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The 7 Most Common Nonprofit Accounting Mistakes and How to Avoid Them

As a nonprofit, part of your mission is to bring good to the community and the world at large. One important aspect of running a nonprofit is ensuring that your books and accounting are in order to help retain your nonprofit status. Accounting for nonprofits can be complicated. Here are some common mistakes when it comes to nonprofit accounting and tips to help you avoid them.

Tip #1: Not Having Formal Accounting Processes

Each nonprofit organization should have a written accounting policy that provides employees and volunteers with details on how to carry out the accounting function, including the acceptance of donations and payment of bills.

In addition, you should create internal policies and procedures that help to identify and prevent any fraudulent activity that might happen.

Having these processes in place can help to provide the public with confidence that the nonprofit is operating in the best interest of the community.

Tip #2: Recording Transactions in the Wrong Period

Nonprofit entities must follow specific timing rules when it comes to recording expenses and contributions from donors. For transactions which occur over multiple periods, expenses should be recorded in the same period that services are rendered.

For contributions that are not subject to any restrictions, donations provided over multiple years should be recorded in the year that they are initially received. Donor restrictions can change the timing of how certain donations are recorded.

Tip #3: Lapse in Reviewing Donor Restrictions

Donor restrictions can not only impact how any funds received can be used, but also how those contributions are recorded in the nonprofit organization's books and records. The contribution should be recorded as advised by the donor and any funds not used within one year should be noted as a net asset of the organization.

Tip #4: Inaccurate Reporting of In-Kind Contributions

Nonprofits in many cases rely on the services of volunteers and service providers to assist with the operations of the nonprofit. Regulations outline specific rules when it comes to recording the value of services used by nonprofits. The fair market value of services provided for specialized skills such as legal, technology, or accounting must be recorded as a contribution to the organization.

Tip #5: Misclassification of Employees

The IRS has been paying particular attention to the classification of employees versus independent contractors. You should review the status of any persons working with your nonprofit to ensure that they are properly categorized, and the appropriate taxes are withheld if applicable. Failure to do so can subject your company to substantial penalties.

Tip #6: Not Understanding Unrelated Business Income (UBI)

The IRS has noted that failure to understand unrelated business income is one of the most common mistakes impacting nonprofit organization accounting. Failure to report or underreporting unrelated business income can have significant consequences for both accounting and tax purposes. Publication 598, Tax on Unrelated Business Income of Exempt Organizations, can help a nonprofit to gain insight on identifying and tracking unrelated business income.

Tip #7: Failure to Invest in the Accounting Function

Nonprofits should ensure that they are investing the proper accounting software and employee training tailored to the unique circumstances of accounting for a nonprofit entity. In addition, your organization should ensure that there is a backup for the nonprofit's accounting data to avoid loss of information and potential delays in meeting compliance requirements.

Accounting for nonprofits can be difficult and without proper procedures in place can potentially impact the tax-exempt status of the organization.

If you have any questions regarding the most common accounting issues of nonprofits and how to avoid them, please contact Frankel Zacharia at 402.496.9100.