MARKS PANETH

ACCOUNTANTS & ADVISORS

NONPROFIT AGENDAS – AUGUST, 2015

WHAT CAN YOU LEARN ABOUT YOUR REVENUE PICTURE?

When auditors examine a nonprofit's financial statements they spend a lot of time on the revenue figures. They look at the accounting methods used to record revenues and perform a detailed income analysis to gain a true understanding of the organization's revenue profile. All of this helps them get up to speed on the nonprofit's financial health.

Get Ready to Roll

Using audit techniques, including year-to-year trends and benchmarking to other nonprofits, can help your nonprofit get a better view of the organization's revenue. In particular, consider the following:

Individual Contributions

To some degree, many nonprofits rely on contributions from supporters to balance their budget. Compare the dollars raised to past years and see if you can pinpoint any trends. For example, have individual contributions been increasing since the peak of the recession? What campaigns have you implemented during that period? Go beyond the totals and determine, for instance, if the number of major donors — say, those who give $1,000 or more a year — has been rising. You get more bang for your fundraising buck when you're able to add major donors to your roster of supporters.

Also, estimate what portion of contributions is restricted by the donor as to how or when it can be used. If your organization has a large percentage of its donations tied up in restricted funds, you might want to re-evaluate your gift acceptance policy or fundraising materials to make sure you're pursuing contributions that give your organization the most flexibility.

Grants

Grants include funding from corporate, foundation and government sources. They can vary dramatically in size and purpose, from grants that cover your operational costs, to monies for launching a program, or payment for services to clients. For example, a state agency may pay you $500 for each low-income, unemployed individual who receives your job training.

Pay attention to trends here, too. For instance, did a particular funder supply 50% of your total revenue in 2012, 75% in 2013, and 80% last year? A growing reliance on a single funding source — an example of a "concentration" that will increase your risk — is a red flag to auditors and it should be to you, too. In this case, if funding stopped, your organization might be forced to close its doors.

Fees for services

Fees from program participants, nonprofits in a joint venture or other third parties can be similar to fees that for-profit organizations earn. Fees are generally considered exchange transactions because the client receives a product or service of value in exchange for its payment. Some not-for-profits charge fees on a sliding scale based on income or ability to pay. In other cases, fees (such as rent paid by low-income individuals) are subject to legal limitations set by government funding agencies.

On an ongoing basis, your nonprofit will need to assess if these services are paying for themselves. For example, fees set five years ago for a medical procedure may no longer be sufficient to cover costs. A decision to raise fees or discontinue the service will probably need to be made.

Membership Dues

If your nonprofit is a membership organization, you likely charge membership dues. Has membership grown or declined in recent years, and how does this compare with similar groups? Make informed predictions about the future of membership dues, especially if you rely on them substantially for revenue. If you suspect that dues income will continue to decline, your organization might consider dropping dues altogether and restructuring. If so, examine other income sources for growth potential.

Apply What You've Learned

Once you've gained a deeper understanding of your revenue picture, you can apply that knowledge to various aspects of managing your organization. For example, you can implement additional controls where exposure is identified and educate your management team to make pricing decisions.

You also will likely acquire information that can help you set annual goals and prepare your budget. For example, if your organization is too dependent on a single government funder, make boosting individual contributions one of your nonprofit's strategic objectives. Be sure to commit staff hours and dollars to achieving that goal.

You're certain to find many other applications based on the information you've learned. Remember to look for concentration risks and upward and downward income trends.

Score with Auditing Techniques

Auditors use income analysis methods to gain assurance that the revenue reported on your financial statements is accurate. You can use these tools to do so much more. Income analysis can reveal whether you rely on too few revenue sources or too many restricted donations, and enable you to compete more effectively with others in your field.

NONPROFIT ACCOUNTING ERRORS – AVOIDING THE PAIN

A study entitled *Accounting Errors in Nonprofit Organizations* was recently published in *Accounting Horizons* by Jeffrey J. Burks of the University of Notre Dame. By examining corrections of errors in nonprofit financial statements, the study found that nonprofits report twice as many errors as similarly sized corporations and an even higher rate compared to publicly traded corporations.

How can nonprofit organizations avoid these problems? Certainly, having a competent audit firm performing annual audits can go a long way in reducing errors in financial statements. However, the study also found that there was a high correlation between errors in financial statements and internal control deficiencies. Independence rules prohibit the independent auditor from being a part of an organization's internal control, so that shouldn't be the answer.

What about the nonprofit's accounting staff? Sometimes, accounting resources at nonprofits are limited by cost concerns and are more focused on the day-to-day challenges of claiming and collecting money from donors and grantors, as well as paying bills and payroll, rather than the sometimes intricate requirements of generally accepted accounting principles (GAAP) and its accounting and disclosure requirements. This may be particularly true at smaller organizations.

When our clients that find themselves in this situation, we often recommend they consider getting help from an "out-sourced" controller or CFO. In this way, they can buy just enough expertise to fill-in the gaps needed, without breaking the bank by bringing on full-time, high level individuals. There are a number of firms that offer these types of services and arrangements can be tailored to the individual circumstances. Of course, we don't feel it's appropriate for an auditor to be involved in the selection of a firm to provide accounting help. If requested, we do provide a list of a number of firms that we have worked with successfully in the past and suggest that the nonprofit use it as a starting point in finding the right firm.

If you need the help of an outsourced controller or CFO, please contact a member of the Marks Paneth Nonprofit and Government Group leadership team for a copy of our resource list.

COST ANALYSIS CAN HELP SWAY FACILITY SPACE DECISION

Sometimes it's difficult to decide whether to lease or buy the space you need for operations. There may seem to be an equal number of reasons to take either route. In such cases, cost analysis can help you make an informed decision.

To compare the two scenarios, you'll have to know or estimate certain costs. On the buying side, this information includes the purchase price and financing terms, such as interest rates and closing costs of the new facility; its expected useful life for your operation; and its estimated value when you expect to sell it.

On the leasing side, gather information on the projected lease term, rate and renewal options available. Also estimate how much interest could accrue on the capital you would spend on a down payment, if you invested that money.

BUY-OR-LEASE CONUNDRUM

Weigh the Pros and Cons of Each Option before Deciding

Is your nonprofit currently leasing your facility? And have you wondered if you should buy property instead of renewing the lease when it expires? Or, perhaps, your landlord has just informed you that the building will be sold — and renewing your lease isn't an option.

Whatever your reason for making the buy-or-lease decision, the process itself can be tough, with many factors to consider. Here are some pros and cons for both alternatives.

The "Up" Side of Buying

Owning a facility typically gives you more control of your work space than leasing can provide. It allows you to build equity, and can stabilize your cash flow and presence in the community.

Essential to some nonprofits is the ability to accommodate special needs, configuring and equipping the space to their specifications. For example, a physical therapy center might not consider the option of leasing a facility because it would need to construct a swimming pool, locker rooms and other *accoutrements.*

The "Down" Side of Ownership

Ownership carries risks. Some nonprofits take on more than they can chew when purchasing property — they fail to project negative scenarios such as a funding drop or local government assessments. And almost everyone today knows the risk of plummeting resale values. If you bought, what would happen if the neighborhood surrounding your building changed and it was no longer near your client base?

Additionally, don't forget operational responsibilities, such as overseeing repairs and maintenance. Will these duties detract from time spent fulfilling your mission?

The Pluses of Leasing

Some argue that leasing office space or a facility has more flexibility than ownership. Say you're uncertain about your client base and your organization could experience substantial growth or decline that requires a different space. It's far easier to move when your lease expires than to sell real estate.

Perhaps you can secure an attractive long-term lease, one that guarantees only modest rent increases, and allows (and sometimes finances) reconfiguring the space to meet your needs. Another lease plus: Most repair headaches — and expenses — will be your landlord's.

Leasing has its Minuses

Nonprofits generally have finite financial resources. Monthly rent can take a big bite from your budget with little return, and the cost can increase dramatically when it's time to renew your lease. Fire insurance and real estate taxes also can be the renter's responsibility if you have what's called "a triple net lease."

Rental costs (assuming they're higher and less stable than potential mortgage payments) can erode funds you'd rather use to sustain and improve programs, or invest.

Which Way to Go?

If your nonprofit has access to the necessary capital and stable funding, an excellent track record in planning and a firm grip on budgeting, you might want to consider purchasing your office space or facility. But if your organization lacks these basics, leasing may be the better option for now. Often it comes down to a comparison of costs.

IT ALL ADDS UP

Partner Profile: Warren Ruppel, CPA

With more than 30 years' experience performing audit and accounting services, Warren Ruppel, CPA, is a sought out resource among governmental entities and nonprofit organizations in the New York metropolitan region. He brings a proven track record in government accounting as former Assistant Comptroller for Accounting of the City of New York, where he was responsible for the City's accounting and financial reporting. In addition, he is a former Secretary of the City's Audit Committee. He currently serves on the Board of the New York State Society of Certified Public Accountant's and is Chair of its Audit Committee.

A noted author, Warren has written several well-respected books about governmental and nonprofit accounting and auditing matters including *GAAP for Governments, Governmental Accounting Made Easy, Not-for-Profit Accounting Made Easy, Not-for-Profit Organization Audits and Not-for-Profit Audit Committee Best Practices*.

Warren is based in Mark Paneth's midtown Manhattan headquarters.

A CODE OF ETHICS SETS THE STAGE FOR DECISION-MAKING

Demonstrating commitment to ethical standards is one way your nonprofit can show that it's worthy of the public's trust and your donors' gifts. Developing a code of ethics — and following it — tells your constituents that your organization lives up to its ideals.

Identifying Your Values

Think of your code of ethics as a statement of how you practice ideals. A code of ethics not only guides your organization's day-to-day operations but also your employees' and board members' conduct.
The first step in creating a code of ethics is determining your values. Start by reviewing your strategic plan and mission statement to identify those ideals integral to your organization. Next, look at peer nonprofits to see which values you share with them, such as fairness and justice, commitment to the community, accountability to the public, and adherence to the law. Also consider ethical and successful behaviors in your sector. For example, if your staff must be certified, discuss those requirements.

You also may want to include practical standards that address current issues or behaviors that contribute to your workplace, such as cooperation and promptness. Although these principles aren't ethical in nature, they're relevant to your nonprofit's image.

Putting Ideals on Paper

Now you're ready to document your expectations and the related policies for your staff and board members. The type and size of your organization will help determine the scope of your code of ethics. But most nonprofits should address such general areas as mission, governance and legal compliance.

You also may want to develop policies on openness and disclosure, inclusiveness and diversity, and responsible stewardship of funds. Establishing policies on conflicts of interest (such as paying board members for their services), professional integrity in such areas as fundraising and grantwriting, and program evaluation is required by some states and although it may be not applicable to the state you operate in, there are questions on the Form 990 that organizations need to answer addressing conflict of interests.

For each topic, discuss how your nonprofit will abide by the law, be accountable to the public and responsibly handle resources. When the code of ethics is final, your board needs to formally approve it.

Getting Staff Up to Speed

Next, it's time to communicate and implement the code. Training employees and board members is essential, because every nonprofit faces issues that may result in illegal or unethical behavior. With a thorough understanding of the code, your staff and board members will find it easier to make the right decisions.

Be sure to present examples of situations that they'll encounter. For example, what should an employee do if a board member exerts pressure to use his or her company as a vendor? You can integrate your ideals in your policies and procedures by addressing real-life scenarios and how your organization handled them.

Finally, if your nonprofit doesn't already have one, put in place a mechanism, such as a confidential tip line, that staff, board members and others can use to raise ethical concerns. If multiple complaints suggest that your nonprofit has some serious ethical issues, create an open forum for stakeholders to discuss them without repercussions.

Once your policies and procedures are in place, you may think the job is over — but it isn't. Your code of ethics represents a continual process and you'll need to review and revise it once a year. Regularly review how the policies are working, discuss strategies to revise those that aren't, and ensure that your nonprofit is following the law.

Your Influence Counts

You can't make ethical decisions for your employees, volunteers and board members. But you can make sure that your organization adopts a set of principles to guide them daily in their work.

NONPROFITS: THE ROCKY BALBOA OF THE US ECONOMY?

Even during the recent recession, the U.S. nonprofit sector has shown its resilience. Consider: During the 21st century's first decade the number of not-for-profits grew 25%, surpassing both the government and private sectors. During the same period, the sector grew jobs at 2.1% while the for-profit sector lost jobs at 0.06%. In fact, nonprofits are now the nation's third largest employer among private industries, nearly tying with manufacturing and lagging only slightly behind retail. In 2010, nonprofits added $779 billion to the U.S. gross domestic product.

So points out an article recently posted on *Forbes* magazine's blog. Authors Nathaniel Calhoun and Darlene Damm, both with organizations in the social sector, attribute nonprofits' growth to certain behaviors. Nonprofits, they say, tend to:

Be more resistant to outsourcing and automation. Whereas the U.S. manufacturing sector has outsourced an estimated 30% to 40% of its jobs, the nonprofit sector is relatively slow in following this trend. And replacing jobs with automation isn't nearly as big of a factor for nonprofits as it is for some, such as transport, manufacturing and white collar specialties such as legal research and accounting.

Take advantage of new technologies that lower costs. Many nonprofits have latched on to technologies that make fundraising easier, such as social media, crowdfunding (raising small amounts of money from a large number of people, typically online), and open sourcing (employing software that can be freely used, changed and shared). More fundraising typically equates to more funds.

Align with the interests and values of the day. The authors point out that an estimated 25% of the population engages in volunteering on an annual basis, and the number of for-profit social enterprises has rapidly increased over the last decade. And billionaires, such as Warren Buffet and Bill Gates, have publicly committed to giving most of their money away to charity.

"Whom You know" Remains a Top Nonprofit Hiring Tool

When it comes to recruiting staff, participants in a recent nationwide survey reported that their nonprofits have neither a formal recruitment strategy in place (52%) nor a formal recruitment budget (67%). So, how do these organizations recruit talent? A total of 91% of the 362 participants in the *2015 Nonprofit Employment Practices Survey* conducted by Nonprofit HR reported "using a network of friends and colleagues as one of their primary recruiting sources."

LEVERAGE OUR EXPERTISE

Marks Paneth LLP is the 35th largest accounting firm in the US and 9th largest in the mid-Atlantic region. We have a long history of serving the not-for-profit community. Today, we work with more than 150 tax-exempt clients and proudly serve 25% of New York's 25 largest charitable organizations, as ranked by Crain's New York Business. Our firm is ranked in the top 1% nationally in pension plan audits and is the 8th largest preparer of Form 990 PFs in the US. Our Nonprofit and Government Group consists of approximately 45 people in New York and Washington DC, including our five Partners and three Directors listed below. If you have questions, please contact one of us. More information can also be found at markspaneth.com.

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