Changing Fiscal Years

When an organization first reports to the IRS as a tax exempt entity, it states its operating year, establishing a year-end that defines its fiscal year. As time goes by, it may be determined that the fiscal year originally established is not best serving the organization and a fiscal year-end change is needed.

This article will guide the organization in making this important change.

Defining the Proper Fiscal Year

Things to consider in defining the organization's fiscal year:

- What is the fiscal year of the organization's largest funding sources? If the organization receives most of its contributions from individuals and foundations, a December 31st year-end might be more appropriate. If it gets a large part of its funding from Federal government sources, a September 30th year-end might be best.

- Timing of significant programmatic activity – typically the organization will want its fiscal year-end to coincide with the lowest level of activity in the organization. The fiscal year should end, whenever possible, just before a period of relative inactivity.

- Consider the finance team – from a financial perspective, there are very determinant times where the finance team is more busy than usual. Closing the fiscal year takes an increased effort. Moving the closing date to when they are less busy might be more appropriate. Also consider the season: Pacific Northwest summers are not to be missed, and you might not want your finance team's focus more on the sun than on reconciling fixed assets!

- Debt covenants – check to see if there would be any effect on debt covenants using the new period.

- Consider how the change may affect grant applications, combined giving campaigns, etc.

- What period will the change be effective? This is important to determine the proper tax due dates with the IRS, as well as audit requirements.

- Some accounting software allows the organization to compare the new fiscal year to similar prior periods. It is helpful to know what past operations would look like using the new fiscal year.

Impact of Change

Changing the organization's fiscal year will have an impact on the organization's tax, audit, budget and other operations.

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Tax impact – a separate form will need to be filed with the IRS that defines the new year-end date, as well as the effective date of the change. In addition, the IRS does not allow a tax period to be longer than 12 months, requiring a "short year" filing to reset the new fiscal year. That means that there must be two IRS filings in that period, which would require more costs in preparing another tax return.

Audit impact – the audit does not need to be limited to a 12-month period and can cover the old and new period. For example, if the organization changes from a June 30th year-end to a December 31st year-end, the audit can cover an 18-month period ending the new December 31st date. It is also a good idea to check with your auditor to ensure availability due to timing changes.

Budget impact – the first year of change will require a combined and expanded period, or it can be prepared as a short period reset, then move forward with a budget for the full new year.

Other impacts – may include employee vacation and sick accruals and limits. Additionally, the accounting system must be changed for the new period.

Additional Costs to Consider

Possible additional costs for change in year-end might include:

- Costs to prepare the short year IRS Form 990
- Audit costs may increase in the first year of change, as it covers a broader period
- Must coordinate with auditors and tax preparers for availability using the new period

Steps to Change the Fiscal Year

When you have decided to change the organization's fiscal year, the following steps will need to be taken:

1. IRS Form 990 for the short period (aka: the stub period) – will need to filed for the stub period between the original and new fiscal year-ends. This return will be due 4½ months after the end of the new fiscal year-end. The words "Change of Accounting Period" will need to be written on the top of the return.

2. File a 990 Extension Request – for the organization's original tax year date and/or he short period if filing will not be ready within the appropriate timeline.

3. Contact affiliates – to be sure that everyone knows of the organization's changed fiscal year.

4. Notify the State – the organization will need to notify the states it operates in to change an accounting year. In the State of Washington, this requires notification to the Office of the Secretary of State, Corporations & Charities Division. In some states, the filing due dates may also change.

5. Change the accounting system – while each system is different, there will be a method that the organization must follow to change their accounting system to the new fiscal year.

If you have any further questions about changing your organization's year-end, speak with your CPA. There may be some additional areas to consider specific to your organization.

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