

## Exempt Organizations: Change in Accounting Period

When an organization first incorporates to begin operations one of the things it must do is establish with the Internal Revenue Service (IRS) what the fiscal year of the corporation will be. For many organizations setting the fiscal year to coincide with the calendar year (e.g. January 1 through December 31) may be the appropriate thing to do. Most churches characteristically have a fiscal year that ends on December 31<sup>st</sup>. For other organizations, such as a private school or mission's organization, the natural cycle of operations is different and consequently a different fiscal year end may be appropriate. For that reason many private schools will set their fiscal year to end on June 30 or August 31.

But whatever year-end is initially established, there may come a time when it becomes appropriate to change the accounting period. When that decision is made, the organization needs to keep in mind that there are certain notifications that will need to be made and protocols followed to ensure a clean transition to the new accounting period.

### **So how does an organization change their accounting period, and how does it affect the preparation of the financial statements and any returns that might be due?**

For religious nonprofit organizations this is a relatively simple process. The following steps should be followed when changing the fiscal year of the organization:

1. The board of directors should approve a motion to change the fiscal year of the organization. The motion should note the current fiscal year and then go on to not the new fiscal year of the organization.
2. The organization should then adjust its accounting records and reporting in the year the change is made to report on the financial and program activities of the ministry for the "short tax period."<sup>1</sup>
3. If the organization is required to prepare and file annual information returns<sup>2</sup> (e.g. Form 990) they should be prepared and filed for the short tax period.
4. When filing the financial information return for the short tax period that results from the change. It then simply notes across the top of the return the phrase: "Change in Accounting Period." This will be sufficient to inform the IRS of the change. For example: In the year it was created, "Religious Organization X" adopts a calendar year accounting period. In Year 4, it decides to change its accounting period to a fiscal year ending

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<sup>1</sup> A "short tax period" is an accounting period of less than 12 months, and usually occurs when an organization starts operations, changes its accounting period or terminates.

<sup>2</sup> If the organization is required to file returns to report "unrelated business income" for the period this same process should be followed to alert the IRS of a change in accounting period.

September 30. It may change its accounting period with the IRS by filing a short tax period return for the year beginning January 1 and ending September 30, of year 4. The organizations next return would then cover the period beginning October 1, of year 4 and end September 30, or year 5.

It is important to note here that if the organization has already changed its accounting period within the last 10 calendar years, this simple option is not available. Instead the organization must prepare and file IRS Form 1128, *Application to Adopt, Change, or Retain a Tax Year*, to change its accounting period. Form 1128 instructions explain how to complete and submit the request.

It also should be noted that an organization may not change its accounting period by filing a Form 990-N for the short tax period. The organization must either file a Form 990-EZ or Form 990, or use Form 1128.

### **Who else should be notified of the change in accounting period?**

A number of organizations may need to be informed of the change. If you have annual filing requirements with the state(s) in which you were organized or in which you operate they will need to be informed. Certainly your auditors should be made aware of the change if you are have annual outside financial statements prepare. Lenders, bankers you do business with, donors and/or congregants, your attorney, all may need to be made aware of the change as well for one reason or another.

### **Conclusion.**

Making a change in your accounting period can involve some work, so it should not be taken with some consideration. But in the end it may well be worth the effort to make the change if the result is to put the organization in a better position to meet its mission goals.

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### **DISCLAIMER**

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