASU should be issued during the summer. The ASU is projected to provide examples that will assist organizations in drafting their statements under the revised guidance.