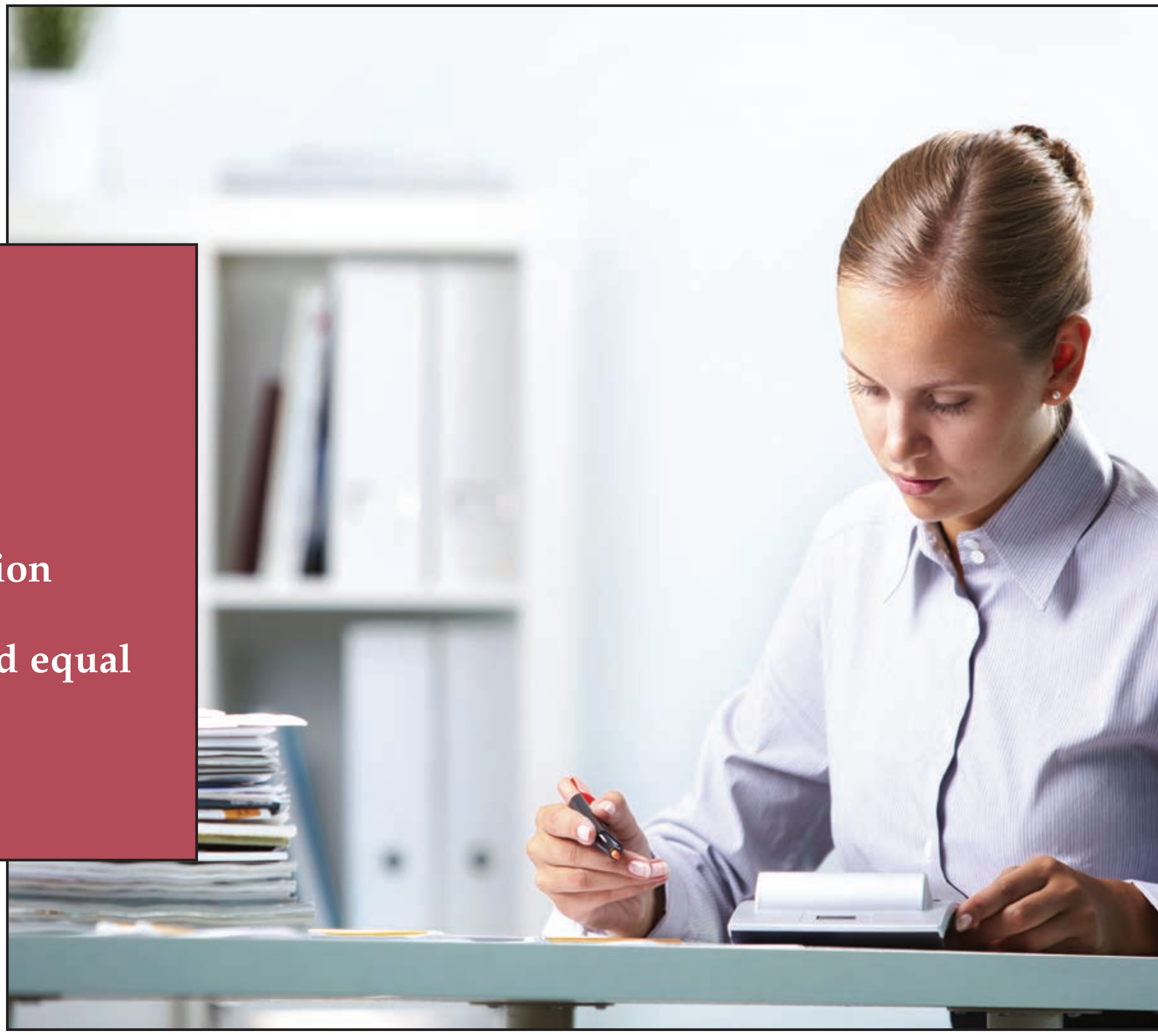
Profitable **Solutions** *for* **Nonprofits**



Summer 2014

Footnotes tell a story

What constituents can glean from your financial statements

When reviewing financial statements, nonprofit board members and managers sometimes make the mistake of focusing solely on bottom-line figures. But financial statements also may include a wealth of information in their disclosures.

Savvy constituents and potential supporters know this and will examine the notes to your financial statements to gain a sense of how well your organization is pursuing its mission. This means that you, too, need to be familiar with the common types of disclosures and the information they make available for scrutiny.

WHAT'S IN YOUR ACCOUNTING POLICIES?

The summary comprises two sections: a brief description of your nonprofit (including its chief purpose and sources of revenue) and a list of the main accounting policies that have been applied in preparing your financial statements (with a subsection for each specific policy). A policy is generally considered significant if it could materially affect the determination of financial position, cash flows or changes in net assets.

The summary outlines specific policies such as:

- The accounting method used in the financial statements (accrual, cash basis or modified cash basis),
- Classification of cash equivalents,
- Fixed asset capitalization and depreciation,
- Investments,
- Uncertain tax positions,
- Recognition of contributions and grants as revenue, and
- Recognition of in-kind contributions.

The disclosure of accounting policies should describe accounting principles and methods that have been selected from acceptable alternatives, and explain

industry peculiarities or unusual or innovative applications of Generally Accepted Accounting Principles (GAAP).

HOW ARE YOUR INVESTMENTS PERFORMING?

Nonprofits must disclose in the notes a variety of information related to investments, beginning with the types of investments, such as equities, U.S. Treasury securities and real estate. Among other information, the notes must disclose the carrying amounts for each major type of investment, current year income, realized and unrealized gains and losses, and information about how fair value is determined.

HAVE YOU HAD RELATED PARTY TRANSACTIONS?

Constituents may look to the related party transaction disclosure to determine if the not-for-profit is susceptible to conflicts of interest. The note describes transactions entered into with related parties such as board members, senior management and major donors. The description should include the nature of the relationship between the parties, the dollar amount of the transaction and any amounts owed to or by the related party as of the date of the financial statements, and the terms and manner of settlement. Guarantees between related parties also must be disclosed.

WHAT ABOUT CONTINGENCIES?

The not-for-profit must disclose any reasonably possible loss contingencies. Contingencies are existing conditions that could create an obligation in the future but arise from past transactions or events. Constituents may find loss contingencies of particular interest because of their potential effect on financial position and net assets. The financial statement notes must disclose the nature of the contingency and provide an estimate of the loss (or state that an estimate can't be made). In certain circumstances, gain contingencies also may need to be disclosed.

Financial statements should disclose information that allows users to compare the total amount of fundraising costs with the related proceeds and total program costs.

Examples of nonprofits' contingencies include:

- Pending, threatened or unasserted litigation, claims and assessments,
- Claims for costs or expenditures that could be disallowed under a government grant,
- Current IRS examinations related to tax-exempt status, unrelated business income, excise or other taxes, and
- Arrangements with financial institutions, such as guarantees and endorsements.

Contingencies related to noncompliance with donor restrictions also should be included in the disclosures.

WHAT WERE YOUR FUNDRAISING COSTS?

Contributors, funding sources and regulators tend to be more interested in total expenses by function, such as fundraising costs, than expenses for line items like professional fees, postage and supplies. Nonprofit financial statements should disclose information that allows users to compare the total amount of fundraising costs with the related proceeds and total program costs. If a ratio of fundraising expenses to funds raised is disclosed, the organization also should describe the method used to compute it.

WHAT'S BEHIND THE NUMBERS?

Bottom-line numbers don't always tell the whole story of an organization's financial health. Board members and management need to follow the lead of their savvier constituents and take the time to read the disclosures so they know the facts behind the figures and can plan for their organization accordingly. ❃

A FORM 990 DISCLOSURE GETS RENEWED ATTENTION

Financial statements aren't the only place where not-for-profits make critical disclosures. Last fall, the *Washington Post* published a blockbuster article that drew public attention to what it dubbed "the most intriguing check box" on the Form 990.

The *Post* was referring to line 5 in Part VI, which asked, "Did the organization become aware during the year of a significant diversion of the organization's assets?" A diversion is "significant" if it exceeds $250,000 or 5% of the organization's receipts or assets.

The writer found that more than 1,000 nonprofits had checked the "yes" box from 2008 to 2012, disclosing losses attributed to theft, investment fraud, embezzlement and other unauthorized uses of funds. Such "financial skullduggery" drained "hundreds of millions of dollars from institutions that are underwritten by public donations and government funds."

The *Post* has now established a public, searchable database of nonprofits that have disclosed diversions. Nonprofits would be wise to expect their constituents to check the database and possibly request further information.

Tips for preventing fraud in your organization

If your nonprofit became a victim of fraud, it wouldn't just hurt your organization's bottom line — the infraction also could do devastating damage to your reputation. By implementing some simple controls, though, your organization can help protect itself from these risks.

SEGREGATE DUTIES

One of the most important preventive measures is the segregation of accounting duties, especially those related to executing outgoing payments. You should assign different employees to approve, record and report transactions. And the employee who generates checks for payment or approves invoices shouldn't also be responsible for signing checks or initiating online payments.

Similarly, the staffer who makes bank deposits shouldn't be charged with reconciling the organization's bank statements. If the nonprofit is too small to segregate duties fully, consider rotating staff through the various duties regularly, or involving a board member to oversee the process. You also can adopt a mandatory vacation policy to make it more difficult for fraudster employees to conceal their schemes.

PROVIDE TRAINING

Research conducted by the Association of Certified Fraud Examiners (ACFE) shows that organizations with antifraud training programs experience lower losses, and frauds of shorter duration, than those without. Nonprofits should provide targeted fraud awareness training not just for managers but also for employees.

Management should encourage employees to report any suspicious activity and enforce an antiretaliation policy.

At a minimum, the ACFE recommends explaining which actions constitute fraud, how fraud harms everyone in the organization and how to report suspicious activity. Managers and employees also should be educated on the behavioral red flags of perpetrators and encouraged to keep an eye out for them. Red flags include an employee who appears to be living beyond his means or one who refuses to take time off. Additionally, some insurance providers offer discounts if certain antifraud training is attended by a majority of staff members.

SET UP A HOTLINE

Fraud hotlines are one of the most effective strategies for uncovering fraud. The ACFE has consistently found that tips are the most common means of detecting fraud. The majority of tips come from employees, but the hotline also should be available and publicized to vendors and constituents.

Management should encourage employees to report any suspicious activity and enforce an antiretaliation policy so employees aren't reluctant to speak up. Ideally, the hotline should be anonymous, or at least confidential.

ASSESS RISKS

Last year, the AICPA published its 2013 *Audit Risk Alert: Not-for-Profit Entities Industry Developments.* The alert urges not-for-profits to develop a formal fraud risk management program, including a fraud risk assessment.

According to the AICPA, a fraud risk assessment should identify:

- The fraud schemes that could potentially happen,
- The possible concealment strategies that a fraudster can use to avoid detection,
- The individuals within or outside the organization who pose the highest risk of committing fraud, such as accounting or information technology personnel,
- The controls currently in place to deter or detect fraud, and
- A list of warning signals or red flags that can be used to educate the organization, including both employees and board members.

The goal of the assessment is to identify any vulnerabilities and gaps in internal controls that could leave your nonprofit susceptible to financial and reputational damage.

MAKE IT A JOINT EFFORT

Cutting the risks of fraud requires the board of directors and management to be aware of your nonprofit's vulnerabilities. Staff also must pitch in, staying on the lookout for red flags, conflicts of interest and other potential issues — and they must be comfortable reporting any concerns. Your financial advisor can help, too, by conducting a fraud risk assessment and suggesting ways to establish appropriate controls. ✻

Not all funds are created equal

Nonprofit organizations typically depend on a variety of funding to keep them alive and well. They need funds to pay their bills, pay their staffs and pay for the costs of running their programs. But savvy nonprofits know that not all that's green has equal value and flexibility. Types of funding vary greatly in how they can — or cannot — be used.

UNDERSTANDING THE TYPES OF GIFTS

Your nonprofit should decide from the onset what type of funds it wants to solicit, and what types it's willing to accept. Here are the three main categories to consider:

Permanently restricted funds. Often called endowments, these funds are subject to lasting donor stipulations, which mandate that the funds be "held in perpetuity." The donor can limit earnings to use for a specific purpose or allow them to support operations.

Temporarily restricted funds. These gifts are subject to donor-imposed stipulations that can be removed with the passing of time or when spent for the purpose intended by the donor.

Unrestricted funds. These funds are free of donor stipulations. Board-designated funds are included

in this category. Although the board has decided to use these funds for a certain purpose, it can "undesignate" the funds at a future date.

PURSUING WHAT WORKS BEST

Charitable organizations need cash to carry out their daily operations and unanticipated costs. Thus, having an adequate and steady stream of funds *without strings attached* — unrestricted funds — is the best way to keep a charity's operations and programs strong and sustainable.

Unlike temporarily or permanently restricted funds, unrestricted funds can be used to cover the cost of operating expenses, such as rent, utilities, salaries and other day-to-day expenses. The grants and individual donations a nonprofit receives for general operating support allow management to refocus its efforts from raising funds to improving programs and responding to emerging community needs.

To secure funds without restrictions, prove to donors that you'll use their money wisely.

FACING PUBLIC OPINION

Before an organization sets out to solicit unrestricted funds from individual and corporate donors, it should understand what it's up against: There's a public sensitivity toward nonprofits that spend too much money on administrative costs and too little on programs that fulfill their missions.

To secure funds without restrictions, prove to donors that you'll use their money wisely. One way to do that is by presenting a healthy program service expense ratio and results-focused information on your Form 990, which is made publicly available.

BEING STRAIGHTFORWARD WITH YOUR CONSTITUENTS

When asking for unrestricted funds, being direct is best. Explain in your fundraising materials how unrestricted gifts offer greater flexibility than restricted gifts and how they help ensure you have adequate funds to keep the doors open. Moreover, encourage donors to make multiyear commitments for unrestricted gifts. Having funding dedicated to future years allows management to plan with more foresight.

Ask funders to designate their donations "as unrestricted funds that help the organization." You also might consider naming a fund after families or individuals who give only unrestricted funds. It might just help encourage contributions of this type.

Sometimes grantors, such as government agencies or foundations, require that funds be restricted to a particular program or function. If that's the case, you may still be able to factor in an administrative component of, say, 8%–10% to help cover operational costs.

DON'T GET BOXED IN

When contributions, large and small, shrink during tough economic times, you'll want to have enough "money in the bank" to help you ride out the storm. Unrestricted funds offer flexibility for funding programs to meet your mission *and* take care of operational costs. ❃

Newsbits

A-133 AUDIT THRESHOLD RAISED FOR SMALL NONPROFITS

The Office of Management and Budget (OMB) has streamlined its guidance on grants management, including administrative requirements, cost principles and audit requirements for federal awards. Among other things, the new rules reduce the burden on smaller nonprofits by increasing the threshold that triggers compliance audits currently performed under OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (also known as single audits).

The federal threshold will jump to $750,000 from $500,000 — nonprofits will be required to undergo a single audit only if they spend $750,000 or more in federal awards in a fiscal year. Those that spend less are required only to make their records available for review or audit by the federal awarding agency, any pass-through agency and the U.S. Government Accountability Office. The new rules take effect for fiscal years beginning on or after Jan. 1, 2015. ❃

STUDY UNCOVERS NONPROFITS' ONLINE FUNDRAISING FAILURES

Most organizations have room for improvement with online fundraising, according to a study of 151 national charities, conducted by the consulting group Dunham+Company and the fundraising think tank Next After. Researchers found that most organizations don't do enough to persuade supporters to sign up for e-mails and that their messages don't provide enough direction as far as actions recipients should take, such as donating or signing a petition.

Of those responding, 37% sent no e-mails within 30 days after visitors signed up to receive them, and 56% didn't ask for a donation within 90 days. Additionally, 84% hadn't made their donation websites easy to read on mobile devices. And 65% of their websites required visitors to click through three or more pages to give online. With contributions hard to come by, your organization should eliminate any of these shortcomings, if applicable. ❃

CENTER LAUNCHES OPEN DATA TOOL

The Foundation Center, a source of information about philanthropy, has launched Foundation Stats (data.foundationcenter.org), an online tool that provides free and open access to data on nearly 82,000 independent, corporate, community and grantmaking operating foundations. Users can explore foundations' basic financial data by organization type, location and fiscal year. The grants section, based on giving by the top 1,000 U.S. foundations, allows users to filter data by recipients' geographic location and by subject area or population group served.

Users also can generate their own tables, charts and graphs to show trends over time, and all custom results can be downloaded for use in spreadsheets. And the tool includes an application programming interface so Web developers can freely extract multiple years of aggregate-level statistics for their own use. ❃