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Understand unrelated business income and how to avoid excess amounts

Newsbits

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Philadelphia, PA
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www.taitweller.com

Tips for communicating financial information to the board

While board members typically bring a variety of talents and expertise to the table, they don't always have extensive experience with financial and accounting matters. So how can you best communicate the essential financial information they need to do their jobs?

THE NEED TO KNOW

There's no denying it — board members can't properly perform their functions if they don't obtain and understand information about the organization's financial position. Without timely financial information, they can neither make informed decisions about goals and planning nor monitor the organization's progress toward those goals. They also can't fulfill their fiduciary responsibilities.

Members of boards with finance or audit committees might be under the false impression that only the committee members need to concern themselves with the financial nitty-gritty. That couldn't be further from the truth — every board member must possess at least a basic understanding of the financial statements to make decisions that satisfy his or her duty of care.

CRUCIAL ITEMS

At a minimum, the board needs to receive the following financial information. On a monthly or quarterly basis, they should receive it in an accurate and timely manner:

* Statement of financial position (balance sheet),
* Statement of activities (income statement),
* Cash flow forecast,
* Actual results compared to budget, and
* Operational figures (for example, cost per unit of service).

IRS Form 990 should be presented to the board annually. And the board should remain up to date on the nonprofit's current goals and programs. Benchmarks make the data more meaningful.

This information will help a board in evaluation mode. When engaged in planning, board members also need trend analyses, information about the external environment and its impact on the organization, financial projections and multiple budget scenarios. Capital projects or new programs under consideration may require specialized budgets of their own.

SETTING THE STAGE

Several steps can help management present financial information to their boards more effectively. For starters, every board member should receive some training on how to read and use financial reports.

The board orientation process should allocate time for new members to meet with the chief financial officer or similar staff person to go over the financial report format, and to understand the organization's critical financial factors. The board members can meet with the CEO or executive director, too, for a review of the organization's financial results and the goals for upcoming programs and new strategic directions.

Periodic refresher sessions for veteran board members also are advisable. Your CPA can make valuable contributions to these meetings and sessions, bringing an independent perspective to the discussions and shedding light on the audit process.

HOW TO DELIVER THE NUMBERS

Before you get to the point of training your board, you'll need to develop a user-friendly format for your financial reports. Bear in mind that graphs are often easier to understand than columns of numbers, and can provide a useful vehicle for sharing trending information.

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Similarly, board members may find it easier to process ratios, which combine two or more pieces of financial data to provide a more comprehensive view. For example, fundraising efficiency can be expressed as a ratio that divides contributed income by fundraising expense.

Use summarized information for income and expenses, rather than providing detailed line items. This makes it easier for board members to focus on the big picture and steers them away from day-to-day micromanaging.

You also should provide a narrative section along with the numbers. You can use the narrative to highlight significant items and explain notable variances between budgeted and actual figures.

Make sure the necessary financial statements are prepared well in advance of board meetings and distributed to board members at least one week before the meeting. This gives them time for review.

YOUR AUDIENCE

No single financial reporting approach or format works for every organization. Take the time to consider your audience and its level of financial expertise when determining how to convey the information they need to fulfill their responsibilities. *

LET YOUR DASHBOARD DELIVER

In recent years, some nonprofits have turned to so-called dashboards to convey financial information to their boards. A dashboard, a one- or two-page snapshot of key metrics, may be especially appropriate for the members of a board that also has an audit or finance committee.

Which indicators should you include on a dashboard? Management should work with the board to select the optimal indicators. Ideally, you want to present the handful of indicators most likely to communicate the organization's performance in critical areas — information the board can use to determine whether you're on track or if corrective action should be taken. Examples include cost per primary outcome, cash reserves and working capital. As with standard financial reports, benchmarks should be included for context.

Remember, too, that numbers don't tell the whole story. Dashboards also can include brief narratives, such as a representative beneficiary story, that demonstrate the nonprofit's work.

Make the most of peer-to-peer fundraising

Peer-to-peer fundraising events — for example, walks and runs — have become one of the most common ways for nonprofits to raise money. But are you doing all you can to maximize and safeguard those funds?

TAP EXISTING RELATIONSHIPS

Peer-to-peer fundraising is often an attractive option for resource-strapped organizations. As opposed to traditional fundraising, which requires you to invest heavily in building relationships with donors, peer-to-peer events let you tap the existing relationships of participants. Instead of relying on staff to get the word out about your organization, you can deploy an enthusiastic battalion of true believers to spread your message and create awareness.

But it's important to remember that awareness isn't the end goal — fundraising is. A study by Blackbaud, a software and service provider for nonprofits, found that peer-to-peer event participants see *participation* and *fundraising* as separate tasks.

According to Blackbaud, these events are frequently marketed as awareness events, with the fundraising aspect only implied. It's not unusual, then, for a participant to sign up for a 10K run, pay the registration fee and not pursue fundraising at all.

Goals make it easier for an organization to implement metrics and analyze financial performance during and after an event.

GOALS LEAD THE WAY

One of the most effective ways to encourage fundraising by participants is to set goals. Blackbaud found that 80% of survey respondents who set a goal raised that amount or more. And participants who are working toward a team goal generally raise more than if they're fundraising on their own. Goals also make it easier for an organization to implement metrics and analyze financial performance during and after an event.

Establish goals at the outset, in the initial materials sent to participants and with online fundraising tools (where both participants and their donors can see goals). Feature the top fundraisers on the event's website and in posts on your social media accounts, and offer low-cost prizes like T-shirts.

Avoid setting goals too high, though. It's best to set lower, achievable goals. Not only will your participants be less likely to become frustrated, but smaller donors will be more likely to feel as if they're making a difference.

Also be aware that, if participation in an event requires meeting a fundraising minimum, a participant might cover the whole amount, rather than actually engage in fundraising that could attract new donors. So while success is usually measured based on the total amount a participant raises, also consider the number of donations a participant generates.

CONTROLS ARE CRUCIAL

By definition, fundraising involves the handling of funds, which presents the opportunity for fraudulent misappropriation and simple accounting errors by nonprofessionals. Nonprofits, therefore, need to implement appropriate controls from the outset.

The good news is that the use of social media to drive peer-to-peer fundraising means that monies are typically submitted through the Internet, as opposed to the not-so-distant past when participants would collect cash and checks. As with any online transaction, you'll need effective controls to protect credit card data and personal information and prevent fraud, including firewalls, encryption and similar protections.

HELP THEM HELP YOU

Although peer-to-peer participants shoulder much of the burden with these events, it's up to your nonprofit to provide appropriate support. Make it as easy as possible — but also as secure as necessary — for them to drum up support. ✻

Keeping an eye on UBI

Understand unrelated business income and how to avoid excess amounts

Like other nonprofits, your organization probably has searched for new sources of revenue during the recession and economic slump. Hopefully, though, you haven't run into problems accumulating too much unrelated business income (UBI). That kind of green can subject your nonprofit to taxes — and even threaten your tax-exempt status.

Here's what to watch out for going forward on the UBI front.

THE IRS DEFINES UBI

According to the IRS, an activity generally is an unrelated business and its income, therefore, is subject to UBI tax if the activity is a *trade or business* carried on *regularly*, and *not substantially related* to furthering your nonprofit's exempt purpose. Typically, all three factors must exist for the income to be considered UBI.

CERTAIN PRODUCT SALES COUNT

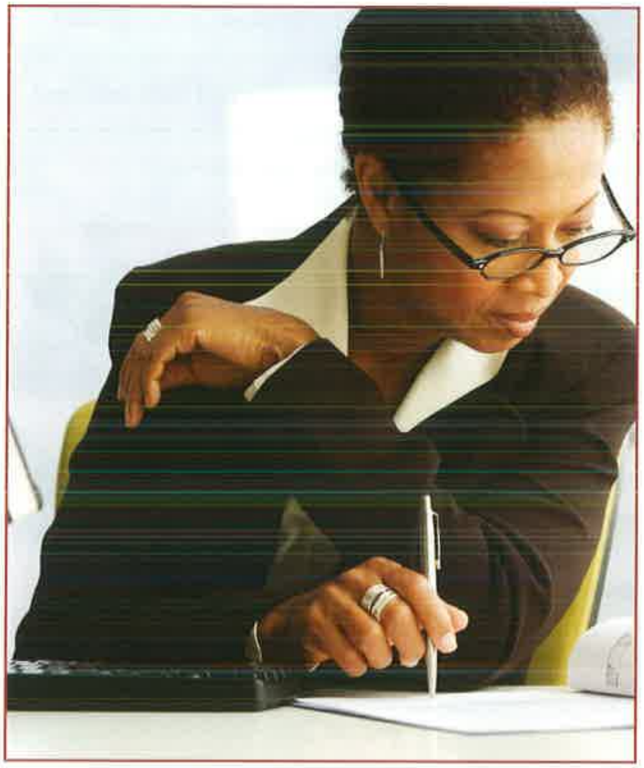
The *types* of activities that can generate UBI often are activities that you might consider fundraising. For example, the IRS counts as UBI the *sale of products that are unrelated to your purpose*. Examples might include sales from a park restaurant or a museum gift shop.

To determine if the revenue is UBI, the IRS suggests that you ask: 1) Are you regularly — that is, frequently and continually — selling the goods to make a profit? and 2) would a *for*-profit organization want to carry on this kind of activity?

If you answer "yes" to these questions, you'll likely need to report the income from the activity as UBI.

AD SPACE REVENUE IS UBI, TOO

Do you sell ad space in your organization's journal, magazine or newsletter or on its website? Language



that induces the reader to buy or use a product or service typically is considered advertising — for instance, a description of the product's or service's quality or a favorable comparison to a similar product or service. And the income from that activity is considered UBI. On the other hand, a brief acknowledgment — listing, for instance, the supporter's name and logo in a program — probably isn't advertising, but rather is sponsorship and considered a donation.

SELLING UNRELATED SERVICES ALSO MATTERS

Let's say that an organization owns a parking lot and opens it regularly to the general public. The parking fee income collected from the lot *is* taxable. That's because the activity — charging a fee for public parking — isn't substantially related to the not-for-profit's exempt purpose. But, if only members and visitors use the parking lot while participating in the organization's activities, the parking fee income *isn't* taxable.

Income from certain investments, from selling membership lists and from gaming activities (see below) also can produce UBI.

EXCEPTIONS TO THE RULES EXIST

There are many exceptions to the rules — for instance, when your volunteers run the activity. According to the IRS, income from any trade or business where uncompensated volunteers perform a substantial amount of the work is exempt from UBI tax.

A transaction's structure also can exclude the resulting income from taxation. While being paid to directly promote products compatible with your mission probably will result in UBI, receiving royalties for licensing others to use your name or logo to promote such products may avoid it.

Other situations in which your nonprofit's income may be exempt from tax include the sale of merchandise that's largely donated, such as in a book sale, or activities related to a convention, trade show or annual meeting. See IRS Publication 598, *Tax on Unrelated Business Income of Exempt Organizations*, for more exemptions.

GAMING IS TICKLISH

The revenue from charitable gaming activities is usually considered UBI and is subject to tax — with the exception of traditional bingo. Newer forms of bingo generally don't qualify for the tax exception, including scratch-off and pull-tab games. Also, to be eligible for the exception, the wagers must be placed, winners must be determined and prizes must be awarded while all players are present.

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REPORT UBI CAREFULLY

All 501(c)(3) organizations should be aware of what is considered unrelated business income. UBI can be a good source of revenue as long as it doesn't overshadow your nonprofit's exempt activities. If you do bring in some revenue of this type, report it accurately. If your nonprofit is audited, it's likely that the IRS will examine your records to see whether your recordkeeping mirrors reality. *

Newsbits

COURT SAYS DONOR IS ENTITLED TO RETURN OF RESTRICTED GIFT

A New Jersey court of appeals held that a charity that solicited and accepted a gift from a donor — knowing the donor's expressed purpose for the gift was to fund a particular aspect of the charity's mission — must return the gift, after it had unilaterally decided not to honor the purpose.

From 2002 to 2004, Bernard and Jeanne Adler donated $50,000 to SAVE, a New Jersey no-kill animal shelter, for a planned expansion.

In 2006, the shelter informed the donors that it was merging with another organization and would instead use their contributions to build a smaller facility in another location. The Adlers sued after the charity refused to return their donation, and they won.

The court of appeals ruled that, absent the donor's consent, a nonprofit can't ignore or significantly modify the expressed purpose for a gift — even if the conditions that existed at the time of the gift changed significantly, making fulfillment of the donor's purpose either impossible or highly impractical.

The case is a reminder of the importance of clearly establishing donor stipulations at the outset and adhering to them. If you're unwilling to accept those terms, the wise choice is to decline the gift.

KAIZEN AIDS FOOD BANK

Japanese automaker Toyota has put a different twist on its philanthropic efforts with the Food Bank for New York City, which helps provide 400,000 free meals each day through its network of community-based programs. Toyota was already a financial supporter, but in 2011 the company offered to help the organization apply the Japanese concept of *kaizen*, or continuous improvement.

Since then, small changes inspired by the concept have had a major impact on the food bank's efficiency. For example, the *New York Times* reported that Toyota engineers reduced the wait time for dinner from 90 minutes to as little as 18 minutes.

COMMUNITY FOUNDATION WEALTH RECOVERS

Since the recession, asset, gift and grant amounts for community foundations have reached new heights, according to a study conducted by the Council on Foundations, a nonprofit association of grant-making foundations and corporations, and CF Insights, a division of the nonprofit consulting firm FSG. The community foundation field represents $58 billion in assets, $6.9 billion in gifts and $4.5 billion in grants.

Average growth rates for those categories ranged from 6% to 15% between 2011 and 2012. Almost 80% of community foundations had 2012 asset levels that exceeded their 2007 levels.

The data was collected from 276 community foundations, including those representing more than 90% of total estimated community foundation assets.

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Please contact us today to discuss your specific needs.

PHONE: Harry DeVerter, 215.979.8802
Karen Vento, 215.979.8813

E-MAIL: hdverter@taitweller.com
kvento@taitweller.com

FAX: 215.979.8811

MAIL: 1818 Market Street
Suite 2400
Philadelphia, PA 19103

Philadelphia, PA **New York, NY** **Iselin, NJ** **www.taitweller.com**