Profitable Solutions *for* Nonprofits

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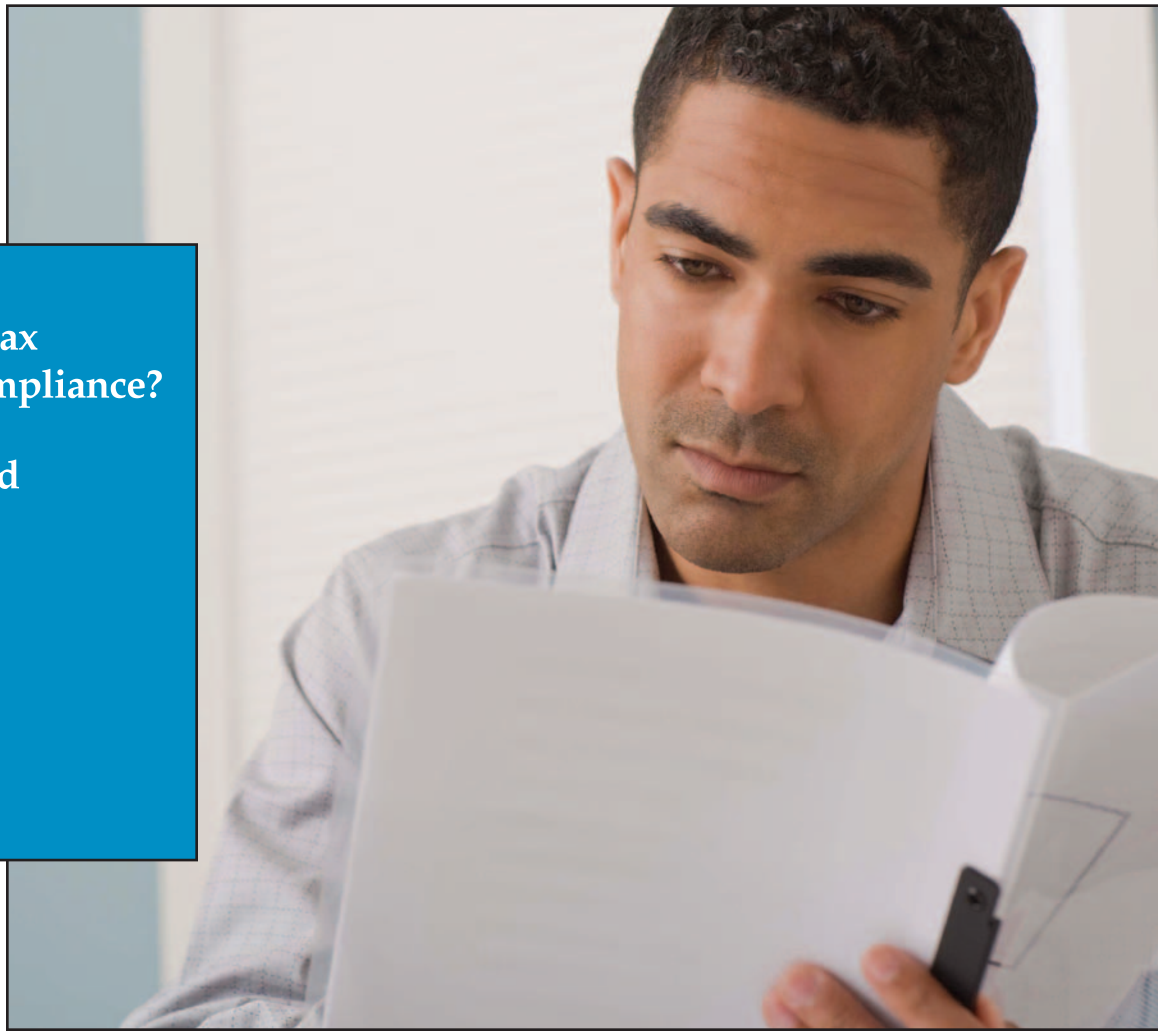

Disclosure of uncertain tax positions: Are you in compliance?

As a not-for-profit, tax-exempt organization, you might think that the subject of "uncertain tax positions" doesn't apply to you. Think again — some of the basics of your operations, including your tax-exempt status, could create uncertain tax positions that trigger critical reporting obligations.

FIN 48 IN A NUTSHELL

For several years now, the Financial Accounting Standards Board (FASB) has required taxpayers that prepare their financial statements according to Generally Accepted Accounting Principles (GAAP) to adhere to Accounting Standards Codification Topic 740, *Income Taxes,* Subtopic 740-10 — more commonly known as FIN 48. Under FIN 48, taxpayers must disclose in their financial statements information on uncertain tax positions (UTPs).

While FIN 48 applies only to positions related to income taxes, the practices of some nonprofits could trigger the disclosure requirement. To determine whether your organization has UTPs under FIN 48, you must engage in a two-step process: recognition and measurement.

Recognition. First, identify the tax positions and determine whether, based on their technical merits, it's more likely than not (more than 50% likely) that the positions will be sustained upon examination by taxing authorities. Assume that your organization will be audited by authorities who have all relevant information on the position.

Measurement. For each position that fails to meet the more-likely-than-not threshold, measure the amount of potential tax liability, including taxes, interest and penalties. If the aggregate amount of all UTPs is material (that is, the omission or misstatement of the amount could influence the economic decision of users taken on the basis of the financial statements), it must be disclosed in the financial statement footnotes (and, in turn, on Schedule D of IRS Form 990). Where financial statements are consolidated, FIN 48 applies to each of the consolidated entities, and the UTPs are aggregated for the consolidated group to see if disclosure is required.

Remember — FIN 48 applies only to *income* tax positions. Positions related to sales, use, payroll, excise and other types of taxes aren't part of the analysis.

THE EXEMPTION ISSUE

You may be surprised by the assertion that a tax-exempt organization could have an uncertain tax position. But uncertainty may exist. For example, if your nonprofit generates substantial net income from unrelated business operations, rather than only from operations related to its exempt purpose, it might be considered a taxable entity. Your organization's exempt status also could be threatened, and thus uncertain, if:

- Insiders receive excessively high compensation or buy undervalued assets from the organization,
- Management focuses substantial attention on generating unrelated business income,

- ✶ The nonprofit engages in substantial lobbying activities, or
- ✶ The organization's current activities are unrelated to the activities originally disclosed to tax authorities as the basis of the exemption.

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Don't assume that, because your not-for-profit has never been audited, its exempt status would necessarily be upheld in an audit. The above factors and others could cost you the exemption.

UNRELATED BUSINESS INCOME

Unrelated business income also can create uncertain tax positions. Nonprofits may take numerous tax positions on its taxable income — including what is and isn't taxable income. Uncertain tax positions regarding unrelated business income also could include:

- ✶ Allocation of expenses against unrelated business income,
- ✶ Not filing income tax returns in a state, local or foreign jurisdiction for unrelated business activities conducted in that jurisdiction,
- ✶ Apportionment of income earned in other jurisdictions, or
- ✶ Deeming an activity that repeatedly generates net operating losses (NOLs) a business activity, and using the NOLs to offset unrelated business income.

The critical question is whether the organization is recognizing too much tax benefit as a result of the tax positions it takes on tax returns for unrelated business income.

FIN 48 AND THE IRS

With the IRS requiring the reporting of your FIN 48 footnotes on Schedule D of Form 990, you can expect that any UTPs will be targeted in an audit. Your financial advisor can help ensure you have the appropriate documentation to withstand scrutiny of these positions. ❋

A window to your world

Making sure your board echoes your community's diversity

Board members are your nonprofit's ambassadors to the constituencies you serve. But when someone from the outside takes a look inside, does she or he see a reflection of your community, or are the images a mismatch?

IDENTIFYING THE PROBLEM

In its infancy, a nonprofit may simply want to get the word out about its mission. So recruiting as many loved ones, friends and friends of friends as possible may be the most efficient approach. As time passes, however, the not-for-profit might find that it's represented solely by one race, sex, religion or economic class.

Such lack of diversity can signal an underlying problem: a disconnect from the community. A nonprofit can improve its funding and program effectiveness when it reflects the population it serves, as well as the community (or communities) in which it operates.

MIXING THINGS UP

What's considered "healthy" diversity will vary from organization to organization. But think of it like this: The more diverse your board is in attributes, the more diverse it will be in thoughts and ideas. This diversity can come in many forms — physical, societal or economic. The goal is to mirror the population you serve in your appointees to the board.

If your bylaws limit the number of board members you can have at any given time, you might consider amending them to include the nonprofit's commitment to board diversity. Be very careful, though, that the size of your board doesn't become unwieldy. There are other ways to commit to well-balanced leadership and community input. (See "Other paths to diversity" on page 5.)

ASSESSING SKILLS AND DEMOGRAPHICS

The first step to a great mix is to ask board members to write their own profiles. In the instructions you give — or on the form you provide — include the attributes you consider important, such as skill sets and a particular demographic. From this information, you'll be able to see what the board may lack.

Look at the group as a whole and assess where the organization lies on the diversity continuum. Imagine a scale from "1" to "5" with "5" displaying your nonprofit's ideal diversity. Assess your members and give yourself a score. The diversity, or lack thereof, should be obvious. You may find, for example, that the board is underrepresented by females, persons of color, young adults or individuals with a financial background.

GETTING THE WORD OUT

Identifying that your board needs more diversity is easy. Figuring out what to do about it can be more difficult. Start with your current board members. Communicate with them the need for diversity — if they haven't already vocalized the need themselves. Ask members to dip into their personal and professional networks to help find the right individual(s) for your nonprofit.

Also gather input from your community and the organizations that serve it. Your chamber of commerce might be a place to start, but there are many options. If your nonprofit lacks the perspective of young professionals, for example, contact a local "young professionals" group in your area or recent college graduates. Does your organization need diversity via a financial perspective? Express your need to a local CPA firm.

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SEEKING EXTERNAL HELP

If you're having trouble finding qualified board members, try a board placement service. Some communities have board training programs for professionals. At the completion of the program, the "graduates" are invited to meet and mingle with organizations seeking new board members. This is a great service for both the new board member and the not-for-profit.

OTHER PATHS TO DIVERSITY

Suppose your not-for-profit wants to add diversity to its leadership to better mirror the community or communities it serves. But the organization also doesn't want to increase its board size for fear of losing efficiency. Until a member of your board ends his or her term, you can beef up diversity by appointing new people to these structures *now:*

An advisory board. Often considered an "informal" board, an advisory board can bring additional qualifications and demographics to your organization. An advisory board is also the perfect training ground for potential leaders.

Board committees or subcommittees. Special projects or areas of interest may warrant recruiting more volunteers to donate time and energy to your organization. If the not-for-profit is national, for example, board committees might serve the interests of particular regions or chapters.

Focus groups. Although not a standing structure, focus groups are extremely useful in collecting the opinions of particular demographic groups on targeted topics.

Professional associations also can be a good recruitment resource. Some state CPA organizations, for example, help match accountants with nonprofits that need volunteers. You also could seek out a nonprofit consultant that can assist with board placement.

OPPORTUNITIES, OPPORTUNITIES

Building an effective board of directors should be a challenge that your not-for-profit happily faces. Every time a board member resigns, an opportunity to give your organization the wings of diversity emerges. ❋

Make your mark by benchmarking

The word "benchmark" may strike some as organizational lingo, but the practice of benchmarking often proves valuable for nonprofits. Nonprofits that incorporate financial benchmarks into their operations are better at anticipating negative financial trends and may even see revenues climb, expenses drop and efficiencies improve.

WHAT IS BENCHMARKING?

Benchmarking is an ongoing process of measuring an organization against expectations, past experience or industry norms for productivity and profitability and then making adjustments to improve performance in relation to those metrics. Ideally, your nonprofit will consider both:

1. Internal benchmarks — to monitor and detect trends, based on your organization's historical results and statistics, as well as expectations, and

2. External benchmarks — to ascertain where it's thriving and where it lags behind, based on data from peers.

Benchmarking provides essential information for effectively developing and implementing strategic plans. It helps an organization keep a watchful eye on its financial health and determine where costs can be cut and revenues increased. Nonprofits can use benchmarks to demonstrate their efficiency to stakeholders such as donors and grantors.

BENCHMARKS FOR NONPROFITS

The first step is to define what your nonprofit needs to measure. Focus on the metrics that are most critical to the success of your mission and the key indicators of the organization's financial health and operational effectiveness. For many nonprofits, those metrics will include:

Program efficiency (program service expenses / total expenses). This ratio identifies the amount you spend on your primary mission, as opposed to administrative and fundraising costs. This ratio is of utmost importance to stakeholders.

Fundraising efficiency (unrestricted contributions / unrestricted fundraising expenses). How many dollars do you collect for every dollar you spend on fundraising? The higher this ratio, the more efficient your fundraising. What qualifies as a good ratio depends on the organization's size, its types of fundraising activities, and so on.

Operating reliance (program service revenue / total expenses). This ratio indicates whether your nonprofit could pay all of its expenses solely from program revenues.

Organizational liquidity (expendable net assets / total expenses). How much of the year's total expenses is considered expendable equity or reserves? The higher the ratio, the better the liquidity.

Also consider benchmarks such as average donor contributions, expenses per member and other ratios that measure trends for liquidity, operating yield, revenue, borrowing, assets and similar metrics. No matter which benchmarks you choose, though, you'll need reliable processes for collecting and reporting the data.

FOR COMPARISON'S SAKE

Comparing the nonprofit's performance to benchmarks allows you to zero in on areas with the greatest potential for improvement. Armed with this information, you may be able to improve performance without making significant changes in your operations. Further, when comparing against external benchmarks, you might improve performance by simply adopting best practices used by your peers.

You can obtain information on other nonprofits' metrics from websites such as GuideStar and Charity Navigator or from commercial software. Information also may be available from state government databases and trade associations. Take steps, though, to ensure you're comparing apples to apples — that the two organizations you are stacking up against each other are truly comparable.

MAKE IT A TEAM EFFORT

Some organizations have found it worthwhile to include staff in the benchmarking process. Their involvement in setting aggressive but attainable benchmarks — and measuring progress — can achieve buy-in and help foster teamwork as your nonprofit moves toward and surpasses its goals. Also include your financial advisor, who can help you select the most appropriate benchmarks for your organization and provide advice on how to improve your financial and operational performance. ❋

Newsbits

IRS LAUNCHES EXEMPT ORGANIZATIONS SELECT CHECK

The IRS has developed a new searchable database that lets users check certain information about not-for-profits' federal tax status and filings. The search tool, called "Exempt Organizations Select Check" (http://apps.irs.gov/app/eos), consolidates three former search sites into one, providing expanded search capability.

Users can select an organization and check whether it 1) is eligible to receive tax-deductible charitable contributions, 2) has filed a Form 990-N annual electronic notice, and 3) has had its tax-exempt status automatically revoked because it hasn't filed the required Form 990–series return for three consecutive years. The search results are sortable by name, employer ID number, city, state, country and other categories.

The site will be updated monthly, and, while organizations that have lost their tax-exempt status for failing to file tax returns can get reinstated, their names will remain on the list of those that have lost their tax exemptions. ❃

MOVING A FOOD DRIVE ONLINE

The Food Bank for New York City has taken its food drive to the Internet. With its interactive virtual food drive fundraising tool, donors can create a personalized Virtual Food Drive page and invite friends, family or co-workers to donate. The Food Bank believes the new approach will help put more meals on the table for New Yorkers in need, faster and at less cost than through traditional food collection drives.

The tool mirrors the online grocery shopping experience. Users can shop the aisles (meat and fish, grains and beans, and so forth), put items in a shopping cart to check out and make a secure donation on the Food Bank Web servers.

The tool also can be used to set up fundraising goals and competitions. Donors immediately see how their participation affects the fundraising goal, and corporations and organizations receive access to full reporting of donations so they can track their campaigns' success. ❃

INDEPENDENT SECTOR SHIFTS ITS FOCUS

Independent Sector, a coalition of nonprofits, foundations and corporate giving programs, has recently decided to redirect the bulk of its efforts. The organization had focused largely on opposing proposals to limit the charitable tax deduction for high-income taxpayers.

This past winter, however, Independent Sector adopted new "Guiding Principles on Deficit Reduction and Tax Reform." The principles build on the premise that — as a matter of justice, fairness and effectiveness — steps taken to address the nation's fiscal challenges should favor policies that won't exacerbate income inequality or increase poverty. The principles will guide the organization's analysis and commentary on budget, deficit reduction and tax proposals. ❃