

THE NEWSLETTER OF THE BDO INSTITUTE FOR NONPROFIT EXCELLENCE<sup>SM</sup>

# NONPROFIT STANDARD



## FINAL ASU 2018-08 ISSUED ON GUIDANCE FOR CONTRIBUTIONS

By Lee Klumpp, CPA, CGMA

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made* in June 2018 to clarify the accounting guidance related to contributions made or received. This ASU applies to all entities (including business entities) that make or receive contributions of cash and other assets, including promises to give and grants. The final ASU can be accessed [here](#).

### BACKGROUND

The purpose of the ASU is to address long-standing diversity in practice and the difficulties in determining whether grants and similar contracts are exchange transactions or contributions. In addition, the ASU addresses the evaluation of whether a contribution is conditional or unconditional, which affects the timing of the revenue recognition. And finally, the ASU addresses the issue of when a contribution is restricted.

As we discussed in our Spring 2018 newsletter in the article entitled, [Updates to FASB Proposed Guidance for Contributions](#), the introduction of the new revenue recognition

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**FINAL ASU 2018-08**

standard also made it imperative for the diversity in practice to be addressed. The distinction between contributions and exchange transactions is important because it determines whether an entity should follow the guidance in Accounting Standards Codification (ASC) 988-605, *Not-for-Profit Entities - Revenue Recognition*, if the transaction is deemed to be a contribution, or the guidance in ASC Topic 606, *Revenue from Contracts with Customers*, if deemed to be an exchange transaction. Contributions are scoped out of Topic 606.

**MAIN PROVISIONS****Characterizing Grants and Similar Contracts in Reciprocal Exchanges or Contributions**

The ASU clarifies and improves the scope and accounting guidance for both contributions received and made to assist all entities in evaluating whether a transaction should be accounted for as a contribution or an exchange transaction. The ASU provides sample indicators of a contribution and exchange transaction to assist entities in making this determination.

The amendments in the ASU clarify how an entity determines whether a resource provider is participating in an exchange transaction by evaluating whether the resource provider is receiving commensurate value in return for the resources transferred or on the basis of the following:

- ▶ The resource provider is not one and the same with the general public. Benefits received by the public as a result of the assets transferred is not equivalent to comparable value received by the resource provider.
- ▶ Exercise of the resource provider's mission or the positive sentiment from acting as a donor doesn't constitute comparable value received by the resource provider for purposes of determining whether the transfer of assets is a contribution or an exchange.

If the resource provider itself is not receiving comparable value for the resources provided, an entity must determine whether a transfer of assets represents a payment from a third-party payer on behalf of an existing exchange transaction between the recipient and an identified customer. If this is the case, this should be accounted for under Topic 606 or other guidance that applies.

In completing this analysis, the type of resource provider should not factor into the determination.

See ASC 958-605-15-6 for specific transactions that should be excluded from this analysis of contribution versus exchange.

**Determining Whether a Contribution is Conditional**

The ASU amendments require an entity to determine whether a contribution is conditional based on whether an agreement includes a barrier that must be overcome and either a right of return of assets transferred or a right of release of a promisor's obligation to transfer assets. If the agreement includes both of these, it is deemed to be conditional, and the recipient is not entitled to the transferred assets until it has overcome the barriers in the agreement.

The amendments include the following indicators to determine whether an agreement contains a barrier:

- ▶ The inclusion of a measurable performance-related barrier or other measurable barrier.
- ▶ The extent to which a stipulation limits discretion by the recipient on the conduct of an activity.
- ▶ Whether a stipulation is related to the purpose of the agreement.

A probability assessment about the likelihood of the recipient meeting the stipulation is not a factor in determining if there is a barrier.

Examples of barriers are provided in the amendments. Depending on the facts and circumstances some indicators may be more significant than others, but no single indicator is determinative.

The right of return or right of release must be determinable from the agreement or another document referenced in the agreement. The agreement does not have to specifically include the phrases "right of return" or "release from obligations"; however, the agreements should be sufficiently clear to be able to support a reasonable conclusion about whether the recipient would be entitled to the transfer of assets or release of obligation. In the absence of any apparent indication that a recipient is only entitled to the transferred assets if it has overcome a barrier, the transaction should be deemed a contribution without donor-imposed conditions.

In the case of ambiguous donor stipulations, a contribution containing stipulations that are not clearly unconditional should be presumed to be a conditional contribution.

If a contribution has been deemed to be unconditional, the entity should then consider whether the contribution is restricted on the basis of the existing definition of the term "donor-imposed restriction." The definition of a donor-imposed restriction includes a consideration of how broad or how narrow the purpose of the agreement is, and whether the resources are available for use only after a specified date.

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**FINAL ASU 2018-08****Simultaneous Release Option**

The ASU provides a nonprofit entity with the ability to elect a policy to report donor-restricted contributions whose restrictions are met in the same reporting period as the revenue is recognized as support within net assets without donor restrictions. To do this the entity must have a similar policy for reporting investment gains and income, report consistently from period to period and disclose its accounting policy. If this policy is elected for donor-restricted contributions that were initially conditional contributions, they may do so without electing this for other donor-restricted contributions. The election of this policy has to be used consistently from year to year and be disclosed.

**TRANSITION**

The amendments in the ASU should be applied on a modified prospective basis; however, retrospective application is permitted as well.

In the financial statements in the year of adopting the ASU under the modified prospective basis the amendments should be applied to all agreements that are either not completed as of the effective date or entered into after the effective date. A completed agreement is an agreement for which all revenue (of a recipient) or expense (of a resource provider) has been recognized before the effective date under the current guidance. The amendments in the ASU should be applied only to the portion of revenue or expense that has not yet been recognized under current guidance before the effective date of the ASU. No prior period statements should be restated and there should be no cumulative effect to opening net assets or retained earnings balances at the beginning of the year of adoption. Standard disclosures for the accounting change should be included in the footnotes in the year of adoption. The ASU contains additional clarifying transition guidance to assist entities if they choose this adoption basis.

**EFFECTIVE DATE**

The effective dates vary depending on whether you are a resource recipient or resource provider and the nature of the entity as outlined below. The effective dates for resource recipients were established so that the effective date of the ASU would align with the effective date of ASC Topic 606. The effective dates for resource providers was delayed by one year. Early adoption of the ASU is permitted.

**Resource Recipient**

Public business entities and nonprofits that have issued, or are a conduit bond obligor for, securities that are traded, listed or quoted on an exchange or over-the-counter market should apply the amendments in the ASU on contributions received to annual periods beginning after June 15, 2018.

All others should apply the amendments for transactions in which the entity serves as a resource recipient to annual periods after Dec. 15, 2018.

**Resource Provider**

Public business entities and nonprofits that have issued, or are a conduit bond obligor for, securities that are traded, listed or quoted on an exchange or over-the-counter market should apply the amendments in the ASU for transactions in which the entity serves as a resource provider to annual periods beginning after Dec. 15, 2018.

All other entities should apply the ASU for transactions in which the entity serves as the resource provider to annual periods beginning after Dec. 15, 2019.

**CONCLUSION**

The ASU contains implementation guidance and practical illustrations to assist with the implementation.

The ASU will likely result in more grants and contracts being accounted for as unconditional or conditional contributions rather than exchange transactions compared to current guidance.

For a more in-depth discussion of the ASU, you can access the BDO archived webinar entitled, *New Accounting Guidance for Accounting for Contributions Received or Made*, [here](#).



For more information, contact [Lee Klumpp](#), partner, at [lklumpp@bdo.com](mailto:lklumpp@bdo.com).





## ARE GRANTS SUBJECT TO REVENUE RECOGNITION?

By Lee Klumpp, CPA, CGMA

### The FASB clarifies longstanding question for nonprofits.

Nonprofits received long-awaited clarification on a key accounting question from the Financial Accounting Standards Board. As discussed in the article on page 1, the FASB released a final accounting standards update (ASU), *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The ASU aims to standardize how grants and other contracts are classified across the sector, as either an exchange transaction or a contribution.

Classifying grants as either a contribution or exchange transaction is the first step in implementing revenue recognition. The clarified guidance in ASU 2018-08 aims to help nonprofits complete that first step in a consistent way across the sector.

This article outlines a practical example of the process to evaluate a grant under the new ASU.

### PRACTICAL EXAMPLE: HOW TO EVALUATE A GRANT UNDER THE NEW GUIDANCE

**Description of 'Nonprofit A':** A large research association that specializes in space exploration. Its mission is advancing scientific discoveries and supporting the advancement of new technology. The organization receives funding from various individuals, corporations and governments to support its efforts.

**Description of the grant:** Nonprofit A received a \$15 million grant from the federal government to finance the costs of a research initiative to test the effectiveness of newly developed technology.

**How should Nonprofit A classify the \$15 million grant?** This grant could be classified as either an exchange transaction or a contribution, depending on the exact parameters of the funding. Let's examine both scenarios:

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## GRANTS

	Classify the grant as an exchange transaction if:	Classify the grant as a contribution if:
Specific provisions of the grant	<p>The resources are paid by the federal government as the work is incurred (cost reimbursement) and request for payment is submitted. The federal government specifies the protocol of the testing, material the technology is made of, and the type and duration of testing that must take place.</p> <p>The federal government requires a detailed report of the test outcome within two months of its conclusion and any intellectual property (IP) as a result of the grant belongs to the federal government.</p>	<p>Nonprofit A makes all decisions about research protocol, material the technology is made of, and the type and duration of testing that must take place.</p> <p>In addition, the nonprofit retains all the commercial rights for any IP that is developed as a result of the research. Nonprofit A still has to produce the detailed report of the test outcome within two months.</p>
<b>Deciding factor:</b> Reason for classifying the grant as an exchange transaction or contribution	<p>This example would be an exchange transaction because of how prescriptive the grant is, and because the government owns the IP. Therefore, in this case <b>the federal government is receiving something of commensurate value.</b></p>	<p>In this scenario, the transaction would be considered a contribution because there is <b>no commensurate value being exchanged.</b></p> <p>Even though Nonprofit A is expected to produce a report, the FASB does not consider this an equal exchange of value. The ASU deems filing this type of specified report to be administrative in nature and not a performance standard.</p>
Is the grant subject to the new revenue recognition standard?	<p>Yes. All exchange transactions are subject to Accounting Standards Codification Topic 606, <i>Revenue Recognition from Contracts with Customers</i>.</p>	<p>No. The above scenario is a conditional contribution, which is not subject to revenue recognition. The condition is met as the work is incurred in accordance with the grant agreement.</p> <p>Determining whether a grant is conditional or unconditional can be difficult. The ASU states that determining if a donor-imposed condition exists is the key to determining when the contribution can be recognized as revenue. The first consideration is whether the grant agreement has a right-of-return requirement in which the grantee must return to the promisor (grantor) assets transferred as part of the agreement or a right to release of the promisor from its obligation to transfer assets. The scenario in the above does not meet any of these requirements.</p> <p>Additionally, the ASU has provided the following indicators that could create a barrier and make the grant conditional:</p> <ul style="list-style-type: none"> <li>▶ The inclusion of a measurable performance-related barrier or other measurable barrier.</li> <li>▶ Whether a stipulation is related to the purpose of the agreement.</li> <li>▶ The extent to which a stipulation limits discretion by the recipient.</li> </ul>

**Disclaimer:** These examples are for illustrative purposes only. Changing even one fact in the example could significantly change the accounting treatment.



## Nonprofit & Education Webinar Series

The BDO Institute for Nonprofit Excellence<sup>SM</sup> provides a complimentary educational series that is designed specifically for busy professionals in nonprofit and educational institutions.

Our 2018 BDO KNOWLEDGE Nonprofit and Education Webinar Series will keep you abreast of trends, timely topics and challenges that are impacting the nonprofit environment and provide you with key takeaways relevant for busy professionals working in and with nonprofit and education organizations. We invite you to take part in this program with members of your organization, including board members.

Stay tuned to the *Nonprofit Standard* blog or refer to [www.bdo.com/resource-centers/institute-for-nonprofit-excellence](http://www.bdo.com/resource-centers/institute-for-nonprofit-excellence) for further details and registration information.

10/25/2018 | 1:00 – 2:00 PM ET

Annual Nonprofit Accounting & Auditing Update

1 CPE hour

11/29/2018 | 1:00 – 2:00 PM ET

Emerging Trends in Charitable Registration

1 CPE hour

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### GRANTS

#### WHAT TYPES OF ORGANIZATIONS NEED TO TAKE ACTION?

- ▶ **Grantees:** All nonprofits that receive grants from foundations, governments or other funding entities will need to assess how they are accounting for contributions. Colleges, universities, research institutions and social services organizations that rely heavily on grants and contracts could see the greatest impact.
- ▶ **Grantors:** Non-governmental organizations like public and private foundations, as well as for-profit entities that issue grants to nonprofits, will need to think about how they write their grants and contracts.

#### WHAT ORGANIZATIONS WILL NOT EXPERIENCE A SIGNIFICANT IMPACT?

- ▶ **Public charities:** As organizations that derive the bulk of their funding from individual contributions, they will be less impacted by this guidance.
- ▶ **Local, state and federal governments:** Nonprofits will still need to assess how they classify federal and state funding, but governmental bodies are not within the FASB's scope and do not need to comply with this guidance. Governments are subject to standards issued by the Governmental Accounting Standards Board.

#### WHAT'S NEXT FOR NONPROFITS?

Accounting changes are like a relay race. Today, the FASB handed off clarified guidance on accounting for contributions and answered a long-standing question for the sector. And now it's up to nonprofits to apply it to their own books and run the rest of the race to implement revenue recognition and finish strong.



For more information, contact [Lee Klumpp](mailto:Lee.Klumpp@bdo.com), partner, at [lklumpp@bdo.com](mailto:lklumpp@bdo.com).





## IRS PROVIDES GUIDANCE ON NEW UBTI RULES

By Marc Berger, CPA, JD, LLM

On Aug. 21, 2018, the Internal Revenue Service (IRS) released [Notice 2018-67](#) (Notice), providing tax-exempt organizations and their tax advisors some much-needed guidance with respect to new Internal Revenue Code Section 512(a)(6). This is the provision in the new Tax Cuts and Jobs Act that requires calculation of unrelated business taxable income (UBTI) separately with respect to each unrelated trade or business.

While the IRS still intends to issue proposed regulations on this issue sometime in the future, the Notice provides some guidelines which will help exempt organizations compute their UBTI in the short-term.

Prior to enactment of Section 512(a)(6), organizations with multiple sources of unrelated business income calculated their UBTI by aggregating the gross income from all unrelated trades or businesses less the aggregate deductions allowed with respect to such unrelated trades or businesses. Section 512(a)(6), effective for tax years beginning after Dec. 31, 2017, requires UBTI to be calculated separately for each trade or business, and that UBTI for any such trade or business shall not be less than zero. In effect,

the provision prevents an organization from using a net loss from one trade or business to offset net income from another trade or business.

In enacting Section 512(a)(6) Congress did not provide criteria for determining whether an exempt organization has more than one unrelated trade or business or how to identify separate unrelated trades or businesses. While the proposed regulations to be issued will address these areas, the Notice provides interim guidance that exempt organizations can rely on in reporting UBTI on their 2018 Form 990-Ts, Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e)).

The Notice provides that in determining whether an exempt organization has more than one unrelated trade or business, it may rely on a reasonable, good-faith interpretation of the law considering all of the facts and circumstances, and that a reasonable good-faith interpretation includes using the North American Industry Classification System (NAICS) six-digit codes. Exempt organizations filing Form 990-T already are required to use the six-digit NAICS codes when describing the organization's unrelated trades or businesses in Block E on page 1 of the return. For example, all of an organization's advertising activities and

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## NEW UBTI RULES

related services, reported under NAICS code 541800, might be considered one unrelated trade or business activity, regardless of the source of the advertising income.

Perhaps the most important part of the Notice pertains to the reporting of an organization's income from investment partnerships. Section 512(c) requires an exempt organization that is a partner in a partnership that conducts a trade or business that is an unrelated trade or business with respect to the exempt organization to include in UBTI its distributive share of gross partnership income (and directly connected partnership deductions) from such unrelated trade or business. Reacting to comments it received from the exempt organization community regarding the potential significant reporting and administrative burden imposed by Section 512(a)(6) on exempt organizations with numerous investments in multi-tier partnership structures that generate UBTI, the IRS intends to issue proposed regulations treating certain investment activities of an exempt organization as one trade or business for purposes of Section 512(a)(6) (A). This would permit exempt organizations to aggregate gross income and directly connected deductions from such "investment activities."

Until the regulations are issued the Notice provides an **interim rule** which allows an organization to aggregate its UBTI from its interest in a single partnership with multiple trades or businesses, including trades or businesses conducted by lower-tier partnerships. The interim rule can be used as long as the directly held partnership interest meets the requirements of either the de minimis test or the control test, which provide:

**De minimis test** – The partnership interest qualifies as long as the exempt organization holds directly no more than 2 percent of the profits interest and no more than 2 percent of the capital interest. Percentage interests held by certain related organizations and individuals are included in this determination.

**Control test** – The partnership interest qualifies as long as the exempt organization (i) directly holds no more than 20% of the capital interest in the partnership; and (ii) does not have control or influence over the partnership. Similar to the de minimis test, certain related organizations and individuals are included in this determination.

In determining the exempt organization's percentage interest in the partnership for these tests, the organization may rely on the information provided to them on Schedule K-1.

The Notice provides a **transition rule** for partnership interests acquired prior to Aug. 21, 2018. This rule treats each partnership interest as a single trade or business, whether or not there is more than one trade or business conducted by the partnership or lower-tier partnerships. Thus, an exempt organization can treat each

partnership interest acquired prior to Aug. 21, 2018 as comprising a single trade or business for purposes of computing UBTI under Section 512(a)(6).

When Section 512(a)(6) was enacted organizations feared having to report and track the annual net income or loss from each partnership investment separately. The gist of these interim and transition rules is that an organization with numerous investment partnership interests may be able to aggregate and treat those investments as one trade or business under Section 512(a)(6).

The Notice also addresses several other issues relating to Section 512(a)(6), including the effect of new Section 512(a)(7), which increases UBTI for certain qualified transportation fringe benefits and qualified parking. The Notice states that UBTI created from 512(a)(7) is not income derived from an unrelated trade or business, and as a result, any amount included in UBTI under Section 512(a)(7) is not subject to Section 512(a)(6).

Along the same lines, the Notice provides that income reported as unrelated business income under Section 512(a)(4), reporting unrelated debt-financed income, 512(b)(13), reporting specified payments from controlled entities, and 512(a)(17), reporting certain insurance income, does not have a nexus to an unrelated trade or business. However, the Notice provides that aggregating income included in UBTI under these provisions "may be appropriate in certain circumstances."

Finally, the Notice sheds some light on the use of net operating loss (NOL) carryforwards from years beginning prior to the effective date of Section 512(a)(6) (Pre-2018 NOLs). These NOL carryforwards are allowed to be used against UBTI as calculated under Section 512(a)(6). The organization will first calculate UBTI for each separate trade or business under Section 512(a)(6)(A), and then apply an NOL carryforward to those trades or businesses with UBTI under Section 512(a)(6)(B). This will have the effect that post-2017 NOLs will be calculated and taken before pre-2018 NOLs (because UBTI with respect to each separate trade or business is calculated under Section 512(a)(6)(A) before calculating total UBTI under 512(a)(6)(B)).

Notice 2018-67 is a good first step in providing exempt organizations some guidance on this one provision in the new law. Stay tuned for additional guidance in the future with respect to all of the tax changes affecting exempt organizations.



For more information, contact [Marc Berger](mailto:mberger@bdo.com), national director, Nonprofit Tax Services at [mberger@bdo.com](mailto:mberger@bdo.com).



# COMPENSATION COMMITTEE WAKE-UP CALL – THE 'OTHER OBSTACLE' TO LEADERSHIP TRANSITION

By Michael Conover

**I have previously discussed the inevitable transition of numerous baby boomers holding leadership posts in nonprofit organizations. The topic has been well-covered in a variety of publications for nearly a decade.**

However, I believe the seismic shift that some have predicted has failed to materialize on a scale that was predicted. I attribute this to a variety of factors, including: delayed retirements out of financial need or resistance to change; belief that age 75 is the new 65; or just procrastination.

The slowdown in the rate of change will not soften its impact. It may intensify it. The delay on the part of these baby boomer executives and the boards to whom they report could increase the likelihood of an unexpected and disruptive leadership crisis. The problems can range from a noticeable decline in performance to an abrupt departure caused by sickness or death. Leadership changes under the best of circumstances are not 100 percent successful; thus, in crisis mode, the odds of success are much slimmer.

The other obstacle I allude to in my title is executive retirement arrangements (or lack of same). As organizations finally confront the departure of a long-tenured and critically important executive, the details of the retirement arrangements come to the forefront. This is the point at which many organizations and executives discover the price that will be paid for failing to address this important issue well in advance. Proper advance planning can not only minimize financial uncertainties for the executive and the organization that may interfere with retirement planning, but can prevent other potential and very expensive obstacles as well.

Many compensation committees have failed to proactively raise the subject of retirement plans and acknowledge the impact that they will have on an orderly retirement / leadership transition. There are a variety of reasons including: financial costs; reluctance to broach the subject of leadership change; mistaken assumptions that arrangements made many years ago will address the needs; embarrassment that arrangements are inadequate or have not been made; etc. Committee members must realize that time is not on their side for addressing retirement-related arrangements. Delaying can create many negative impacts for both the executive and the organization.

I would like to describe a few different scenarios that illustrate the types of situations we have discovered in "11th hour" reviews of retirement arrangements:

- ▶ **Plan Document Failures:** Plan documents (e.g., employment contracts, deferred compensation arrangements, life insurance plans, etc.) developed many years ago and / or those that have been drafted without the benefit of needed expertise to ensure compliance with current requirements pose potential problems to the unwary.

The inclusion of what appear to be ordinary terms in the arrangements, or the failure to include critical details, can prove disastrous in terms of potential tax liability and penalties for the executive as well as the employer. Language included to ensure that retirement resources are secure may produce inadvertent vesting of a benefit and tax liability long before it is actually available. Similarly, incorrectly structuring payments can result in an unforeseen tax liability and punitive excise tax penalties.

If these issues are identified proactively or within a time period that corrective actions can be taken, the problems can be minimized. There is, however, a point at which it is simply too late.

- ▶ **Plan Administration Failures:** In some instances, well-drafted plan documents are not adhered to from an administrative standpoint. Contributions, excess contributions, payment amounts and / or payment terms are made that fail to follow plan requirements. The failure to ensure compliance may result in adverse tax consequences to the executive and the organization.

Failure to properly recognize and report details of retirement arrangements are also common. The executive's W-2 form, personal tax return and the organization's Form 990 may all need to include information related to the plan arrangements as well as timely recognition of income when vesting occurs. Discovering these issues after the fact can necessitate amending prior year returns and also involve adverse tax consequences to the executive and the organization.

- ▶ **Improbable Catch Up:** A compensation committee's failure to establish a specific position on retirement benefits for the executive, as well as a specific objective for the level of benefits to be provided well in advance of the probable retirement event, drastically diminishes the likelihood of providing any level of benefit beyond that provided to all employees. Waiting until just a year or two prior to retirement will likely place an unreasonable financial burden on the organization to fund a benefit that might have been spread over many years of employment. Similarly, large contributions / payments

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toward the very end of employment may trigger an excess benefit situation, or the appearance of same, that may create adverse consequences for the executive and the organization.

### THE WAKE-UP CALL

Most compensation committees spend most of their time on decisions about current cash compensation (i.e., salary, bonus and incentive) matters for executives. Clearly, these are important matters and ones that require the committee's attention in light of the disclosure of this information to external stakeholders and the public. I am not suggesting the committee members spend any less time on them.

I am however suggesting that compensation committees incorporate an immediate and recurring review of the organization's retirement program to ensure that all documentation, administration and funding are in accordance with the organization's policy, on track to meet stated objectives and fully compliant with pertinent regulatory and reporting requirements. Regular checkups may also be beneficial in helping the organization to be more attentive and proactive on succession / transition needs. As we have pointed out, delay on these matters is the enemy of effective solutions.

Executive management also has a role to play in this wake up call. Steps should be taken to ensure that the compensation committee has access to all internal and external information and advice that will assist them in their efforts to ensure that all steps have been taken to ensure that the retirement arrangements pose no obstacles to the inevitable retirement and leadership succession that every organization faces.



For more information, contact Michael Conover, managing director, Specialized Tax Services – Global Employer Services, at [wconover@bdo.com](mailto:wconover@bdo.com).

# HOW PREDICTIVE ANALYTICS IS TRANSFORMING NPO FUNDRAISING

By Joe Sremack, CFE, and Gurjeet Singh, MCP

**The art of nonprofit fundraising is quickly becoming a science. Fundraising is a vital process for the mission of many nonprofit organizations (NPOs), and the better organizations are at this process, the more effective they become in their missions.**

Historically, this process consisted of following standard fundraising processes and tracking the results to periodically adjust the processes based on results. This feedback loop could take months or years; however, NPOs have begun improving this process by utilizing analytics, rather than simply responding to past results.

Perhaps the most important technological breakthrough for NPO fundraising in recent memory is predictive analytics. This technology is enabling NPOs to run more effective fundraising campaigns and quickly boost their fundraising results. Rather than relying on evaluating the effectiveness of past fundraising efforts and basing decisions on opinions and experience, predictive analytics provide guidance on what will likely be the most effective campaigns, whom to target and how to allocate resources to maximize fundraising results. This article discusses how predictive analytics works and several ways it can be employed to enhance your fundraising efforts.

### WHAT IS PREDICTIVE ANALYTICS AND HOW DOES IT FIT WITHIN NPOS?

Predictive analytics is a set of techniques and technologies that extract information from data to identify patterns and predict future outcomes. Based on a variety of statistical techniques and software technology, predictive analytics helps to understand the relationships between data points, and identify patterns within the data, as well as factors contributing to the prediction. This whole analysis can be configured to show prediction based on various factors and can be refined further over time as more information is included in the analysis.

Predictive analytics is being employed across numerous industries, including nonprofits. The most common examples of predictive analytics are found in data-centric industries—such as tech firms, finance, and insurance—where data is readily available and the ability to predict outcomes directly relates to the financial success of those organizations. The same is true of NPOs. While NPOs may or may not collect millions of records across hundreds of data points, they do collect a sufficient amount of donor information, marketing touch-point records, and other information that can be utilized for predictive analytics, and that predictive ability can make a significant difference in fundraising efforts.

NPOs are uniquely positioned to benefit from predictive analytics. Most NPOs house the kind of data that can fuel detailed analysis, which results in actionable insights. They have donor information that often includes a wide array of demographic information, historical behavior information and information about how donors responded to past fundraising campaigns. This type and breadth of information can quickly be converted into predictions and more effective fundraising campaigns. Even if the NPO only has hundreds or thousands of donor records—as opposed to hundreds of thousands or more—that is sufficient for creating effective predictive analyses.

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## PREDICTIVE ANALYTICS

### HOW PREDICTIVE ANALYTICS WORKS

In the traditional fundraising process, several steps are typically employed across different layers of an NPO's data. First, key donors are identified and targeted. This may be done based on selecting key individual donors, by a prior donation level threshold, and/or demographic information. Next, past campaigns are assessed, and new campaigns may be discussed and evaluated. Finally, a plan is developed and executed to drive fundraising. For this entire process, the rigor of data analysis and the evaluation of past campaign effectiveness may vary by organization but, at a high level, the processes are similar: organizations make use of data and personal judgment to drive future fundraising efforts.

The predictive analytics process runs alongside this methodology to augment it, which acts as an advisor to existing activities and decision-making processes. Predictive analytics offers a way to look at the information in a new way by incorporating your existing methods and institutional knowledge. Predictive analytics can be run parallel to your process to offer new ideas, prove or disprove existing ideas and approaches, and provide a way to gauge how effective new approaches to fundraising will be.

A major misconception about predictive analytics is that it can replace a fundraising team or will serve as a stand-alone fundraising strategy function. A predictive analytic model is only as effective as the information and guidance that is provided to it, and performing predictive analytics effectively requires institutional knowledge and refinement. Predictive analytics is a statistical and technological way to utilize data based on institutional knowledge, so it is useful only if it is designed, implemented and evaluated by data and industry experts.

A typical scenario for NPOs to implement predictive analytics is when an NPO recognizes that its fundraising efforts could be improved. They currently may have sufficient data to understand what worked well in the past, but they often rely on comparisons between past approaches and new approaches, market research

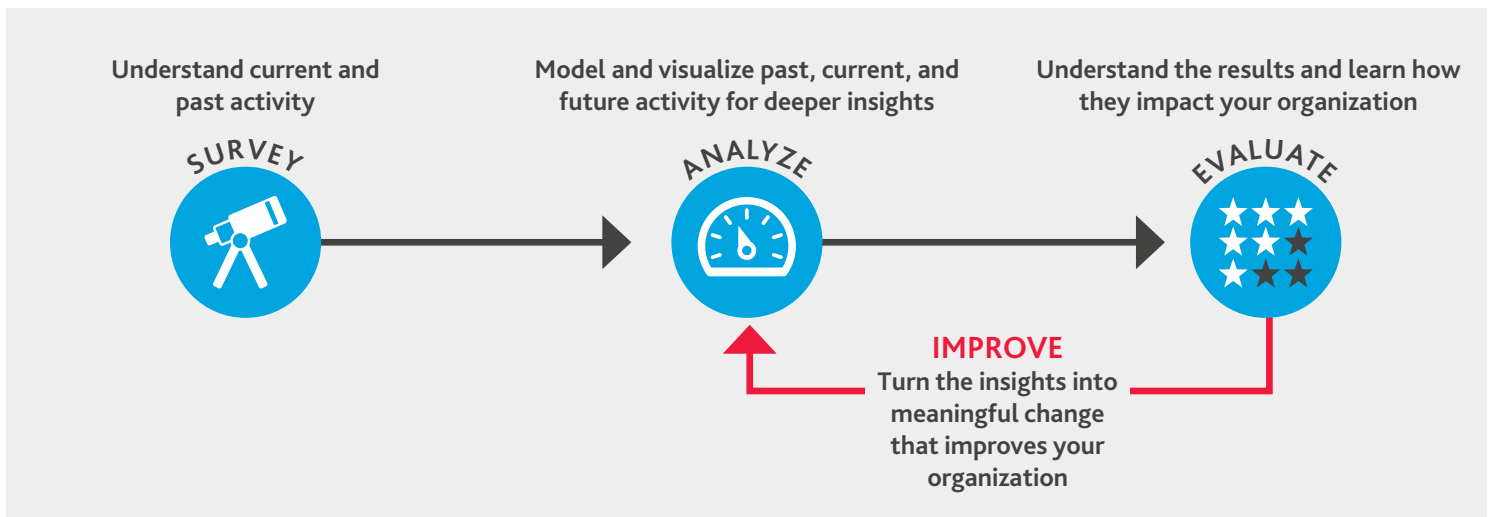
### When Should NPOs Consider Predictive Analytics?



- ▶ Seeking to improve fundraising results
- ▶ Facing competition for donors
- ▶ Fundraising efforts not meeting goals and objectives
- ▶ Exploring opportunities for new or enhanced fundraising campaigns
- ▶ Shrinking donor base or difficulty reaching your donors

and small test campaigns for evaluating new ways to raise funds. They also recognize that these techniques test ideas and require an investment of time and resources, which may not deliver the level of results they want. This leads them to work with a data science team or a predictive analytics software package to improve their process. This begins the predictive analytics development, which may produce immediate results.

The predictive analytics process involves several steps. First, the organization's goals are outlined and historical data is surveyed to map the goals to key data points. In this step, the organization determines which questions it wants answered and whether the data it needs is available. Next, a predictive model is developed, and the data is analyzed and visualized to derive insights. This step is where forward-looking analyses and findings are derived from historical data, and it involves specialized analysis using specialized software and/or custom-developed logic in a programming language, such as Python or R. The results are next evaluated to determine whether the analysis was effective and, if so, how to apply the findings for meaningful actions. Finally, an iterative process of refining and re-running the analysis is performed based on the findings and changes. These steps are outlined below:





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## PREDICTIVE ANALYTICS

### WHAT CAN NPOS PREDICT?

One way that NPOs can increase fundraising results is by using predictive analytics to identify the people who are most likely to donate as well as those who will not. Through this analysis, NPOs can identify potential donors based on utilizing past donor information to identify the characteristics that most accurately determine whether someone donates. Unlike traditional analysis methods that only examine past donation information, predictive analytics leverages information—such as age, income, lifestyle, past donation information and associations to NPOs with similar missions—to pinpoint donors. With this information, NPOs can more precisely target a pool of potential donors to maximize fundraising results.

For example, an NPO with a list of 3,000 past donors and 2,500 potential donors may only be able to directly contact 2,000 donors through in-person meetings, phone calls and/or direct/digital mailing due to budget constraints. Because of this constraint and the need to maximize fundraising, the NPO wants to know which of the 5,500 potential donors to contact. The NPO utilizes predictive analytics to assign a donation probability to each potential donor based on historical donation information and each potential donor's characteristics to then target only the donors with a high probability. This helps reduce the overhead of devoting resources to individuals or groups who are unlikely to donate and maximizes the donor conversion rate.

In addition to discovering the likelihood of donations, predictive analytics can be used to predict donation amounts. Analyzing donors for both their donation likelihood and predictive donation amount further helps NPOs identify key donor targets. An NPO may not get much value from identifying donors if they will donate in small amounts or if there is a high degree of donation amount variability. Instead, predictive analytics can be performed that assigns both a donation probability and an expected donation amount if they donate. This is an expected value for donors, and

this information can be calculated to optimize the fundraising campaign. If an NPO identifies five high-value donors who only have a 40 percent donation probability, targeting those may still be more valuable than pursuing five low-value donors who have a greater than 90 percent probability of donating.

Predictive analytics can be applied to almost any area of NPO operations. While improving fundraising is often the first goal, predictive analytics can be used to improve other areas of the organization. Several examples of these are:

- ▶ Mission-specific goals
- ▶ Operational performance
- ▶ Cost forecasting
- ▶ Community and government outreach

### CONCLUSION

Predictive analytics is an important method for improving your fundraising process. Just as major retailers, financial institutions and healthcare companies are utilizing predictive analytics to maximize revenue and reduce costs, NPOs have an opportunity to make use of this technology within their own organizations. Regardless of the volume of fundraising you are doing or the makeup of your donors, you can benefit from applying predictive analytics.



For more information, contact [Joe Sremack](mailto:jsremack@bdo.com), director, Data Analytics & Automation, at [jsremack@bdo.com](mailto:jsremack@bdo.com) or



[Gurjeet Singh](mailto:gsingh@bdo.com), senior manager, Data Analytics & Automation, at [gsingh@bdo.com](mailto:gsingh@bdo.com).

# IDENTIFYING AND OVERCOMING COMMON NONPROFIT CHALLENGES

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

**Nonprofit organizations are uniquely shaped by their mission, history, size, program goals and community.**

But leaders of these organizations—whether a CFO at a global health services charity, a CIO of an education endowment or the executive director at a museum—share a common goal of advancing their organization's mission. To drive forward progress, it's essential that leaders understand where their organization sits in relation to its peers on objective measures of performance.

The BDO Institute for Nonprofit Excellence's 2018 benchmarking survey, [Nonprofit Standards](#), surveyed leaders at midrange organizations (those with less than \$25 million in annual revenue), upper-midrange organizations (\$25-\$75 million in annual revenue), and large nonprofits (above \$75 million in revenue) to reveal insights nonprofits can leverage to strengthen their organization. Across the spectrum, the report finds that upper-midrange organizations face more significant challenges than their smaller and larger peers.

## FUNDING CHALLENGES AMID RISING COSTS

While 56 percent of upper-midrange nonprofits saw their revenues grow over the past year, this was dwarfed by the 69 percent of large nonprofits and 70 percent of midrange nonprofits that also saw some revenue growth. At the same time, nearly half (49 percent) say declining revenue and funding is at least a moderate challenge, compared to 45 percent of midrange and large organizations. Perhaps as a result of this challenge, 49 percent of organizations at this scale maintain six months or less of operating reserves, and one third cite maintaining adequate liquidity as a moderate or significant challenge—indicating a potential gap in the fiscal safety net for these organizations.

Some of the funding challenges upper-midrange nonprofits face may be attributable to the types of funding sources these organizations rely upon, including individual contributions (15 percent), government grants (12.6 percent), fundraising/special events (11.4 percent), and corporate contributions (7.8 percent)—all of which can be either cyclical in nature or impacted by regulatory changes, such as tax reform.

Nevertheless, amid these challenges in securing funding, upper-midrange nonprofits face the same challenges as all other organization sizes in addressing rising overhead costs: 58 percent of upper-midrange nonprofits and nonprofits overall say rising costs is at least a moderate challenge.



## PROGRAM GROWTH EMPHASIZES IMPORTANCE OF COMMUNICATING IMPACT

Despite challenges in securing funding, upper-midrange nonprofits are working to expand their program offerings and deliver on their core mission. Organizations in the upper-midrange devote 80 percent of their total expenditures to program-related activities—compared to 78 percent for large nonprofits and 68 percent for midrange nonprofits. Forty-two percent of upper-midrange nonprofits also say the inability to meet demand for their services is a high or moderate challenge, and 58 percent are responding by planning to introduce new programs in the next year without eliminating others.

This program expansion makes demonstrating impact to stakeholders more important than ever. When it comes to making an impact, nearly all nonprofits surveyed (93 percent) communicate their impact outside of the organization; meanwhile, 72 percent of upper-midrange nonprofits say some portion of their donors have demanded more information about outcomes and impact than before.

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## NONPROFIT CHALLENGES

But as nonprofit leaders know all too well, reporting impact to donors and other stakeholders is no easy task. Organizations in the upper-midrange are more likely than midrange or large nonprofits to say they face moderate or significant challenges in reporting impact, including having no consistent framework for measuring and reporting (66 percent vs. 56 and 53 percent, respectively), lacking clear program objectives and/or key performance indicators (55 percent vs. 43 and 41 percent, respectively), and inadequate financial resources devoted to reporting (55 percent vs. 31 and 33 percent, respectively).

### RECRUITMENT AND RETENTION CHALLENGE UPPER-MIDRANGE ORGANIZATIONS

Nonprofits derive their strength from dedicated and driven employees, yet recruitment and retention remain a high or moderate challenge for 6 in 10 nonprofit leaders. Upper-midrange nonprofits are the most concerned, with 70 percent citing recruitment and retention as a high or moderate challenge, compared to 61 percent of large organizations and only 35 percent of midrange organizations.

Key factors in keeping employees engaged and growing employee satisfaction levels for all organizations include having competitive compensation levels (59 percent), up-to-date technology (58 percent), internal communications (54 percent), and management-employee relations (51 percent). These challenges were all most pronounced among upper-mid-sized organizations. While 7 in 10 midrange nonprofits were able to provide at least a 3 percent increase in employee compensation levels within the last year, only 44 percent of upper-midrange and large nonprofits were able to do the same.

### OVERCOMING KEY CHALLENGES: PLANNING AHEAD

Do the data show that upper-midrange nonprofits are doomed? Not at all. Instead, this year's *Nonprofit Standards* highlights the success of many nonprofits that were able to overcome these classic scaling challenges to grow successfully and expand their programs.

While not comprehensive, below are some best practices for organizations looking to overcome these challenges.

**Fundraising Effectiveness:** Nonprofits looking to increase their fundraising effectiveness should:

- ▶ **Match their donor behavior.** Nonprofits should consider what influences their donors to donate in general—and to their organization specifically—and tailor their messaging accordingly.
- ▶ **Reduce their giving barriers.** It's critical that organizations regularly update and modernize their donation channels

(including online and mobile giving platforms) to keep pace with changing consumer behavior.

- ▶ **Leverage data analytics.** Nonprofits should dig into their own data to understand the demographics of their core contributors and to identify new prospects. (See the article on page 10 entitled, *How Predictive Analytics is Transforming NPO Fundraising*.)

**Donor Communications & Impact Reporting:** To ensure smoother donor communications and reporting, nonprofits should:

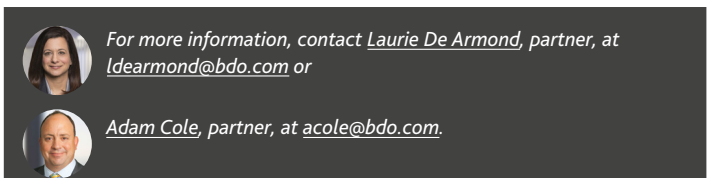
- ▶ **Start with the end in mind.** Organizations should identify the story they want to tell their stakeholders and paint a vision of what the world could look like if their mission were achieved.
- ▶ **Make reporting an ongoing process.** Nonprofits should gather and report data on a quarterly or monthly basis to keep stakeholders in the loop and make year-end reports less daunting.
- ▶ **Remain transparent.** Nonprofit reports offer an unparalleled opportunity to contextualize an organization's metrics and finances.
- ▶ **Share their report widely.** Organizations should distribute their report via multiple channels so both existing and prospective donors have a chance to see it.

**Staffing and Recruiting:** To maintain and attract top talent, nonprofits should:

- ▶ **Stay competitive in their local market.** Nonprofits should ensure their policies make their organization an attractive place for potential employees.
- ▶ **Capitalize on flexible work options.** Remote work arrangements can be both beneficial to employees and cost-effective for organizations.
- ▶ **Remain proactive about succession planning.** With 4 million baby boomers retiring each year, the need for a succession plan is a "when" rather than an "if" scenario.

The more upper-midrange nonprofits—and those of all sizes—can learn from benchmarking against their peers, the better prepared they will be to advance their mission and support continued growth. Gaining intelligence is vital to staying afloat.

*Adapted from article originally published in NC State University's Philanthropy Journal News.*





# SIGNIFICANT RULE CHANGE FOR CERTAIN TAX-EXEMPT ORGANIZATIONS REPORTING DONOR INFORMATION

By Marc Berger, CPA, JD, LLM

On July 16, 2018, the Internal Revenue Service (IRS) released Revenue Procedure 2018-38, modifying the information reported to the IRS by certain tax-exempt organizations on their annual Form 990 or Form 990-EZ information return. Affected organizations will no longer be required to report the names and addresses of their reportable contributors on Schedule B of their Forms 990 or 990-EZ.

This change affects all organizations that are tax-exempt under Section 501(c), other than charitable organizations described under Section 501(c)(3). This includes labor unions, trade associations, social welfare groups, issue-advocacy groups, local chambers of commerce and veteran groups. Nevertheless, Section 527 political organizations, like charitable organizations, will still be required to report the names and addresses of their reportable contributors on their annual returns.

The reasons provided by the IRS for the change include decreased compliance costs for affected organizations, reduced consumption of IRS resources in connection with the redaction of such information and reduced risk of the inadvertent disclosure of information that's not open to public inspection.

The tax-exempt organizations relieved of the obligation to report the names and addresses of their contributors must continue to keep this information in their books and records in case the IRS wishes to examine this information. In addition, the change does not affect the reporting of contribution information on Schedule B, other than the names and addresses of contributors, including the dollar amount of contributions.

The revised reporting requirements apply to information returns for tax years ending on or after Dec. 31, 2018. Thus, the revised requirements generally will apply to returns that become due on or after May 15, 2019.

## IMPLICATIONS FOR NONPROFITS

Reactions to the new rules from those affected are strong.

### Advocates claim it as an important win that supports:

- ▶ **Data privacy:** While the IRS isn't allowed to disclose confidential donor information, it has inadvertently done so in the past. Eliminating this information from tax filings will reduce the chances it may be accidentally released or fall into the wrong hands.

- ▶ **Free speech:** Free-speech advocates believe donor information should be kept private, so that it can't be used by the government to target donors. For example, the IRS was previously accused of unfairly targeting Tea Party and progressive groups.

### Critics express several concerns:

- ▶ **Hampers fraud detection:** The IRS may not need donor information for tax administration purposes, but it is useful for detecting fraud. The government will now have no means to track how cash is being funneled into these tax-exempt organizations, leaving the door open to potentially dangerous and foreign influences.
- ▶ **Reduces fiscal transparency:** The move is a major setback for those who champion more transparency around political donations. While donor information was never disclosed to the public, the government will now remain in the dark about how foreign actors might be influencing the political landscape.

Regardless of the new guidance, all tax-exempt organizations should still diligently collect information about their donors to prepare for a potential audit or change of course by the IRS down the road.

*Reprinted from the Nonprofit Standard blog.*



For more information, contact [Marc Berger](#), national director, Nonprofit Tax Services at [mberger@bdo.com](mailto:mberger@bdo.com).

## INSTITUTE PERSONNEL CONTACTS:

### WILLIAM EISIG

Atlantic Managing Partner,  
Executive Director, BDO Institute for  
Nonprofit Excellence<sup>SM</sup>  
703-336-1401 / weisig@bdo.com

### MARC BERGER

Director, Nonprofit Tax Services, BDO  
Institute for Nonprofit Excellence<sup>SM</sup>  
703-336-1420 / mberger@bdo.com

### PATRICIA DUPERRON

Director, National Governmental  
Assurance Practice, BDO Institute for  
Nonprofit Excellence<sup>SM</sup>  
616-776-3692 / pduperron@bdo.com

### DICK LARKIN

Director, National Nonprofit  
Assurance Practice, BDO Institute for  
Nonprofit Excellence<sup>SM</sup>  
703-336-1500 / dlarkin@bdo.com

### LEE KLUMPP

National Assurance Partner, BDO Institute  
for Nonprofit Excellence<sup>SM</sup>  
703-336-1497 / lkumpp@bdo.com

### TAMMY RICCIARDELLA

Director, National Nonprofit  
Assurance Practice, BDO Institute for  
Nonprofit Excellence<sup>SM</sup>  
703-336-1531 / tricciardella@bdo.com

### ANDREA WILSON

Partner, Nonprofit and Education Advisory  
Services, BDO Institute for Nonprofit  
Excellence<sup>SM</sup>  
703-752-2784 / aewilson@bdo.com

For more information on BDO USA's service offerings to this industry, please contact one of the following national practice leaders who will direct your inquiry to the appropriate partner in your market:

### WILLIAM EISIG

Executive Director, BDO Institute for  
Nonprofit Excellence<sup>SM</sup>  
703-336-1401 / weisig@bdo.com

### LAURIE DE ARMOND

Partner and National Co-Leader,  
Nonprofit & Education Practice  
703-336-1453 / ldearmond@bdo.com

### ADAM COLE

Partner and National Co-Leader,  
Nonprofit & Education Practice  
212-885-8327 / acole@bdo.com

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