

nonprofit agendas

AUGUST/SEPTEMBER 2009



Strategic and financial planning
Borrowing from business

How to account for losses
on endowment investments

Fight the good fight
7 strategies for struggling nonprofits

News for Nonprofits

Borrowing from business

Read the headlines today and you might be thankful that you're with a nonprofit organization rather than a for-profit business. While stories of corporate fraud and mismanagement seem to dominate the news, there are still lessons to be learned from business if you want your organization to have a strong future.

CREATING AN OVERALL PLAN

To ensure they're moving toward where they want to be in the future, successful businesses create and implement strategic plans. And while some nonprofits also take this route, many do not — at least not as seriously as do many businesses.

Just as for-profit business boards and owners do, your board needs to think through where it wants to see the organization in three to five years. In the nonprofit world this translates to such questions as: Is your mission still relevant? Do the programs that you now deliver support your goals? Should any programs be transitioned or abandoned? Although it's easy to linger at status quo, top-performing organizations of all kinds set out long-term goals in a strategic plan and then reorganize their operations to meet them.

A strategic plan should address:

- * Your nonprofit's mission, image and definition of constituencies;
- * Lessons learned since your last strategic plan;
- * The use and effectiveness of your communication tools;
- * Your facility (plans to downsize or expand);
- * Possible mergers or acquisitions;
- * Your investment policies;

- * How to build and attract endowment funds; and
- * The profile of target board members.

Thinking through such initiatives, and then putting them in writing, will help keep your board from investing resources — both financial and nonfinancial — in opportunities that won't provide the returns you anticipate over the long term.



DEVELOPING A FINANCIAL ROADMAP

In addition to your overall strategic plan (and budgets), a strategic *financial* plan should express your organization's financial goals and provide a methodology for monitoring progress. A well-thought-out plan will help ensure you have enough funds to handle program activities.

Your plan should include objectives that tie into the strategic plan, such as improving areas that impact cash flow. To achieve its strategic goal of developing better member relations, for example, an association might set these objectives: to increase net new members by 15%, to boost dues revenue by 12% and to increase the gross margin on education activities to 25%.

Your plan should include calculated returns on investment (ROI). It also should list significant initiatives and outline methods for projecting and monitoring cash flow needs. This will ensure that your organization's accounts receivable are current and programs can be funded as needed.

Break-even analysis serves as an early warning system for programs that aren't working.

Break-even analysis is a useful tool to determine what would be the minimum level of operating income required for the organization to cover its fixed and variable expenses (including payroll, rent and utilities) in full so that it's essentially at a break-even point. Break-even

analysis also serves as an early warning system for programs that aren't working.

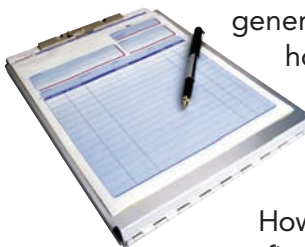
By monitoring program outcome measures and understanding your organization's break-even point, you will have the ability to quickly determine whether or not a particular program will require additional funding sources in order to sustain it for a certain number of clients. If additional sources of funding or mission reserve funds are unavailable, the break-even analysis would enable your organization to easily determine the necessary cuts in program spending.

STICKING WITH IT

All in all, your organization must do its work to create a sound strategic plan — and then follow it, flexing it as necessary. Without this commitment, like poorly managed for-profit businesses, your organization is likely to flounder. *

How to account for losses on endowment investments

In today's market, you're likely to be recording losses on your investments instead of gains. For your *unrestricted* investments, your organization records those losses — both unrealized and realized — in an unrestricted fund. But, for your permanently and temporarily *restricted* endowment fund investments, it's more complex.



GENERALLY SPEAKING ...

Investment activity — that which generates unrealized and realized gains and losses,

dividends, and interest — increases or decreases an organization's unrestricted net assets, unless the donor or an applicable law restricts the use of that income. Nonprofits generally can use the investment income however they see fit. For example, they could use it for administrative costs, such as payroll or office supplies, for programming or for fundraising.

How you record the investment activity on your financial statements depends on donor stipulations or applicable law. If a donor contributes specific investments (for example, 30 shares of

Microsoft stock) and states that it's permanently restricted, then the related earnings and losses also would be permanently restricted, unless the donor specifically states otherwise.

If a donor contributes cash and lets the organization choose its own investment vehicle — for instance, \$600 to invest in 30 shares of stock — the earnings and losses are unrestricted (unless the donor explicitly says otherwise).

Assume you have donor-restricted endowment funds, with no donor stipulations on the investment earnings. Statement of Financial Accounting Standards (SFAS) No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, requires that net losses first reduce any investment income on a fund that has been recorded as temporarily

restricted. When those earnings are exhausted, you must then decrease unrestricted net assets for any loss in excess of those amounts.

Why must unrestricted funds suffer? With the historical-dollar-value accounting method, the value of the donor-restricted endowment fund is "set" at the time it becomes an endowment. The investment must never go below this amount unless there's a true dip into the funds, and that requires donor consent.

How you record an investment activity on your financial statements depends on donor stipulations or applicable law.

To clarify terms

Endowments are gifts or donations to your nonprofit that are held permanently. Generally, your organization can use the income from these funds in any way you choose, but not the principal. There are three general types of endowments:

Permanent endowments. With this type, the donor restricts the use of the principal donation. For example, you receive \$15,000 as a permanent endowment, and your organization needs to maintain \$15,000 in perpetuity.

Term endowments. The donor restricts the use of the principal donation for a specified term. For instance, you receive \$15,000 as a term endowment to provide support for 10 years. After that, the money is available for your organization's use.

Quasi-endowments. These are board-designated funds, frequently set up or restricted for a specific purpose. For example, your board could set up a reserve for capital improvement or for operating costs.

A POSSIBLE SCENARIO

Suppose your organization receives a \$15,000 permanently restricted donation (an investment) whose donor explicitly states that the investment's earnings are to be used for scholarship purposes. This means that the earnings are recorded as temporarily restricted until the purpose is met.

If, in Year 1, the investment earned \$750 and your organization didn't spend it for its purpose, at year end that amount would still be in temporarily restricted net assets. If, in Year 2, the investment lost \$1,000, you would decrease that temporarily restricted fund by the \$750 earned and unspent in Year 1. You then would decrease the unrestricted fund by \$250 for the difference.

When the market recovers and your donor-restricted endowment fund shows gains, SFAS No. 124 will require the unrestricted net assets to "recover" any losses that were recorded from this fund. In the example above, imagine that in Year 3, the investment earned \$1,500. Now you'd "give back" the \$250 to the unrestricted fund. The rest would be recorded to the temporarily restricted fund, which was the donor's intent.

HOW UPMIFA FITS IN

Your state may have adopted the provisions of the Uniform Prudent Management of Institutional Funds Act (UPMIFA). If so, and if you have a donor-restricted endowment fund that stipulates its earnings are unrestricted, you would classify those earnings as temporarily restricted.

You could release this restriction when those earnings are appropriated for expenditure, such as in a formal budgeting process. You also can set an organizational policy that specifically states this, and this should be documented in your board minutes.

UPMIFA also eliminates the historical-dollar-value accounting method. Instead, it focuses on what constitutes prudent spending while taking care to preserve the funds.



FUTURE EXPECTATIONS

Although your unrestricted fund seems to be suffering in this trying economy, the market will eventually recover, and the fund will likely be made whole again. In the meantime, keep in mind that these investment losses are unrealized until you actually sell the securities. *

Fight the good fight

7 strategies for struggling nonprofits

Massive drop-offs in grants, sponsorships and donations from once-staunch supporters have marked the current economic downturn. Accordingly, problems with cash flow — and staying in the black — have followed for many nonprofits.

If you're like most organizations, you've already taken many steps to cut costs. Wage freezes, staff cuts, eliminating out-of-town travel and many other money-saving measures are now the norm. But there are other actions you can take to ensure that your nonprofit continues to stay afloat. Here are seven of them:

1. Revisit your organization's mission. Now is a good time to review your organization's mission and its programs. Perhaps there's a particular program that, while not critical to

your organization's mission, provides a huge drain on cash balances and staff attention. Saying good-bye to that program can be a difficult step — but the reward is eliminating cash drain and freeing up funds for more pertinent programs or administrative necessities. If a program cut is done right, there could be no break in service to the individuals served, as they can be redirected to similar programs in other organizations.

2. Examine your investment portfolio. Are you one of the many nonprofits with portfolio investments or idle assets that aren't generating operating income? Donated real estate, collections and other nonmarketable holdings are examples of these types of investments. If so, now may be the time to divest some of these possessions

and obtain the operating funds you need to stay afloat. While the market may not be ideal for liquidating certain investments, they can be a good source of operating cash if cash flow is a priority.

3. Review your permanently restricted endowments per UPMIFA. Another potential source of operating funds is your organization's permanently restricted endowment funds. Passage of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) last year — and the full or partial adoption by most states — may allow you to prudently spend what was once considered the untouchable original principal (or historical balance) of funds that nonprofits were required to maintain into perpetuity.

Access to these funds generally is available when the donor of the original gift is silent about restrictions or doesn't specify that UPMIFA provisions don't apply. In some cases, an original condition or restriction may no longer be practicable — or may now be impossible to achieve. In those situations, UPMIFA makes it much easier for the organization to get those restrictions lifted, thereby releasing the funds for other more practical purposes. Consult your attorney first to be sure.

4. Contact the original donor. Whether or not UPMIFA provisions open up a potential source of funds, your nonprofit could take another route by approaching the endowment's original donor. Ask the donor to lift all, or some, of the spending restrictions so you may use a portion of the funds for operating costs. Many endowments were made in more lucrative times, with the donor's original intent to nourish the organization's future cash flow. But given the state of the economy, your current

need to supplement your operating fund may be easily communicated.

5. Rely more heavily on board members. Don't hesitate to turn to your board in tough economic times. Board members usually have a passion for their organization and its mission and will do whatever they humanly can to assist. In many cases, board members already have employer backing for your organization. And that company may be willing to step up its financial support. Board members likely have other community contacts as well. Sometimes all you need to do is ask.

6. Focus on your most effective fundraising activities. Nonprofits frequently have several fundraising events each year to raise money. Look at each of these activities and determine which ones are most effective. If one or more of these events or activities fail to provide a good return for the time and expense involved, consider alternative fundraising events. Look for an option that has a higher rate of return — and thus enhances operating funds.

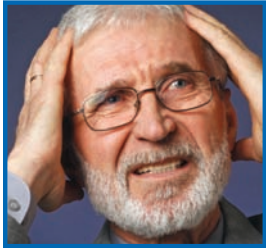
7. Look to "recession-proof" sources. Focus your efforts on sources of funding that aren't necessarily affected by the recession, such as governmental funding programs. The state or federal government already may have earmarked funds for organizations with programs like yours. As part of your fundraising activities, exhaust these opportunities by submitting applications for grants to all likely providers.

Whether or not your nonprofit will survive this recession may depend on the ability of your management and board to come up with creative ways to generate operating cash flow for the organization. The ideas above, while not all-inclusive, point to cash sources you may need to sustain your organization. *



NEWS FOR NONPROFITS

EXCISE TAX TO FOLLOW MADOFF PONZI SCHEME?



More than 150 private foundations invested with Bernard Madoff, and their losses have forced several charities to close. But the effects of this investment travesty could live on.

The IRS is looking into whether excise taxes apply to private foundations and their board members who placed up to 100% of their portfolio assets with Madoff. These taxes would be based upon the Internal Revenue Code provision that excise taxes can be assessed on a private foundation and its board for making investments that jeopardize the charitable purpose.

William Josephson, former head of New York State's Charities Bureau, told the U.S. Senate Finance Committee that it would make public policy sense to apply to public charities some of the additional restraints that already are on private foundations. This pertains to activities such as self-dealing, excess business holdings and jeopardy investments.

Similar discussions have come up in the Senate Finance Committee in the past. And in light of the recent scandal, greater regulation of charitable organizations' investments is likely. *

SELLING TAXABLE PRODUCTS



Does your charity sell products on an ongoing basis and, if so, does this create unrelated business income tax (UBIT) liability for your organization? As nonprofits increasingly search for extra revenue, this question becomes more relevant.

If the products you sell are created by the individuals that your organization serves, they generally are exempt from UBIT. For example,

a nonprofit serves emotionally disabled children and, as part of their therapy, they create artwork that is sold. The sales proceeds aren't taxable.

But if the product isn't sold in substantially the same form as originally created, it could be subject to UBIT. For instance, if the artwork is used to make salable greeting cards, that income would be subject to the tax.

Generally, UBIT applies when the activity meets three conditions: 1) It's a trade or business, 2) it's regularly carried on, and 3) it doesn't further the organization's exempt purpose. *



EMPLOYMENT TAX WARNING

As nonprofits face budget crunches, some are trying to save payroll taxes and benefits expenses by treating individuals as independent contractors rather than employees. In light of large federal budget deficits, the IRS is looking more closely at this area to ensure that earnings are not escaping income and payroll taxes through underreporting.

In her remarks at the 2009 Georgetown Law CLE "Representing & Managing Tax-Exempt Organizations" conference in April, IRS counsel Catherine Livingston reminded participants that nonprofits are still required to withhold employment tax on pay to employees. You'll "hear more from the Service on this issue," she warned. *