

## NONPROFIT AGENDAS – MARCH, 2016

### DOES YOUR BOARD UNDERSTAND BUDGET-SPEAK?

Although budget approval is one of the more important roles played by a nonprofit's board of directors, not every board member is a savvy businessperson used to budget work. At least some board members might be unfamiliar with key budget terms. And there's even a greater chance that they're reluctant to admit when clarification is needed.

To help your board responsibly discharge their budget-related duties, make sure that, at a minimum, they understand the following terminology and concepts.

#### Budget types and approaches

Part of a board member's confusion about budget terms may stem from the reality that different organizations use different approaches to budgeting, as well as different types of budgets. A single nonprofit, for example, may employ more than one kind of budget. The following definitions should help board members better grasp what they're considering when handed a "budget."

**Accrual basis.** In contrast to cash basis (defined below), accrual basis matches income and its related expenses in the same accounting period. That means income is recorded when earned, contributions are recorded when pledged, and expenses are recorded when incurred, regardless of when the products or services are actually received or paid. Accrual basis accounting is required by Generally Accepted Accounting Principles (GAAP).

**Capital budget.** A capital budget is a decision-making tool used by an organization when it's considering the cost and timing of significant and potentially long-term projects, such as a building purchase. Many not-for-profits prepare a capital budget each fiscal year, prioritizing purchases of capital expenditures for the coming year.

**Cash basis.** A nonprofit using cash basis doesn't record income until the cash is received or expenses until they're paid. Most nonprofits need to draft a cash budget whether or not the accounting method followed for their financial statements is on the accrual basis. The cash budget also may include use of restricted funds when the funds are spent for the intended purpose or over a period of time. Some smaller organizations budget and keep their books only on the cash basis.

***Income-based budget.*** This budget is built from realistic projections of reliable income for the budgetary period. Expenses must come in under the income projection.

***Incremental budget.*** An incremental budget begins with the prior budget's detail and builds the budget by computing percentage increases or reductions to each line item.

***Zero-based budget.*** In contrast to an incremental budget, a zero-based budget assumes that no existing program will necessarily be continued and no money will necessarily be spent. It facilitates comprehensive evaluation of every revenue and expense component.

## **Budgetary terms**

Your board members also need to understand common terminology used in not-for-profit budgets, including the following:

***Capital expenditures.*** Organizations make capital expenditures to acquire or improve long-term assets such as property, vehicles or equipment. They're expensed over time through depreciation, rather than immediately.

***Depreciation.*** The cost of a capital expenditure is spread (or "amortized") across the asset's useful life through depreciation expense, matching the use of the asset to each accounting period and increasing the odds of having the necessary cash on hand to replace the capital asset at the end of its life.

***Fixed costs.*** Those costs that don't change based on the number of projects, clients or other variables a nonprofit experiences are referred to as "fixed costs." They're incurred regardless of the level of activity or services. Fixed costs include permanent administrative staff, rent, and licensing or reaccreditation.

***Variable costs.*** As the name suggests, variable costs change as the level of activity or services changes. For example, the more seniors your organization feeds, the higher the food costs will be.

***Direct costs.*** Direct costs are incurred for a specific program or project. Examples include supplies for a community outreach program or food costs for a senior meals program.

***Indirect costs.*** Also known as "overhead" or the "common cost pool," these costs don't relate solely and specifically to an identifiable program or project, but are necessary to its completion. They may include management salaries, rent, postage, utilities, internet usage, and accounting and legal fees. Indirect costs have always been an area of stakeholder scrutiny but they have gained more attention since the Office of Management and Budget changed its Uniform Guidance to provide for reimbursement of reasonable indirect costs incurred under a government grant.

## Knowledge is power

A realistic budget lays the foundation for a not-for-profit's ongoing financial viability. To ensure that your board members are qualified to understand and approve such budgets, get them up to speed on critical budget terms.

### SIDEBAR: DON'T FORGET IN-KIND CONTRIBUTIONS

When defining budget terms to your board of directors, pay special attention to what are known as *in-kind contributions*, a phrase that's not part of everyday language for most people. In-kind contributions are noncash donations of goods and services such as office space, parking, professional services, supplies or clothing.

Although these contributions ultimately have no effect on an organization's bottom line — because they're recorded as revenue when received and as an expense when used — it's wise to document them in the budget. By doing so, you'll provide stakeholders with a better picture of what's required to perform your mission.

### UPGRADE YOUR INTERNAL CONTROLS

#### Reviewing the COSO Framework Can Help

Perhaps you cringe when you see news stories on nonprofit fraud, worrying that your organization could be next in line to be cheated and scandalized. If strengthening the internal controls at your not-for-profit is at the front (or the back) of your not-for-profit's to-do list, now is as good a time as any to do something about it.

A sensible starting point is a look at [\*Internal Control — Integrated Framework\*](#), a document issued in 2013 by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The framework can help you establish, strengthen and assess the controls set up to safeguard your operations from fraud.

#### Is it required?

Although publicly-held companies are required by the SEC to evaluate internal control over financial reporting using a recognized control framework, other for-profits and nonprofits aren't required to use a framework for the oversight of internal controls. Auditors *do* generally rely on the framework's concepts when they assess internal controls. And the framework is mentioned as a resource for "best practices" in the new Uniform Guidance for federal grant awards.

Even if you're under no obligation to follow COSO, its framework has proven over the years to be an effective risk management tool for many different types of organizations. The updated version, which incorporates recent technological developments, the move toward increased globalization and the demand for better governance, is designed to help organizations apply internal controls more broadly to operations, reporting and compliance objectives.

### **What's the foundation?**

Both the original and revised COSO frameworks are built around several interrelated components:

- Control environment — a set of standards, processes and structures that provide the basis for carrying out internal controls, such as ethical values, performance measures and people management,
- Risk assessment — the process for identifying and assessing risks related to achieving an organization's objectives,
- Control activities — actions that help ensure that management's directives to mitigate risks are carried out, such as authorizations and approvals, verifications, reconciliations, and segregation of duties,
- Information and communication — the flow of information necessary to support the internal control function, including continual communication throughout the organization, between board members and executives as well as with external stakeholders, and
- Monitoring — both separate and ongoing evaluations of the internal control system's performance over time and reporting of any deficiencies that are found.

COSO stresses that each of these components must be in place and fully functioning for an internal control system to be effective.

To help organizations turn abstract concepts into actionable items, the new framework introduces 17 principles related to the five components. For example, three principles apply to “control activities”:

1. Select and develop control activities that mitigate risks,
2. Select and develop technology controls, and
3. Deploy control activities through policies and procedures.

In addition to the 17 principles, COSO offers 81 “points of focus” in its report. These provide guidance in designing, implementing and conducting internal controls and in assessing whether relevant principles are present and functioning.

## What are your internal control concerns?

If governance is a particular concern, you might focus on the framework's guidance about directors' independence from management and best practices for expertise on audit committees.

If your nonprofit's concern is employee fraud, you can use the framework to assess current risks (such as poor hiring decisions), strengthen controls (such as annual performance reviews), and communicate ethical expectations to staffers.

Or if a new accounting software system is being selected, you can use the framework to help guarantee that the selection process follows proper acquisition procedures. Following the framework also can ensure that the product selected is subject to strong controls related to password protection and security levels that allow access only to the appropriate users.

## Get inspired

Nonprofits have looked to COSO for guidance in designing, strengthening and assessing internal controls for more than two decades. With the revised framework for internal controls still in its childhood, consulting the document for inspiration and direction makes more sense than ever.

## MARKS PANETH ANNOUNCES NEW LEADERSHIP APPOINTMENTS

We're pleased to announce several leadership appointments. Effective January 1, 2016, Steven Eliach was appointed Principal-in-Charge of Tax; Steven Henning appointed Partner-in-Charge of Advisory; and Michael McNee appointed Partner-in-Charge of Attest. "These leadership appointments – the first of several strategic initiatives in 2016 – represent our ongoing efforts to enhance the quality of our firm and its services to our clients," said Harry Moehringer, Managing Partner. [Read the press release here.](#)

## PINPOINTING KEY ISSUES IN LICENSING AGREEMENTS

As the economy slowly crawls back, many nonprofits are still experiencing stagnant or even declining revenues, prompting them to look to nontraditional types of revenue sources — including licensing agreements and mailing list leasing programs.

Large organizations, such as the American Red Cross and the Girl Scouts of America, have been in the licensing and mailing list leasing game for some time. But licensing and leasing arrangements aren't only for the behemoths. With the requisite amount of care (and legal advice), your organization, too, might be able to both generate revenue and further its mission by improving awareness of its brand through logo recognition.

## **Consider the brand**

Of course, licensing your name or trademark to commercial companies to use on their products could help or hurt your brand. For that reason, you'll want to conduct due diligence on any prospective licensees to reduce the risk of the arrangement blowing up in your face.

In addition to confirming that a licensee has no skeletons in its closet, you also need to consider whether your organization's mission and values align with those of the licensee. One potential licensee might offer significantly higher royalties than another, but if the former's products undermine your brand image or mission, you'll lose more than you gain in the long run.

The American Medical Association (AMA) learned that the hard way years ago when it entered into an exclusive five-year licensing deal with Sunbeam Corporation to use the AMA's endorsement and logo on home health care products such as thermometers, air cleaners and vaporizers. The AMA pulled out of the deal after public outcry over conflict of interest and commercialism. The organization ended up paying Sunbeam almost \$10 million to settle after the corporation sued the AMA for breach of contract.

You also can protect your brand by including provisions in the agreement addressing conditions of use, quality control standards and termination rights. And it's vital that your organization monitor licensees' use of your name or trademark throughout the entire period covered by the agreement.

## **Play a passive role**

Fortunately, nonprofits enjoy a royalty exclusion that generally prevents licensing revenues from being subject to unrelated business income taxes (UBIT) — as long as the nonprofit plays a passive role.

You shouldn't actively provide services to the licensee, but you may actively protect your brand or logo that is being licensed.

## **Take practical steps**

While the possible benefits are substantial, so are the required resources. You'll need to allocate staff to perform a comprehensive evaluation of your brand and its place in the marketplace, develop marketing strategies to locate and land appropriate prospects, and keep an eye on licensees' uses of your intellectual property on an ongoing basis. You also should retain legal counsel to review all agreements.

The resource-intensive nature of licensing prompts some nonprofits to outsource it to a consultant. This option allows the organization to focus on its core mission-related functions while still enjoying the benefits. If you pursue this route, you can expect to pay an upfront fee for strategy development, with possibly a monthly retainer and a percentage of the royalties the consultant secures.

## Explore the possibilities

You might be surprised at the value commercial companies and consumers attach to your organization's brand. If you find interest from potential licensees, your financial and legal advisors can help you determine an appropriate licensing strategy.

## NEWS FOR NONPROFITS

### Guide helps foundations explore impact investing

Three philanthropy groups (Exponent Philanthropy, Mission Investors Exchange and Arabella Advisors) have released a free guide to help foundations with small staffs navigate impact investing — making investments designed to generate measurable social or environmental benefits along with financial returns. *Essentials of Impact Investing: A Guide for Small-Staffed Foundations* is intended to boost awareness and the use of impact investing tools (for example, tools to measure and monitor investment performance, supply technical guidance to foundations and grant makers, and expand the impact investing community). You can download the 162-page guide at <https://www.missioninvestors.org/search/site/essentials>.

### Female leaders' pay lags behind

According to a new report from GuideStar, salaries for women continue to lag behind men in comparable positions at nonprofits of all sizes. The gap is most significant for female chief executives at organizations with budgets of \$2.5 million to \$5 million. Their median salary was 23% less (\$111,183) than that of their male peers (\$136,882). Women execs fared best at organizations with budgets of less than \$250,000, making 6% less (\$42,105) than their male counterparts (\$44,592). The report is based on 2013 IRS filings by approximately 105,000 not-for-profits.

### Facebook offers "Donate Now" button

Facebook has introduced a call-to-action option for nonprofits to connect with people who care about their causes. The "Donate Now" button can be placed on link ads and Facebook Pages. The American Cancer Society and the Red Cross already have partnered with Facebook, so users can donate by providing payment information directly through that social media site. Now nonpartner organizations also can use the button. Users will be directed to the nonprofits' website after viewing a pop-up stating that the organization isn't endorsed by or affiliated with Facebook.

### ABLE accounts can help individuals with disabilities

The Achieving a Better Life Experience (ABLE) Act of 2014 permits states to establish a new kind of account with tax-free earnings for individuals with disabilities. Families in the states that have

passed legislation can make contributions to the ABLE accounts of eligible disabled individuals — this without jeopardizing the beneficiaries' eligibility for certain means-tested federal programs (subject to some limitations). Are you aware of what may be available in your state?

The accounts can be used to cover qualified expenses such as education, housing and transportation. Other uses: obtaining and maintaining employment and acquiring personal support services and assistive technology. The accounts generally can be opened for individuals with significant disabilities developed before age 26. Contributions to the account are treated as nontaxable gifts to the beneficiary.

#### **PARTNER PROFILE: MICHAEL MCNEE, CPA**

[Michael McNee](#) has served as the Partner-in-Charge of the Nonprofit and Government Group since 2002. In this role, he has been instrumental in building the practice. Today, we work with a broad range of nonprofit entities, including third party government-funded organizations and many of the largest charitable organizations in the New York region. In addition, Mike was recently appointed Partner-in-Charge of the firm's Attest Services. In this role, he is responsible for overseeing the delivery, quality and growth of the firm's audit and other attest services. He is based in Marks Paneth's midtown Manhattan headquarters.

When not working on client or firm-related matters, Mike enjoys spending time with his family and he is an avid reader of history books. Among his many volunteer activities, he finds the work he does supporting the developmentally disabled particularly rewarding. Mike also enjoys football, especially when the Patriots lose.

#### **Plan – Coordinate – and File**

If you have not yet filed your required ACA tax reporting forms, now is the time to begin assembling the necessary information to process Forms 1094 and 1095. The compliance obligation will likely require a joint effort by the payroll, HR and benefits departments to collect the relevant data. If you are unsure of your reporting obligations or need assistance complying with the ACA's information-reporting requirements, please contact us.



## 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 20% 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 six Partners and four Directors listed below. If you have questions, please contact one of us. More information can also be found at [markspaneth.com](http://markspaneth.com).

### Nonprofit and Government Leadership Team

[Michael McNee](#), Partner-in-Charge of the Nonprofit and Government Group

[Hope Goldstein](#), Partner

[Joseph J. Kanjamala](#), Partner

[Sibi Thomas](#), Partner

[Warren Ruppel](#), Partner

[Anthony J. Tempesta](#), Partner-in-Charge of the Westchester Office

[Alan Becker](#), Director

[Howard Becker](#), Director

[John D'Amico](#), Director

[Robert Lyons](#), Tax Director, Exempt Organizations

© Marks Paneth LLP 2016 | [markspaneth.com](http://markspaneth.com)

NEW YORK CITY | WASHINGTON, DC | NEW JERSEY | LONG ISLAND | WESTCHESTER

[Privacy Policy](#) & [Legal Disclaimer](#)