

## **NONPROFIT AGENDAS JANUARY 2010**

### **PUT YOUR BEST FOOT FORWARD**

#### **Giving donors and funders the financial information they need**

Donors and grant-making organizations often are approached by nonprofits about which they know little or nothing. Increasingly sophisticated, many of these donors and funders will research your nonprofit and benchmark it against other nonprofits to determine if it's worthy of their gift.

In today's highly competitive charitable-giving climate, it's critical to put your best foot forward and provide potential donors as much useful information as possible. But what information is important to a donor or funder before it makes a sizable donation or funding commitment? And what financial benchmarks and other analyses will they examine when making an evaluation?

#### **Ensure information is accurate, favorable**

A donor likely will request two pieces of information to make its assessment. One is a copy of your most recent financial statements prepared by your accountant, and the other is a copy of your most recently filed Form 990.

Your job is to make sure that information in these documents not only is accurate, but presents your organization in the most favorable light possible. Armed with this information, your potential donor will be able to see how your nonprofit stacks up against similar organizations in a way that has the best chance of working for you.

#### **Get to know benchmarking ratios**

Funders and donors often take information from a nonprofit's financial statement and Form 990 and plug it into these benchmarking ratios:

Program spending ratio. One of the most common benchmarking measurements, this ratio is calculated as follows:

$$\frac{\text{Program expenses}}{\text{Total expenses}}$$

The resulting percentage represents the portion of your organization's expenditures spent on program service. The higher the percentage, the more efficient your nonprofit is with donor dollars.

In its *BBB Wise Giving Alliance Standards for Charity Accountability*, the Better Business Bureau (BBB) holds that a nonprofit should have a program efficiency ratio of 65% or higher. Due to the recession, the BBB released a statement on December 3, 2009 that temporarily relaxes the ratio to 55%. This temporary measure does not yet have a sunset date. Additionally, several nonprofit watchdog organizations, including Charity Navigator and the American Institute of Philanthropy, routinely rate and publish this percentage for some of the larger and more prominent nonprofits.

A donor or funder will benchmark your nonprofit against these percentages to determine if your organization — or someone else's — will likely spend its dollars most efficiently. Because of this, it's important to accurately categorize your expenses by *function*. This maximizes the amount allocated to program costs as opposed to management and general or fundraising expenses.

Fundraising efficiency ratio. This is another of the most common ratios and is calculated as follows:

$$\frac{\text{Total fundraising expense}}{\text{Contribution income}}$$

“Contribution income” refers to those contributions received as a direct result of its fundraising activities. This resulting percentage is a signpost of how much it costs to raise each contribution dollar. Generally, the lower this percentage, the more dollars available to support program services. The BBB states that this percentage should be no more than 35%, which would mean it costs no more than \$0.35 to raise each contribution dollar. Again, this percentage was temporarily relaxed to 45% in the December 3, 2009 press release by the BBB that was previously discussed.

Management and general to total expenses. Another good measure of a nonprofit’s efficiency is the portion of expenditures spent to support administrative functions. This percentage is calculated as follows:

$$\frac{\text{Total management and general expenses}}{\text{Total expenses}}$$

Most donors want to see their donations support program services and thus will look for organizations with a low percentage of management and general to total expenses, usually in the range of 25% or less. A nonprofit with a high percentage for this generally will be deemed inefficient in running its organization, unless it’s able to communicate the reasons for the unusually high percentage.

### **Consider other factors**

Most donors and funders will consider other financial factors as well. For example, some may perform trend analysis, placing the three most recent years of financial information side by side to see the increase or decrease trends in revenue and expenses. A decreasing trend in financial support could indicate that the nonprofit will be unable to sustain itself in the future. Additionally, if program expenses are growing at a slower rate than fundraising or supporting services, the nonprofit could be experiencing some inefficiencies or mismanagement.

Many donors and funders also will examine your accumulation of unrestricted net assets. A successful not-for-profit *avoids* accumulating an excess of unrestricted funds that otherwise could be directed toward program services. According to BBB guidelines, a nonprofit’s unrestricted net assets available for use should be no more than three times the size of its past year’s expenses or three times the size of its current year’s budget, whichever is more.

Too much excess funds might signal to a donor or funder that its resources aren’t needed. But you can avoid the appearance of accumulating too much in excess funds if the board designates a portion of the unrestricted reserves for a specific purpose, such as a contingency or building fund.

### **Capture information accurately**

These are some of the common methods used to measure and analyze the financial effectiveness of a nonprofit’s operations. Be aware of these techniques. And make sure your organization carefully and accurately reports its financial information to project itself as positively as possible when someone applies them. Consult your financial advisor on the proper way to capture this information.

## **NAVIGATING TROUBLE SPOTS ON REVISED FORM 990**

Many nonprofits, having filed extensions for more time to prepare the revised Form 990 for 2008, are now wrestling with some of the form’s questions. If your nonprofit has more than \$1 million in gross receipts and over \$2.5 million in total assets, it’s required to file the new form.

### **Do questions about policies perplex you?**

Form 990 asks questions about whether your nonprofit has certain written policies relating to organization governance, such as conflict-of-interest and whistleblower policies. On the one hand, the Internal Revenue Code doesn't *require* you to have these policies. But the IRS has stated it will use your responses "to assess noncompliance and the risk of noncompliance" with federal tax law. The message: A lack of these policies could result in closer IRS scrutiny.

Organizations often ask if they can adopt a policy *after* the close of their tax year and still respond on the form that they have the policy in place. This depends on the policy — the instructions to these Part VI questions indicate the specific time or period to be used to answer particular questions.

### **What's an "independent voting member"?**

Nonprofits frequently ask about the definition of "independent voting member of the governing body." Form 990 instructions are exact about the three-part test to be used to determine whether a board member is independent — all three parts must apply at all times during the year:

1. The member isn't compensated as an officer or other employee of the organization or a related organization,
2. The member didn't receive total compensation or other payments exceeding \$10,000 from the organization or related organizations as an independent contractor, and
3. Neither the member nor any family member was involved in a "transaction with interested persons" as required to be reported on Schedule L.

Your nonprofit must make a "reasonable effort" to obtain information about independence. According to the IRS, it would be reasonable to distribute a questionnaire annually to each of your officers, directors, trustees and key employees.

Your questionnaire should define "independent voting member" and ask for the information required to respond to Questions 1 and 2 in Part VI. These questions address whether the board member is independent and whether officers, directors, trustees and key employees have family or business relationships with other officers, directors, trustees or key employees.

### **What about controlled entities?**

Another major governance issue is whether a controlled entity can state that it has certain policies in place if its controlling entity has them. Yes, the controlled entity can respond affirmatively if it has officially adopted the controlling organization's policies.

If it hasn't, the controlled entity should explain in Schedule O that it is governed or otherwise affected by the policies of the controlling organization.

### **What are "related organizations" in Schedule R?**

Many organizations are uncertain if they have "related organizations" as mentioned in Schedule R. To determine this, refer to the definition for related entities in the glossary located in the Form 990 instructions. The same definition for related organizations is used throughout the form.

Related organizations also include organizations that are indirectly owned. For example, if Nonprofit Filing Organization A owns 80% of Taxable Corporation B, which is a 70% partner in Partnership C, A controls both B and C. And Organization A must report both entities in the appropriate parts of Schedule R.

### **Where to find more answers**

The IRS has issued FAQs for the compensation sections (Part VII and Schedule J) of Form 990. Additional FAQs and other filing tips are posted every several weeks on [irs.gov/charities](https://www.irs.gov/charities) and are archived on the site. Your CPA also can help answer questions that aren't addressed in the form's instructions.

## REASONS MOUNT FOR A CONFLICT-OF-INTEREST POLICY

Questions on the new Form 990 are the latest reasons to have a conflict-of-interest policy in place. The new form, now in use for 2008 returns, directly asks if your tax-exempt nonprofit has a written conflict-of-interest policy.

### New IRS requirements

The form also asks if your officers, directors, trustees and key employees are annually required to disclose “interests that could give rise to conflict.” And it inquires if your organization “regularly and consistently” monitors and enforces policy compliance.

The IRS doesn't *require* charities to adopt a conflict-of-interest policy (or other policies). But lacking such a policy could prompt the agency to take a closer look at your tax returns. (See “Navigating trouble spots on revised Form 990” for more information on the new form.)

### Tax-exempt status

Having a conflict-of-interest policy also is important for obtaining tax-exempt status. A significant part of the application for organizations seeking 501(c)(3) tax-exempt status deals with questions of possible conflicts with key employee and board members. The application also asks if your organization has adopted a conflict-of-interest policy consistent with the IRS's sample policy included in the application instructions.

### Connections and disclosures

Your conflict-of-interest policy should address the questions mentioned above from the new Form 990. It also should cover whether any of your officers, directors or trustees are connected to each other through family or business relationships. And it should state whether the individuals who approve compensation arrangements follow a conflict-of-interest policy.

Your policy also should require the board and key staff members to annually pledge to protect your organization's integrity by disclosing interests, relationships and financial holdings that could result in a conflict of interest. Making formal disclosures and having a signed statement usually occurs annually, but board and staff members should update information as needed and speak up when issues arise that could pose a conflict.

Most policies specify that board or staff members who have a possible conflict on an issue should abstain from discussion and decision making regarding that issue. Keep in mind that you can describe instances when there might be exceptions.

You can find examples of conflict-of-interest policies and language for annual disclosures on the Internet. Your audit firm or professional advisor also may be able to supply a sample policy you can customize for your organization. An attorney can check the policy to make sure it doesn't conflict with other governing documents, such as your bylaws, or statutes in your state.

### Message from the top

Keep in mind that it's your organization's leaders who set the stage for avoiding conflicts of interest. If they're open in their discussions about the subject — and take the actions necessary to make sure conflicts don't evolve — your full staff and board will get the message. And any regular observer to your board meetings will be able to discern that conflicts of interest are off limits for your nonprofit.

## NEWS FOR NONPROFITS

### Family Foundations to Fill Funding Gap?

A reported decrease in charitable contributions may have you wondering who's going to fill the gap. GuideStar recently asked charities to compare contribution levels for March through May 2009 with those for the same period a year earlier. Of those responding, 52% said contributions

had decreased, 29% reported they'd stayed about the same, and 18% indicated contributions had risen from the prior year.

Page Snow of the Foundation Source, an administration services provider, wrote in August that, of the 72,000 foundations in the United States, fewer than 50 have endowments of more than \$1 billion." The vast majority — more than 90% — have endowments of less than \$10 million, and most of these organizations are family foundations. Snow released the figures in "Applying for Funding from Family Foundations: Results of a New Survey," which appeared on GuideStar.org.

Although family foundations may have relatively small endowments, their sheer numbers appear to make them a logical source for charities in which contributions no longer cover budgeted expenses. What should you bear in mind as you approach this audience amid the stiff competition?

According to the Foundation Source survey, relationship building is the most essential part of the fund-seeking process. Of the 120 respondents, 77% said they don't consider unsolicited requests. So, if you're not already building bridges, it may be time to start.

### **Heads Up, Foreign Account Holders**

Do you have authority over — or are you the signer on — a bank or financial account in a foreign country at any time during the calendar year? If so, you or your organization will likely need to file a Foreign Bank and Financial Accounts (FBAR) report, Form TD F 90-22.1.

The report is customarily due the June 30 after the calendar year, but a recent extension gives filers a break. IRS Notice 2009-62, issued Aug. 7, provides that individuals and organizations that need to file an FBAR report for the 2008 and earlier calendar years have until June 30, 2010, to do so.

According to the IRS, a foreign financial account includes any bank, securities, securities derivatives or other financial instruments account. The agency is proposing that the definition also include foreign financial accounts in which the assets are held in a commingled fund and the account owner holds an equity interest in the fund, such as mutual funds or private equity funds.

Penalties for failing to file the FBAR report can be substantial — up to \$500,000 — and can include criminal sanctions. No reporting is required if the foreign account under your authority has holdings less than \$10,000.

## **SPOTLIGHT ON MP&S**

### **Marks Paneth & Shron Revenue Maximization Checklist**

The Real Estate Group at Marks Paneth & Shron LLP (MP&S) has developed a Revenue Maximization Checklist to help property owners ask the right questions and gain maximum benefit from existing lease provisions. A well designed audit of procedures surrounding property accounting such as billing, collections, lease abstracts and lease audits conducted by accountants deeply versed in commercial real estate can turn up unanticipated revenue opportunities and help ensure that property portfolios are yielding maximum returns.

### **Best Practices for 2010**

Marks Paneth & Shron has issued the firm's annual "smart business moves" statement for 2010. In this year's statement, MP&S emphasizes the importance of businesses maintaining their sense of vigilance and accountability in the coming year.

### **Economy Creates Changes in Wealth Management Services**

As the financial crisis took hold, many high-net-worth individuals withdrew assets or left their wealth management firms. But as the economy improves, wealth management firms are seeking ways to alter their business models and provide a better service to risk-averse clients, who are

demanding more transparency. Daniel Kesner, a partner in our Family Office and Business Management Group, has commented on recent changes in wealth management services.

## MP&S FAST FACTS

- One of the 10 fastest-growing accounting firms in the United States (*INSIDE Public Accounting*)
- The 32<sup>nd</sup> largest accounting firm in the nation and a leader in accounting and auditing (*Accounting Today*)
- The 13<sup>th</sup> largest accounting firm in the New York Area (*Crain's New York Business*)

## HAPPY NEW YEAR

On behalf of Marks Paneth & Shron, best wishes for a happy and healthy New Year.

## FOR FURTHER INFORMATION

If you have any questions, please contact **Michael L. McNee, CPA, Partner-in-Charge** of the MP&S Nonprofit and Government Services Group, at 212.503.8954 or [mmcnee@markspaneth.com](mailto:mmcnee@markspaneth.com). You may also contact one of the following members of the group:

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In addition, more information on the MP&S Nonprofit and Government Services Group can be found at [www.markspaneth.com](http://www.markspaneth.com).

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