Look before you leap: Key considerations when seeking loans

Teaming up
How to handle financial reporting for two

The tax side of transportation benefits: Are you up to speed?

Newsbits

Profitable Solutions for Nonprofits

New Orleans | Houston | Baton Rouge | Covington | Houma
Check out our Nonprofit Industry Group page and nonprofit blog. laporte.com/industry/nonprofit
Look before you leap: Key considerations when seeking loans

For-profit businesses aren’t the only organizations that can find themselves in need of a loan. Nonprofits also may land in situations that call for relatively quick cash. If your organization is in such a spot, consider the decision to borrow carefully.

Loans vs. other funding sources

The primary drawback to a loan is that you must pay it back. That’s generally not a concern with donations or grants, assuming you meet the performance obligations.

Other hurdles include having to pay interest. And rates for nonprofits tend to be higher than those for businesses, as the loans are considered riskier since nonprofits often don’t have comparable financial resources. The fees associated with certain loans — for example, appraisals, closing costs and attorneys’ fees — pile up quickly, and you may be required to make a significant down payment.

On the other hand, once you’re approved for a loan from a reputable lender, you know you’ll get the funds. And applying for a loan generally requires less time and effort than applying for grants, holding fundraising events or wooing major donors. You’ll usually get the money sooner, too.

Right — and wrong — times to borrow

Many nonprofits operate in environments where revenues peak and dip throughout the year. Many bills and expenses don’t match up to this cycle, though, which can lead to cash flow crunches. For example, nonprofits often see a big jump in

Credible lenders will review at least three financial ratios when determining whether to make your organization a loan. Following are the most common:

The loan-to-value (LTV) ratio is often used when financing a capital asset. It compares the value of the property that’s the collateral for the loan with the loan amount. Because loans to nonprofits are viewed as higher risk (especially in the absence of a loan guarantor), lenders usually require an LTV ratio of 70% or lower.

The debt coverage ratio (DCR) measures the cash flow available to service the proposed debt. It compares the available operating income with the new debt, including principal and interest payments. Nonprofits are more likely to qualify for a loan if their DCR is at least 1.20.

The debt-to-income (DTI) ratio is an easy representation of the loan amount you’re requesting compared with your total revenue. Lenders generally frown on nonprofit DTI ratios showing the new loan greater than 3.0 to 3.5 times annual revenues.
donations around year end or receive grants in lump sums. A revolving line of credit may be the type of loan to provide needed liquidity in these situations.

Cash flow issues also can arise less predictably. A previously reliable funding source might dry up with little to no notice. Or a natural disaster could hit at a time when cash reserves are low. In such circumstances, you may want to consider a bridge loan, typically lasting no longer than one year. Bridge loans are used to fill a funding gap until more permanent financing is secured or a financial obligation is satisfied.

Longer-term loans can be an option for capital purchases (for example, equipment or facilities upgrades) or projects such as a new building. You may intend to finance the project with a capital campaign. However, campaigns can take longer than anticipated, and pledges might not materialize. A loan can help you avoid delays as the project progresses.

Similarly, you can come across mission- or operations-related opportunities that require prompt action. Perhaps office space you’ve had your eye on suddenly becomes available, or you encounter an attractive strategic opportunity. Loans may prove the only way to bring such possibilities to fruition.

Of course, loans aren’t the answer to every cash gap. If you’ve been running a budget deficit for several periods, adding debt usually isn’t advisable. Even if you can obtain a loan, the interest rate likely will be quite high. You’re generally better off trimming expenses and raising revenues.

Application information

To increase your odds of securing a loan, collect necessary information before reaching out to lenders. This also will expedite the process.

Lenders generally want to see:

› Plans for the loan proceeds,
› Several years of tax filings and audited financial statements,
› Reports of pledges, receivables, accounts payable and outstanding debt,
› Descriptions of major funding sources, and
› A board resolution approving the loan.

Additionally, you may also need to have on hand information about your organization’s history (including articles of incorporation and bylaws), short- and long-term strategic plans, programs, funding, management, and the board of directors. Finally, prepare cash flow projections showing a repayment plan.

Don’t wait

The types of information required to obtain a loan demonstrate how important it is for nonprofits to maintain accurate records and prudently manage financial resources. These practices are critical for every organization, but you’ll be glad to have followed them consistently if your nonprofit ever needs to borrow.
Teaming up
How to handle financial reporting for two

So, you’ve recently joined forces with another entity to boost efficiency, save money and better serve your constituencies. Sounds like a smart move. But does your accounting staff know how to report the activities of the two organizations? Much will depend on the nature of your new relationship.

How should you approach collaborative arrangements?

The simplest relationship between nonprofits for accounting purposes may be a collaborative arrangement. These are typically contractual agreements in which two or more organizations are active participants in a joint operating activity. Both entities are vulnerable to risks and rewards that hinge on the activity’s commercial success.

Costs incurred, and revenues generated from transactions with third parties, should be reported, on a gross basis in its statement of activities, by the not-for-profit that’s considered the “principal” for the specific transaction. The principal is usually the entity that has control of the goods or services provided in the transaction. Follow Generally Accepted Accounting Principles (GAAP) for your situation.

Payments between participants are presented according to their “nature,” following accounting guidance for the type of revenue or expense the transaction involves. Participants in collaborative arrangements also must make certain financial statement disclosures, such as the purpose of the arrangement and each organization’s related rights and obligations.

And if one organization relinquishes control?

Another collaborative option is for the board of one organization to cede control of its operations to another entity (for example, by allowing the other organization to appoint the majority of its board) as part of its decision to engage in the cooperative activity. A new legal entity isn’t created. In fact, an acquisition has taken place. The remaining organization is considered the acquirer. The remaining entity must determine how to record the acquisition based on the fair value of the assets and liabilities of the nonprofit acquired.

If the value of the assets net of the liabilities received is greater than the amount paid in the acquisition transaction, the difference should be recorded as a contribution. If the value is lower than the price paid by the acquirer, the difference is generally recorded as goodwill. But, if the operations of the acquired organization are expected to be predominantly supported by contributions and return on investments, the difference should be recorded as a separate charge in the acquirer’s statement of activities.

What if your nonprofit assumes control of the other entity, and GAAP requires you to present consolidated financial statements? In this situation, you must
account for your interest in the other organization and the cooperative activity by applying an acquisition method described in GAAP.

If it’s your not-for-profit that cedes control of its operations to another entity, that organization may need to consolidate your nonprofit (including the cooperative activity) beginning on the “acquisition” date. If your nonprofit will present separate financial statements, you must determine whether to establish a new basis for reporting assets and liabilities based on the other entity’s basis.

In many cases, if a new legal entity is formed, it’s used only to house the cooperative activity instead of all activities of the organizations that are collaborating. This would be neither a merger nor an acquisition. But to determine the proper accounting treatment, it’s important to look at which, if any, collaborator has control over the activity.

What about mergers?
In some circumstances, two organizations may determine that the best route forward is to form a new legal entity. A merger takes place when the boards of directors of both nonprofits cede control of themselves to the new entity.

In these situations, the organizations’ assets and liabilities are combined as of the merger date. The accounting policies of the original entities must be conformed for the new entity.

New world order
In your new collaborative world, financial reporting will be different for you than it’s been in the past. Accounting rules can be complicated, but not impossible. Your CPA can help you navigate the new waters.

The tax side of transportation benefits: Are you up to speed?
The Tax Cuts and Jobs Act (TCJA) included several provisions of interest to nonprofits, including one that dramatically altered the treatment of so-called “qualified transportation fringes” (QTFs). With the new rules now in place for a full tax year and IRS guidance issued, some organizations may need to learn how the latest revisions are likely to affect their bottom lines.

New treatment
Pre-TCJA, for-profit and nonprofit employers could offer employees tax-free QTFs such as certain parking arrangements, van pools and transit passes. For-profit employers could deduct the benefits provided. The amount excluded from an employee’s taxable income was subject to an inflation-adjusted limit, with excess amounts taxable.

QTFs remain tax-free for employees under the TCJA. (The limit for 2019 is $265 per month.) However, nonprofits generally must treat the associated expenses as unrelated business taxable income (UBTI), taxed at the corporate rate of 21%. Your organization also might incur state income tax liability if you provide the benefits. (The TCJA suspends the exclusion of qualified bicycle commuting reimbursements from employee income until 2026, too.)
Calculation of UBTI increase
In late 2018, the IRS released interim guidance to help nonprofits determine how much they must increase their UBTI if they offer qualified parking benefits. “Qualified parking” refers to parking provided near the business premises or at a location from which the employee commutes to work (other than home). You can provide it on property you own or lease.

The guidance indicates that, until the IRS issues proposed regulations (not published as of this writing), nonprofits that own or lease facilities where their workers park may use any “reasonable method” to determine the additional UBTI. It provides a four-step “safe harbor” method the IRS will automatically deem reasonable.

The IRS also warns against some prohibited activities. For example, using the value of employee parking rather than actual costs to determine expenses allocable to employee parking in an owned or leased facility isn’t considered a reasonable method. Also, for tax years starting on or after January 1, 2019, a method that doesn’t allocate any expenses to parking spaces reserved for employees isn’t considered reasonable.

If you pay a third party to provide parking in a lot or garage for your employees, the increase in UBTI generally equals your total annual cost. But, remember that, if the per-spot fee exceeds the per-employee monthly limit on income exclusion, the excess is taxable compensation for the employee and doesn’t increase your UBTI.

Several clarifications
Importantly, the guidance makes clear that an increase to UBTI due to QTFs doesn’t constitute an unrelated trade or business. As a result, if your organization has only one unrelated trade or business, and it has more deductions than gross income, you can offset the increase in UBTI from QTFs with those excess deductions.

The guidance also clarifies the effect of UBTI increases on the requirement to file Form 990-T, “Exempt Organization Business Income Tax Return.” It explains that amounts that increase UBTI should be included when determining whether you exceed the $1,000 gross income threshold that mandates filing.

Next steps
A January 2019 study commissioned by Independent Sector found that the new tax on QTFs will divert an average of $12,000 per year from a nonprofit’s budget. About 10% of the more than 700 nonprofits surveyed were considering dropping the benefits. QTFs can provide a valuable competitive edge in a tough job market, though, and some state and local laws require such benefits. Consult with your CPA about how best to proceed.
Giving to donor-advised funds jumps

The National Philanthropic Trust (NPT), the largest U.S. donor-advised fund (DAF) sponsor, has some good news about grants to nonprofits from DAFs. It reports a 39% increase in the dollar amount of such grants made from its sponsored funds in fiscal year 2019, for a total of $1.39 billion. That represents a 28% increase in the number of grants made over the previous year. The jump aligns with reports from other DAF sponsors. Fidelity, for example, reported a 48% increase in grant-making from DAFs in the first half of 2019. And Schwab said it experienced a 33% increase in the dollars granted from DAFs in fiscal 2018.

NPT donors recommended grants to organizations in arts and education to the environment and human services. An NPT spokesperson says the figures were especially notable considering concerns about the effects of tax reform and the global economic climate.

Is your fundraising professional heading out the door?

More than half of nonprofit fundraisers plan to leave their current jobs in the next two years, according to a new survey commissioned by the Chronicle of Philanthropy and the Association of Fundraising Professionals. The survey questioned more than 1,000 fundraisers in the United States and Canada. It digs into the reasons behind the impending exodus, which can threaten organizations’ financial stability.

Many respondents cited pressure to meet unrealistic fundraising goals, low pay and frustrating organizational cultures as reasons to leave. And 30% indicate they have recently left or plan to leave the development field entirely in the next two years; 5% of the survey respondents had already left fundraising. Some of this attrition might seem tied to the retiring Baby Boomers who work in fundraising. But only 12% say they plan to retire or have other personal reasons for leaving.

Community foundation asset growth stagnant in 2018

With the investment market showing signs of increasing volatility in the past two years, community foundation assets grew less than 1% in 2018. That’s according to a new report from CF Insights, a service of Candid, the organization that resulted from the merger of the Foundation Center and GuideStar. These findings, based on research conducted annually for more than 30 years, include more than 250 community foundations, which collectively hold more than 90% of the field’s assets.

Assets of foundations with fiscal years ending in June or earlier grew 9%, but foundations operating on a calendar-year basis saw a median 3% drop in asset values from the previous year. It’s worth noting, though, that the market slowed during the second half of the year.

This publication is distributed with the understanding that the author, publisher and distributor are not rendering legal, accounting or other professional advice or opinions on specific facts or matters, and, accordingly, assume no liability whatsoever in connection with its use. ©2019
Impacts of the Tax Cuts and Jobs Act on Nonprofits

When donors gave to a charitable organization before 2018, they were able to deduct the donation from their taxes if they itemized. The changes the 2017 Tax Cuts and Jobs Act (TCJA) made to deductions resulted in a dramatic drop in the number of taxpayers for whom itemizing made sense. As a result, the number of people who included an itemized deduction for a charitable donation on their tax return declined as well, from 24% in 2017 to 8.5% in 2018.

The TCJA impacted not just taxpayers but also the nonprofits they support. Signs indicate that the TJCA is causing charitable contributions to shrink. Individual giving decreased by 3.4% in 2018 when adjusted for inflation, according to Giving USA 2019: The Annual Report on Philanthropy for the Year 2018. Most nonprofits cannot tighten their belts more, so the best way to adjust may be to revisit your fundraising strategies.

If you believe shrinking contributions are or will be affecting your nonprofit, begin planning by profiling your donor base. Along with helping assess your risk exposure, donor profiles enable more targeted fundraising. Include factors such as age, income, and giving history in those profiles. Use those categories to reach out to different donor types effectively (calls versus email versus social media).

Also, examine how well your messaging demonstrates the value of giving. Do you express donations in terms of the impact on individual lives or services? How did a contribution help your nonprofit achieve results for the year? Did a donation improve standards of living for a person or a community? Make sure that the story you tell is about the impact of the individual donation.

As the tax code changes, don’t lose sight of what has worked in the past. Make sure your board is on board with your plans and spend time cultivating your relationships. Ensure your efforts are selling the vision of your organization. Remember the saying that fundraising is really “friendraising” and is a year-round, continuous effort.

Looking Ahead

Some legislators are proposing workarounds to make charitable donations more tax-advantaged again. For now, both the increased standard deduction and many changes to the itemized deduction expire in 2025. Watch for updates as the tax code evolves.

If you are uncertain about how to plan for TCJA impacts, contact LaPorte Tax Director Bruce Prendergast, CPA, at bprendergast@laporte.com.

Established in 1946, LaPorte CPAs & Business Advisors is one of the largest independent accounting and business advisory firms in the region, serving a variety of clients, including over 250 nonprofits, from five offices in Houston and Louisiana.