Marks Paneth & Shron LLP
Certified Public Accountants & Consultants

NONPROFIT AGENDA
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DONOR INTENT BECOMING HOT-BUTTON ISSUE

Gift documentation, acceptance guidelines ward off future problems

"If wealthy donors can't be sure their money will be used appropriately, they're likely to be reluctant to give. As always, it's the abuse of a few that ruins things for the many."
— *Investor's Business Daily* editorial, March 13, 2008

This editorial viewpoint highlights the central issue in what is probably the largest donor intent lawsuit in U.S. history: *Robertson v. Princeton University*, expected to go to trial this fall. This case could set the stage for charitable giving in this century.

Allegations of Fund Misuse

The controversy in the case revolves around accusations by the Robertson family that Princeton University inappropriately spent more than $200 million from a charitable fund established to prepare graduate students at the University's School of Public and International Affairs for U.S. government careers in foreign policy and diplomacy.

William Robertson, the lead plaintiff, hopes that the lawsuit not only will remedy the problems at Princeton, but also send a message to all nonprofits. "The people who support you expect you to use their money wisely and for the purpose for which it was given," said Robertson, as quoted in *PNNOnline*. "If you do not, expect consequences."

This isn't an isolated incident. A number of similar cases have hit the judicial system in the last several years. Among the more prominent defendants are H. Sophie Newcomb Memorial College (affiliated with Tulane University), the Barnes Foundation and the Catherine B. Reynolds Foundation. These cases highlight a major dilemma for charities: They must act as loyal stewards of donated funds while also maintaining proper authority over them.

Of course, once donors complete a gift, they have no more control over the funds. But certain expectations often exist when a gift is made, and a charity must walk a fine line in serving both masters.

Poor Records

Much of the challenge that charities encounter is due to vaguely documented contribution arrangements from years earlier. Without such documentation, when a donor is no longer around, it becomes difficult to interpret intent.

Change in circumstances also plays into the challenge for the charity. For example, Newcomb College had operated as part of Tulane University since it was established by a charitable gift in 1886. But after Hurricane Katrina, Tulane needed to consolidate and cut back on expenses to contain costs. The gift's original intent was to maintain the college as a separate entity, but financial circumstances have forced a change.

Charities also encounter difficulties when donors specify a use for funds. This creates problems when it comes to meeting ordinary operation expenses — in other words, paying the bills. And, on rare occasions, a charity finds itself in a position where a donation has created revenue in excess of what is required for its intended use. The charity then faces the question of what to do with the excess money while still adhering to the gift's intent.

Preventive Measures

So, how can you reduce the likelihood of conflict over donor intent?

Many charities now adhere to the Donor Bill of Rights (see sidebar), created by a consortium of organizations involved in fundraising. First and foremost, your organization should have a clear understanding of the donor's intent — and documentation that supports it. Carefully consider whether to accept a gift when narrow, binding restrictions are placed upon its use.

Because circumstances change, you need flexibility in using a gift based upon economic, environmental and social factors. It's imperative to discuss with the donor the necessity of not creating too narrow a focus for the gift, such as on a particular program that may not be relevant in the future.

For example, don't accept a donation to support "the kindergarten class of Mrs. Smith." Instead, make sure the gift is structured to support all early childhood education in the county. Also insist on the ability to make alterations due to social or cultural change. And make sure, of course, that any restrictions put on the gift are not illegal (such as discriminatory).

All charities should have clear guidelines for accepting gifts, including direction about:

- Types of assets that can be accepted and the required relevance of the donation's intent to your nonprofit's mission,
- Ethics related to donor involvement, including involvement in determining investment policy and use of the funds,
- Representations made to the donor: for example, that the donor be given a full description of all aspects of any proposed charitable gift plan, and that there be discussion about what happens if circumstances change and the original intent is no longer relevant, and
- A method or procedure for thinking through the impact of gifts before accepting them.

The board and staff should be educated in gift acceptance so that they don't agree to accept gifts that will create future problems.

Put it in Writing

Above all else, keep clear notes from the discussions with the donor, documenting his or her intent and thoughts behind the gift. This documentation may play an important role in the coming year, coming decades — or beyond.

Donor Bill of Rights

You might consider adopting a donor bill of rights similar to this one created by the Association of Fundraising Professionals, the Association for Healthcare Philanthropy, the Council for Advancement and Support of Education, and the Giving Institute: Leading Consultants to Non-Profits.

1. To be informed of the organization's mission, of the way the organization intends to use donated resources, and of its capacity to use donations effectively for their intended purposes.
2. To be informed of the identity of those serving on the organization's governing board, and to expect the board to exercise prudent judgment in its stewardship responsibilities.
3. To have access to the organization's most recent financial statements.
4. To be assured their gifts will be used for the purposes for which they were given.
5. To receive appropriate acknowledgement and recognition.
6. To be assured that information about their donation is handled with respect and with confidentiality to the extent provided by law.
7. To expect that all relationships with individuals representing organizations of interest to the donor will be professional in nature.
8. To be informed whether those seeking donations are volunteers, employees of the organization or hired solicitors.
9. To have the opportunity for their names to be deleted from mailing lists that an organization may intend to share.
10. To feel free to ask questions when making a donation and to receive prompt, truthful and forthright answers.

ONE FOR ALL AND ALL FOR ONE

How to transition leadership during a merger or acquisition

Mergers and acquisitions are taking place more often among both large and small nonprofits today. Greater funding opportunities, the ability to boost program services while making better use of limited resources and a solution to the Baby Boomer retirement of a critical executive are all reasons to consider these options.

For nonprofits taking the plunge, one of the most daunting challenges — one likely to determine the effort's success or failure — is transitioning the key leadership so that it stays invested and involved in the process.

Many Cooks, One Broth

The leadership of every not-for-profit organization is vested in both board members and internal management. A complex and ever-changing combination, this structure can bog down decision making and make transitions of any kind challenging. Yet, when it comes to fusing two organizations into one, investing time to develop relationships among all of the leaders pays off in the eventual satisfaction of everyone involved.

Discussions between the two parties often begin at least a year before the actual change takes place. And whether it's a merger forming a new organization or an acquisition enlarging an existing nonprofit, there are five important phases to pass through:

1. Idea phase. Internal managers, and then board leadership, typically meet as a group to discuss the benefits of joining forces. Once that decision is made, nonprofits often breeze on to the development phase, and overlook formalizing their decision to merge. This is a mistake.

2. Formalizing phase. The two nonprofits need to formalize their decision to combine. This can be achieved in a letter of intent that outlines expectations, agreed-upon roles for each organization as a whole and the timeframe for the change.

It's in this phase that the two organizations and their leaders learn about each other and decide whether they — as groups and individuals — want to go forward with the plan. When this phase is attended to, the merger is significantly more likely to succeed.

3. Development phase. Key leaders must be evaluated for their complimentary skills, and the role each will play in the new organization should be determined. Also, the board and management must work together to develop a shared vision for the new organization. To get there, certain group traits are invaluable: mutual respect and trust, flexibility and the willingness to compromise, and determination to put the success of the common mission ahead of personal goals and benefits.

As with the due diligence process described below, it's important to involve professionals in the development process. You'll need input from an accountant on the financial areas and from an attorney on the legal issues. Equally important is the input of one or more professionals trained in evaluating the strategic areas relevant to the new organization. Sometimes you'll find that expertise right in front of your nose, in the organizations' original leaders.

For example, in a recent merger of five local chapters of a national organization, the former CEOs took on leadership of various strategic areas including finance, advocacy, technology and program services. The group also came to a consensus on who should hold the CEO role in the new organization.

The team that works through the development phase must include representatives of all stakeholder groups, including board members, key management and staff, and citizens served. Involvement of these groups will result in greater buy-in. It also will help everyone understand that, though difficult changes — including the possible loss of some leaders — may need to take place, a healthy new organization will emerge.

4. Due diligence phase. Due diligence involves formal research and an investigation into each of the combining organizations. With the assistance of skilled attorneys, accountants and other professionals, any potential stumbling blocks will come to light. By the end of the process, all involved should have a thorough knowledge of the background, financial standing and legal issues facing the new organization.

5. Actual transition phase. The planned changes are implemented during this final phase, making it the most difficult and time-consuming. An official name change, an application for a new license, and communication with the community all need to take place in the final months. A move of the physical location requires even more time and planning.

One Happy Family

With the proper approach and clearly defined roles for the key players, this multi-step process can create a stronger more effective organization — one that can continue to make the most of its mission in the years to come.

VALUING AND REPORTING GIFTS IN KIND AND DONATED SERVICES

As a not-for-profit organization, the support you receive during the year doesn't come only in the form of straight cash donations or fees for services. Support also comes in the form of gifts in kind or donated services. Under certain circumstances, these sums must be recorded on your books and recognized as revenue, expenses, and/or assets at year end — something smaller nonprofits sometimes don't realize.

Your challenge comes in two parts: 1) deciding if it's proper to book the amounts of these gifts in your financial statements, and 2) determining what amounts to assign.

Gifts in Kind

Gifts in kind generally involve the receipt of a piece of tangible property or property rights. They may take many forms, including free or discounted use of facilities; free advertising; collections, such as artwork to display or sell; and other tangible property, such as office furniture or supplies. While this isn't an all-inclusive list, it's a good representation of the types of gifts in kind a nonprofit may receive.

First, you need to determine whether the item can be used to carry out your mission or sold to help fund operations — in other words, does it have a value to your nonprofit? If so, it should be recorded as a donation and a related receivable once it's unconditionally pledged to the organization.

Next, to measure gifts in kind, use fair value. Base the value on what it would cost your organization if it were to purchase that item outright from an unrelated third party. It's fairly easy to assign a fair value to property, such as furniture, equipment or inventory — you can look up the going price for a similar item in the marketplace. But when the gift is a collection, a donated facility, donated advertising — or something that doesn't otherwise have a readily determinable market value — its fair value is more difficult to assign.

Without an independent appraisal to substantiate the gift's value, you may need to rely on a good faith estimate from the donor. So, you should obtain all corroborating evidence that the donor can give you. Then firm up that amount and evaluate whether it was reasonably set. If the value is more than $5,000, the donor is required to obtain an independent appraisal for tax purposes, which will give you documentation for your records.

Donated Services

When it comes to donated services, Statement of Financial Accounting Standards (SFAS) No. 116, *Accounting for Contributions Received and Contributions Made*, has specific rules on when a nonprofit should recognize the fair value of these amounts in its financial statements. The accounting guideline specifies two criteria for determining when to recognize the donation:

1. If the service creates or enhances a nonfinancial asset. Such services are capitalized at fair value on the date of the donation. These types of services either create a nonfinancial asset (in other words, a tangible asset) or add value to an asset that already exists.

Donated services that create or enhance a nonfinancial asset do not necessarily need to be specialized in order for them to be recognized. For example, the value of a carpenter's time (a specialized service) to build an addition to a building would be capitalized as part of the building, as would the value of a volunteer's time to paint the interior walls (a nonspecialized skill). But routine equipment maintenance shouldn't be recognized, because it doesn't enhance a nonfinancial asset.

2. If the service requires specialized skills, is provided by persons with those skills, and would have been purchased if it hadn't been donated. Such services are accounted for by recording contribution income for the fair value of the service provided. You also must record it as a related expense, in the same amount, for the professional service provided.

Specialized skills usually refers to professional skills provided by attorneys, accountants, architects, carpenters, electricians and the like. Developing these skills usually requires specialized schooling or training. Normally, this would exclude general volunteer time provided by individuals throughout the year at your facilities, events and office. That's because these volunteers typically don't need specialized skills to perform their assigned tasks.

Nonetheless, your nonprofit may want to disclose the total number of volunteer hours it received during the year in its financial statement footnotes, to help emphasize the commitment made by the community to your nonprofit. If the service doesn't meet either of these criteria, it shouldn't be recognized.

Doing it Right

Identifying when a gift in kind or donated service needs to be recorded on your financial statements isn't difficult if you follow the rules. Your accounting professional can help you sort through the fine points.

NEWS FOR NONPROFITS

Google launches portal for nonprofits

Nonprofits now have a way to find all of the Google tools available for their use in one location. Google's new portal for nonprofits (www.google.com/nonprofits) houses links to Gmail, Google Grants, Calendar, Checkout (the online payment service), Blogger and more.

Google Checkout is free to nonprofits until 2009. Google Grants lets you place ads through AdWords for no cost during the time of the grant to raise awareness of and increase traffic to your Web site. Applications are reviewed regularly and each award recipient receives at least three months of in-kind advertising. Tutorials for each tool show ways to use the services most effectively, including video tutorials that demonstrate how other nonprofits creatively use Google's tools to their advantage.

Final Rules About Excess Benefits

The IRS has released final regulations clarifying the relationship between tax-exempt organizations and sanctions for excess benefit transactions. Under Section 4958 of the Internal Revenue Code, the IRS can collect penalty taxes from insiders who approved transactions that had greater value than the organization received in return.

In the final regulations, the IRS added an example of reasonable compensation to consider when determining if your organization has engaged in excess-benefit transactions. The regulations state that the IRS will take into consideration an organization's efforts to adopt and follow safeguards to prevent excess benefit transactions, whether or not they were successful.

Next Generation of Leaders Concerned About Money — and More

Many potential next-generation leaders of nonprofits see a number of barriers in their road to becoming executive directors. In the study *Ready to Lead? Next Generation Leaders Speak Out,*

conducted by the Meyer Foundation, a Washington, DC-based grant-making foundation, 64% of respondents have financial concerns about a career in the nonprofit sector.

Other worries include work-life balance; lack of mentorship; structural limitations as far as professional growth and development and obscure career advancement paths; and an unappealing executive director job description, particularly overwhelming fundraising responsibilities.

Despite these concerns, one-third of the respondents still aspire to be an executive director, and 40% feel they will be ready within the next five years.

IRS Checking, Testing for Compliance

The IRS released a fact sheet (FS-2008-14) summarizing its two processes for ensuring that tax-exempt organizations don't abuse their tax-exempt status.

A *compliance check*, which can prompt an examination, reviews how well an organization adheres to the recordkeeping and information-reporting requirements — or the consistency of its activities — with its stated tax-exempt purpose. During a check, the IRS agent won't ask to examine books or records or ask questions about tax liabilities. It's possible to have more than one compliance check per tax year if facts and circumstances warrant it.

Unlike a compliance check, an examination (or audit) reviews an organization's books and records for a particular period to determine tax liability. It also determines whether the nonprofit will continue to be qualified for tax-exempt status. A *correspondence* examination — conducted via letters, phone calls and interviews — is generally limited in scope and focuses on only one or two tax-return items. A *field* examination is generally more comprehensive and is held at the nonprofit's site.

FOR FURTHER INFORMATION

If you have any questions, please contact **Michael L. McNee, CPA, Partner-in-Charge** of the Nonprofit and Government Services Group, at 212.503.8954 or mmcnee@markspaneth.com, or one of the following members of the group.

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SPOTLIGHT ON MP&S:

In September, Warren Ruppel published a book entitled "Knowledge-Based Audits™ of Not-for Profit Organizations with Single Audits." The book discusses techniques for performing audits of financial

statements, audits in accordance with Government Auditing Standards, and single audits in accordance with OMB Circular A-133.

Over the past few months, Michael McNee and Robert Lyons issued the following Client Alerts. Read the Alerts at the links below.

- IRS Response to Charitable Organizations' Use of Wireless Devices
- Reporting Requirements of Alternative Investments
- Campaign Intervention and the IRS Perspective

MP&S WELCOMES ITS NEWEST CLIENTS:

- Educational Broadcasting Corporation (Channels 13 & 21)
- Rome Chamber Music Festival
- Scottish Rite Foundation
- Weston United Community Renewal

MP&S FAST FACTS:

- Nationally, the 29th largest accounting firm and a leader in accounting and auditing (*Accounting Today*)
- The New York Area's 15th largest accounting firm and one of the top five fastest growing firms in our market (*Crain's New York Business*)