Choosing a Fiscal Year

A custom-tailored fiscal year can improve the clarity and timeliness of your accounting information.

By Tejdev Sandhu

When choosing a fiscal year, many nonprofits use the January 1 - December 31 calendar year by default, perhaps because it's comfortably familiar from its near universal application for personal tax returns. However, a nonprofit organization's requirements aren't like those of an individual. You'll likely be much better served by a different fiscal year.

To ensure effective decision making, your board should select a fiscal year that represents your actual operations. Once established, the fiscal year should be changed only for clear and compelling reasons so that financial statements remain comparable from year to year.

What Are the Advantages of a Custom Fiscal Year?

Selecting a custom fiscal year can yield many benefits, including diminished workload bottlenecks and lower costs. Here are some of the most powerful reasons to rethink your fiscal year.

1. Make Sure Your Financial Statements Reflect the Truth

Accounting based on a calendar year can result in deceptive financial statements, causing undue confusion among less financially sophisticated board members. Consider the example of a nonprofit that raises funds uniformly throughout the year to cover major expenses concentrated in January of the following year. Assume that the nonprofit is expanding steadily, with both revenues and expenses increasing by $10,000 per year. The following simplified financial statement could result:

STATEMENT OF ACTIVITIES (CALENDAR YEAR)

	2018	2019	2020
Revenues	$30,000	$40,000	$50,000
Expenses	$25,000	$35,000	$45,000
Change in Net Assets	$05,000	$05,000	$05,000

The above statement shows an increase in net assets year after year, but if the fiscal year were adjusted to end on January 31, roughly the opposite results:

STATEMENT OF ACTIVITIES (FISCAL YEAR)

	2018	2019	2020
Revenues	$30,833	$40,833	$50,833
Expenses	$35,000	$45,000	$55,000
Change in Net Assets	-$04,167	-$04,167	-$04,167

Simply changing the cut-off point has altered the nonprofit's apparent financial health. A board reviewing the first statement would likely be unconcerned. But the same board reviewing the second statement might well may be spurred to institute cost-cutting measures.

2. Lessen the Impact of Errors

The Christmas and New Year's holidays are major collection periods, with many nonprofits receiving a large influx of donations between mid-December and mid-January. One concern at year-end is allocating donations to the appropriate reporting period. Mailed checks, for example, are allocated based on their postmark dates rather than by the dates that they're cashed or by the dates listed on the checks themselves. A check dated December 31 but mailed locally on January 2 could easily be categorized by mistake in the same manner as other checks mailed before year-end that required longer transit times. Similar period allocation errors could occur with other forms of payment and expenses during such a busy time.

Shifting the fiscal year-end to a time when the nonprofit is engaging in fewer transactions accomplishes two things:

- **It improves the likelihood** of period allocation errors being detected.
- **It reduces the costs** of correcting the errors.

It's easier to verify the accuracy of period allocations for a few transactions than for hundreds of them. The cumulative impact of a smaller number of errors is also less likely to be considered material, which reduces the likelihood that you'll be forced to reissue your financial statements.

3. Reduce the Burden on Your Accounting Staff

As long as external parties don't require calendar-year reporting (as for certain government-sponsored grants), a properly chosen fiscal year can make things much easier for your accountants. Closing the books at fiscal year-end is a complex, multi-step process. To save time, some of these steps, such as the creation of accrual reserves for

expected future expenses, can be completed before year-end. However, if the accounting staff is already fully engaged with the processing of donations, closing steps might be delayed to cope with the expanded workload. This problem is particularly salient for part-time or volunteer accounting personnel who cannot reasonably be expected to work overtime during the holiday season. Furthermore, some end-of-year issues pertinent to the accounting function may require clarification from non-accounting staff, which means other staff members may need to be available to answer questions as well. Staff may not be as responsive as normal during family holiday activities. The result is that it takes longer to issue the financial statements.

By moving your fiscal year-end to a slower time of year, you can avoid conflicts with fundraising drives, holidays, and other annual events. Moving the year-end to a low activity period will reduce your accounting staff's workload, leading to faster financial statement preparation. With financial statements available sooner, promotional materials and reports can be distributed to potential donors sooner as well. Faster preparation also provides information to the board sooner after the end of the year, enhancing the board's ability to exercise financial oversight.

More sophisticated fiscal-year systems can yield additional benefits at the weekly level. For example, the 52-53-week fiscal year approach ends each year on the same day of the week, which may be advantageous for those wishing to reliably schedule accounting work during a point of low transaction volume, such as Sunday. Another advantage of this approach is that it avoids disruption of accounting records normally maintained on a weekly basis, as would occur if the accounting period ended in the middle of the week.

4. Lower Your Tax & Audit Fees

The adoption of a new fiscal year can shift audits and tax preparation out of the busy season of accounting service providers. Whereas May 15 is the calendar-year deadline for nonprofit tax returns, this deadline can be shifted to the 15th day of the fifth month after the fiscal year-end, whenever that may be (https://www.irs.gov/charities-non-profits/annual-exempt-organization-return-due-date). Audit timeframes will then be shifted to correspond with the production of financial statements.

If a tax preparation or audit firm is experiencing lower work volumes, you should be able to negotiate a lower fee. Even if a specific firm is unwilling to reduce its fee, you can shop around and secure a firm that may have otherwise been unavailable. Furthermore, tax and audit work should have a faster turnaround time since fewer clients are competing for the firm's attention.

How Should You Go about Establishing a Fiscal Year?

Once your board and accounting staff have decided to change your organization's fiscal year, the next step is to check your bylaws to determine the specific procedure for doing so. The bylaws will typically list the fiscal year as well as voting instructions for how the fiscal year can be changed. If you have an auditor, you should discuss this potential change with the audit firm as well to avoid any potential audit ramifications.

Although the procedures to modify your tax year are easy to implement, the specific rules vary. As outlined by the IRS, a nonprofit should file Form 990 or 990-EZ for the shortened tax period resulting from the change. "Change in Accounting Period" should be written at the top of the short year return. No other formalities are necessary, and you can then file future returns based on your new fiscal year. If you have already changed your fiscal year in the previous 10 years, you should file Form 1128 (https://www.irs.gov/charities-non-profits/exempt-organizations-annual-reporting-requirements-filing-procedures-change-in-accounting-period). Because several exceptions to the broad tax guidelines provided above are possible based on your unique circumstances, your board may wish to seek the services of a tax professional.

You should also consider more detailed accounting changes that may be required if you change your fiscal year. Modern accounting software packages generally tolerate fiscal-year changes well, but manual adjustments may be necessary in certain circumstances. February year-ends, for example, may require manual adjustment every four years to account for leap years, and 52-53-week fiscal years may also require adjustments. Additionally, based on laws in your state, you may need to contact charitable-solicitation divisions with which you're registered and let them know that you're changing your fiscal year.

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