Three Myths That Hurt Not-for Profit Organizations

from **AZ CPA May/June 2021**
by **ASCPA**

by Lisa B. Lumbard, CPA, CGFM

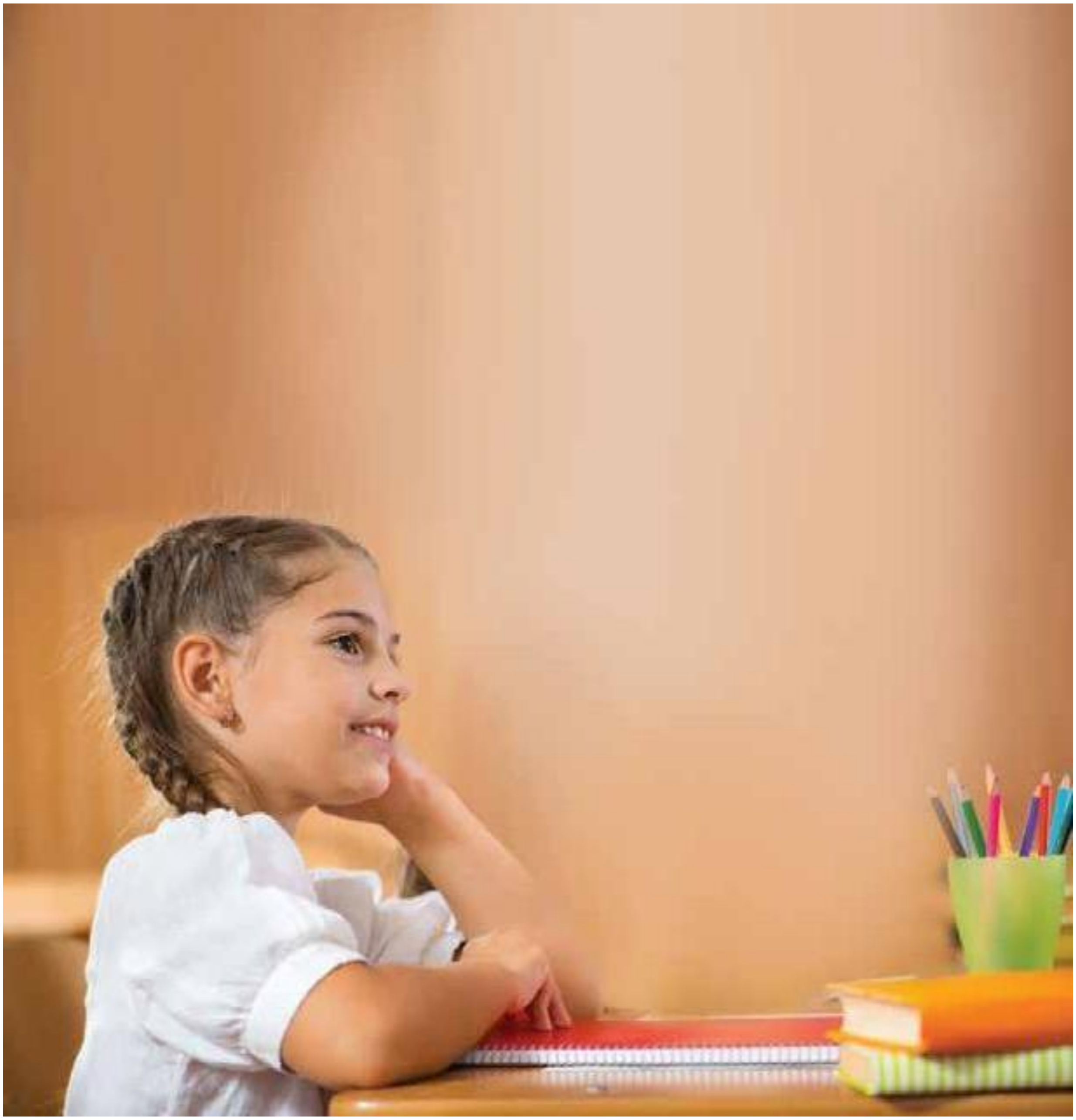
In presenting annual audit reports to not-for-profit governing boards over the past 30 years, I ran into many beliefs held by both board members and their donors that can seriously hurt the organization's ability to fulfill its cherished mission. For those readers who also work with not-for-profits, I suspect you have similar stories of your own or you will in the future!

MYTH ONE — Not-for-profit organizations will lose their tax exempt status if they make a profit

This was the loud protest I got from a panicked board member when I presented their organization's audited financial statements in which they reported a profit. As accountants, we readily understand that an organization, whether for-profit or not-for-profit, cannot provide goods and services without covering costs and making a profit. Many not-for-profits are founded by good-hearted people in response to a need. However, often they do not take into consideration that profits need to be accumulated for such things as: 1. Tax law changes, such as the increase in the standard deduction, that resulted in significant declines in contributions 2. Economic downturns that reduce contributions 3. Capital asset maintenance and replacement 4. Facility, technology and staff expansions needed to meet growth in demand for services 5. Loss of key personnel and volunteers 6. Significant events, like a pandemic which can cause both a spike in demand for services and a simultaneous reduction in revenues.

Fortunately, the United States legislature understood the necessity for profit accumulation. Between 1894 and 1969, Congress developed the basic principles and requirements of tax exemptions for charitable and voluntary organizations.

You will note throughout this article that I use the terminology “not-for profit” organizations rather than “nonprofits,” because organizations cannot survive unless they do make a profit. Some in the profession propose that it might be even clearer to simply refer to such organizations as “tax-exempt.”



MYTH TWO — The lower a not-forprofit organization’s management and general costs ratio, the better the organization

As auditors and accountants, you know the dangers of inadequate internal controls. However, this myth persists among donors, and the not-forprofits to which they contribute often perpetuate the myth by bragging about their low overhead. According to the Stanford Social Innovation Review — The Nonprofit Starvation Cycle: Organizations that build robust infrastructure – which includes sturdy information technology systems, financial systems, skills training, fundraising processes and other essential overhead – are more likely to succeed than those that do not.

In 2014, GuideStar, Charity Navigator and BBB Wise Giving Alliance issued two public letters to not-forprofits and donors asking for help in debunking this damaging myth. The letters boldly state that financial ratios

are not a proxy for overall nonprofit performance and not-for-profits need to manage with a focus on results. In 2016, the president of the National Council of Nonprofits indicated that the overhead norm should be 25 to 35 percent. Since then, I have seen recommendations as high as 43 percent, which might be appropriate for exempt organizations that rely largely on nonprofessional volunteer services that do not meet the revenue and expense reporting criteria under generally accepted accounting principles. Note: If your organization meets the thresholds for rating by Charity Navigator, check their website for all of their financial rating criteria.

Personally, any charity that claims “99 cents out of every dollar we get goes directly to programs” will not get a dime of donation from me because I will assume they are either lying or have no internal controls!

MYTH THREE — Not-for-profit organizations will lose their taxexempt status if they do any lobbying

This myth is also connected to the misconception that our legislators understand not-for-profit organizations and how essential they are to the social, physical and economic wellbeing of our country. From my personal attendance at legislative hearings, I can assure you many do not! Therefore, legislators need to be informed. Additionally, the legislators who are bold enough to propose legislation that helps not-forprofits need support at the hearings for their bills.

The IRS Form 990 defines lobbying, requires the costs of such activities to be reported on Schedule C and allows for election under Section 501(h) to define specific thresholds for organizations who spend more than minor amounts on such activities. Clearly, lobbying is allowed.

However, it is true that 501(c)(3) organizations are absolutely prohibited from directly or indirectly participating in a political campaign for (or against) any candidate for elective public office.

Did you know that the initial emergency legislation drafted to address the massive business closures from the COVID-19 pandemic left out not-for-profit employers? Thanks to the lobbying work of the National Council of Nonprofits and their state members, including the Alliance of Arizona Nonprofits, this situation was partially corrected so at least small not-for-profits could participate in the initial Paycheck Protection Program.

There is still much work to be done to educate the Federal and State legislators. The devastating impact of the increased standard deduction on contributions and the horrific costs of unemployment taxes on those not-for profits who had elected to self-insure because they had such low turnover prior to the pandemic mandated shut downs are just two such issues.

If you work in a not-for-profit organization, you are in a position to educate their leadership that lobbying is indeed permitted. If they are new to lobbying, please advise them to discuss their options and limitations with their Form 990 preparer and/or auditor.

As experienced CPAs, many key concepts like the importance of making a profit and maintaining strong internal controls in providing any service or product seem obvious to us. However, what is obvious to us, may not be obvious to many of the other good-hearted people involved in charitable organizations. Whether you are working with a not-for-profit organization as the CFO, accountant, treasurer or independent auditor, you have a valuable perspective that is of significant benefit to the not-for-profit organization! l

Lisa B. Lumbard, CPA, CGFM is the founder of Lumbard Consulting, LLC which provides not-for-profit leadership training and consulting. For 25 years, her previous firm, Lumbard & Associates, PLLC, provided single audit and other attestation services to local governments and not-for-profit organizations throughout Arizona. She currently serves on the Arizona State Board of Accountancy, the Alliance of Arizona Nonprofits Public Policy Committee and as subject matter expert, Valleywise Health Finance, Audit & Compliance Committee and the Arizona Hispanic Chamber of Commerce Finance Committee. Contact Lisa B. Lumbard at lisa@lumbardconsulting.com.

Lisa Lumbard will be presenting on the topic: The Care and Feeding of Your Not-for-Profit Leaders at the ASCPA Virtual Not-for-Profit Conference on June 24. You can register at www.ascpa.com/npc21.