Attorneys and Accountants: Playing together well in the sandbox

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Speakers

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Why does it matter how Finance and Legal interact?

- Good governance, strict compliance with the law and regulations, and effective risk management have become key elements of diligent and sustainable management.
- Organizations are expected to review and adjust their legal, accounting, finance and compliance functions for these new challenges.
- Having legal, accounting, finance and compliance function effectively depends on an environment of respect and collaboration.

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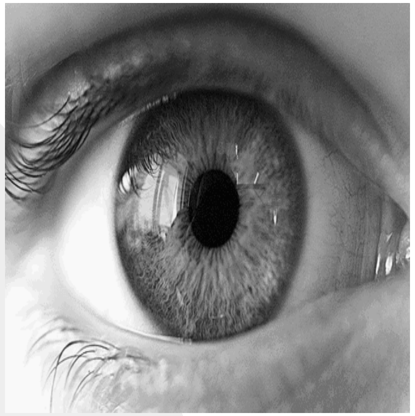
Who is watching?



- Congress
- Internal Revenue Service and other Agencies
- Federal and State Attorneys General
- Federal Funding Agencies and their Offices of Inspector General
- State Legislatures and Revenue Services
- State Charitable Solicitation Office
- Better Business Bureau, Wise Giving Alliance, Charity Navigator, Guidestar
- Donors and other Stakeholders
- The General Public
- The Media – Investigative Reporters

And some of them understand numbers!

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What Would Finance Like Attorneys to Know?

- An understanding of basic accounting and internal control environment
- How to utilize, question and understand financial reports and information when presented
- Comprehension of which types of agreements and other transactions require both Legal and Finance review
- The risk environment and corporate insurance.
- So, let's get started!

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Let’s start with language

- Difference between a fiscal year and a calendar year
- Difference between a journal and a ledger
- Difference between depreciation and amortization

Assets + Liabilities = Net Assets

An economic resource that is expected to benefit the organization in the future		Something the organization owes and represents the creditor's claim on the organization's assets		Similar to retained earnings in a for-profit entity. Net Assets represent the residual of assets over liabilities which are available for future activities or restricted by donors for a specific purpose or time
It is something that has value and the organization owns or has control of it.		Ex. Accounts payable, notes payable, salaries payable		There are no shareholders generally in NFP organizations
Ex. Cash, Investments, Inventory, Fixed Assets				The NFP organization's Net Worth

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Accounting Methods – Cash versus Accrual

Cash Basis	Accrual Basis
Recognize revenue when cash is received	General Accepted Accounting Principles (GAAP) require the use of accrual basis of accounting
Recognize expense when a cash disbursement is made	Revenues are recoded when earned and expenses are recorded when incurred.
Simple: Primarily used for small less sophisticated organizations	Complex and requires knowledge of GAAP

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Benefits of Accrual Accounting

- Assets and Liabilities are valued at either historical cost (fixed assets), amortized cost (debt) or fair value (financial assets). Changes in valuation methodologies can significantly impact the balance sheet and the statement of income and expense.
- **Record revenue** when **earned** vs. when received and **record expenses** when **incurred** v. when paid.
- Depreciation (for fixed assets)/Amortization (for intangible assets) is the process which gradually records the loss in value as the benefit of use is received. The corresponding expense related to this decrease in value is recorded as an expense over the useful life of the asset. This is a non-cash activity.

Benefits of Accrual Accounting, continued

- Balance Sheets often distinguish between "current" (something reasonably expected to be converted into cash or mature within the next year) and "non-current" (something long-term from the balance sheet date).
- A number of balance sheet accounts require estimation and/or application of judgment:
  - Allowance for uncollectible accounts - Contingencies
  - Goodwill
  - Pension Liabilities
  - Useful life of fixed assets

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About the revenue received…

- Understanding functional allocation
- Basics of fund accounting, including restricted and unrestricted net assets and releasing restrictions *
- Basic rules regarding an endowment and what CFO’s worry about.*

* subject to change with the adoption of Accounting Standards Update 2016-14

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Now we are getting into reporting

- Key items to know about/look for/what attorneys can accidentally impact in a Financial Statement
- Basics of the 990
- Spotting financial problems in a nonprofit (key items to look for that should set off alarm bells)
- The importance of financial due diligence of vendors and sponsors
- The basics of risk management and insurance

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FUNDRAISING

Finance needs to know how to book revenue, both in terms of timing and characteristics. Things to consider:

- What is a conditional promise to pay in a donor agreement v. an absolute one?
- Is it simply a promise on the donor's part? What if the donor does not pay?
- What other language in a gift instrument is important to Finance?
- What about a multi-year pledge that the organization relies on to build a building or run a program?

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FUNDRAISING, continued

Finance needs to know how to book revenue, both in terms of timing and characteristics. Things to consider:

- How does functional allocation affect a donor or corporate agreement? Who determines?
- What are the different tax treatments for sponsorship and royalties?
- What are the implications of advertising and promotion services? Does the wording in proposals and publicity make a difference?
- What else do we need to know about UBIT?

Types of Financial Statements

- ***Financial Position*** (or *Balance Sheet*) shows what the assets (things of value) and liabilities (debts) of the nonprofit were at a given point in time.

- ***Statement of Activities*** shows what comprises the revenue and expenses of the operation for a given period of time and, generally, whether there was a net gain or loss. Also includes the *Changes in Net Assets,* which is used to provide exact information on the changes in each class of net assets. It generally shows the opening balance, adds or subtracts the net change in net assets for the year (the change in net assets is calculated by adding the revenue and subtracting the expenses, and then shows the ending balance.)

- ***Statement of Cash Flows*** demonstrates where the cash came from and how cash was used.

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Audited Financial Statements

- *Statement of Functional Expenses* shows a detailed breakdown of expenses by expense type (e.g., salaries, rent, etc.) and by program and supporting services. This statement is currently only *required* for voluntary health and welfare organizations. This will be required for all nonprofits per Accounting Standards Update 2016-14, effective for fiscal years beginning after December 15, 2017.

- And now a few words about an audit…..

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Contracts Requiring Finance Review

- Leases (lessor or lessee)
- Donor Agreements
- Research or Government Grant Agreements
- Debt Agreements
- Split Interest or Trust Agreements
- Separation or Severance agreements with promise to pay (with the new rules regarding sexual harassment matters)
- Multi-year agreements
- Multi-party agreements or joint ventures with for-profits
- If payment occurs at a different time then good/services are provided

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More Considerations re contracts

- Who is responsible for and what is involved in a shared agreement between the organization and its subsidiaries or related entities?

- Which contracting/invoicing issues does Finance cares about?

Governing documents

- Who determines whether to set up a taxable subsidiary, or other related entity?
- What about changes to By-laws and Articles of Incorporation?
  - Example: California requires dissolution language.
- What do you need to know when filing IRS Form 990?

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Additional thoughts

- Who looks at changes to employee benefit plans or post-retirement benefits?
- What are warning signs that should trigger concerns or further inquiry?

Perhaps it is all about Risk Management

- What is the organization's risk tolerance?
- Who determines?
- How does insurance affect the risk environment?

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Q & A (1)

- What are good (or bad) collaborative techniques?
- How do reporting structure and division responsibilities come into play?
- How else would your organization benefit from better collaboration?

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Q & A (2)

- What would attorneys like accountants to know

Thank you!

- Please complete the upcoming survey.
- Feel free to contact us with questions.