Profitable Solutions For Nonprofits

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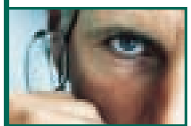
Katz, Sapper & Miller
Certified Public Accountants

800 East 96th Street
Suite 500
Indianapolis, IN 46240

Phone: (317) 580-2000
Fax: (317) 580-2117

Heavy duty

Help board members understand their fiduciary responsibilities



Heightened Congressional and public scrutiny of tax-exempt organizations has thrust non-profit board members into the spotlight. Lawmakers, watchdog groups and others are keenly interested in nonprofits' governance practices. Given the growing interest in nonprofit activities, it's a good idea for board members to re-examine their roles and responsibilities.

Understanding fiduciary duties

Nonprofit board members — whether compensated or not — have a fiduciary duty to the organization. The Law.com Dictionary defines a fiduciary as a person "who has the power and obligation to act for another … under circumstances which require total trust, good faith and honesty."

Some states have laws governing the responsibilities of nonprofit board members and other fiduciaries. But in general, a fiduciary has three primary duties:

1. Duty of care. Board members must exercise reasonable care in overseeing the organization's financial and operational activities. Although disengaged from day-to-day affairs, they should understand the organization's mission, programs and structure, make informed decisions, and consult others — including outside experts — when appropriate.

2. Duty of loyalty. Board members must act solely in the best interests of the organization and its constituents, and not for personal gain.

3. Duty of obedience. Board members must act in accordance with the organization's mission, charter and bylaws, and any applicable state or federal laws.

Board members who violate these duties may be held personally liable for any financial harm the organization suffers as a result.

Avoiding conflicts of interest

One of the most important components of the duty of loyalty is the obligation to avoid conflicts of interest. In general, a conflict of interest exists when an organization does business with:

- A board member,
- An entity in which a board member has a financial interest, for example as an owner, investor, officer, employee or consultant, or

How can a volunteer be liable?

Most nonprofits depend on the generosity of volunteers and board members, and there's a common misconception that volunteers are shielded from liability. In fact, though they do enjoy some protection from financial responsibility, that protection isn't absolute.

Congress enacted the Volunteer Protection Act of 1997 (VPA) to encourage people to volunteer without fear of liability, and many states offer similar protection. Under VPA, a volunteer is someone whose yearly compensation (in money or other value) is no more than $500. VPA protects volunteers against liability for negligence committed when acting within the scope of their employment, except when operating a vehicle.

But the law doesn't protect volunteers who cause harm through "willful, criminal, or reckless misconduct, gross negligence, or a conscious, flagrant indifference to the rights or safety of the person harmed." And VPA limits liability only to third parties. It doesn't affect a volunteer's liability to the organization itself.

- Another company or organization for which a board member serves as a director or trustee.

To avoid even the appearance of impropriety, it's also a good idea to treat a transaction as a conflict of interest if it involves a board member's spouse or other family member, or an entity in which a spouse or family member has a financial interest. The key to dealing with conflicts of interest — whether real or perceived — is *disclosure*. The board member should disclose the relevant facts to the board and abstain from any discussion or vote on the issue, unless the board determines that he or she may participate.

Disclosing key information

Full disclosure often is the most effective way for fiduciaries to meet their obligations. Consider the case of Richard Grasso, former Chairman of the New York Stock Exchange (NYSE). In 2006, a New York court ordered him to repay almost $100 million in compensation from supplemental retirement plans due to a provision of the state's Not-for-Profit Corporation Law. At press time, the case was on appeal.

The court held that Grasso had breached his fiduciary duty to the then-nonprofit NYSE by accepting excessive compensation and failing to disclose the enormity of his compensation package to the board. The court also criticized the board for failing to do its homework.

Taking responsibility

The rules concerning the liability of fiduciaries are complex. But nonprofit board members can meet their obligations by acting in good faith, putting the organization's best interests first, making informed decisions and disclosing any potential conflicts of interest. ✧

In good form

Get ready for the new Form 990

Form 990 is much more than a tax return. Many nonprofit organizations consider it their most effective tool for communicating with donors and the public about their missions, operational performance and financial results.

Recently, Form 990 underwent a major redesign, and last June the IRS published a draft for public comment. The revised form should be ready for the 2008 tax year, for returns filed in 2009. Becoming familiar with the changes now will enable you to develop procedures for tracking and collecting the information the new form requires.

Significant improvements

In overhauling Form 990, the IRS aimed to enhance transparency, promote compliance and minimize the burden on filing organizations. The revised form highlights controversial areas, such as executive compensation and insider loans, to pinpoint potential compliance problems and make it easier for donors and others to locate the information they need.

The new form consists of a 10-page core and 15 schedules to be completed by certain types of filers or organizations involved in specific activities. One major improvement: Questions on related subjects are grouped together in a more logical format than on the current form.

Some other highlights:

Summary section. The first page includes a summary of the entire return, providing a snapshot of key financial and operational information. In addition to your mission and three most significant activities, you'll need to report:

- The number of people receiving more than $100,000 in compensation,
- The highest amount of compensation for any one person,
- Compensation paid to officers, directors, trustees and other key employees, in the aggregate and as a percentage of program service expenses,

- The number of members of your governing body, and the number of those who are independent,
- Management, fundraising and program service expenses, and
- Fundraising expenses as a percentage of contributions received.

Take special care when completing this summary section, which will likely be the only part of the form that many users read.

Compensation. The revised form expands the compensation information required, moving it up to Part II on page 2. Schedule J requires detailed information about the pay of certain highly compensated or former officers, directors, trustees and other key employees. You'll need to break down compensation into 11 components, highlighting potentially problematic practices, such as equity-based compensation, fringe benefits and supplemental retirement plans.

Governance. Part III requires Sarbanes-Oxley-inspired disclosures about key governance, management and financial reporting matters. Examples include board composition; whether you have written conflict-of-interest, whistle-blower and document retention or destruction policies; whether you have an audit committee; the level of review of your financial statements by an independent accountant; and the extent to which the board reviews Form 990 before filing.

These items are of great interest to donors and other readers. You may want to re-evaluate your governance policies and procedures in light of heightened disclosure requirements.

General activities. Part VII asks 17 questions about your organization's activities. Many are designed to prompt completion of a schedule or elicit information about suspect activities. Some areas covered are foreign activities, conservation easements, provision of credit counseling, maintenance of donor-advised funds, investment of tax-exempt bond proceeds and activities conducted through partnerships or limited liability companies.

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Schedules. Besides Schedule J, other noteworthy schedules include:

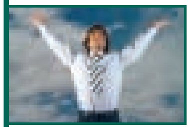
- Schedule C, which requires information on political and lobbying activities,
- Schedule D, which seeks supplemental financial information — for instance about uncertain tax positions disclosed under the Financial Accounting Standards Board's Financial Interpretation No. 48,
- Schedule H, to be completed by hospitals and other medical care facilities and which requires detailed information about community benefits, and
- Schedule L, which expands the information currently required about loans to and from highly compensated employees and other disqualified persons.

Additional schedules cover foreign activities, fundraising, tax-exempt bonds, noncash contributions and related organizations.

Time to prepare

Before implementing revised Form 990, the IRS may make more changes. Begin preparing now by consulting your financial advisors to learn whether you'll need to modify your accounting systems. Or you may need to develop new procedures to capture the information Form 990 will require for the 2008 tax year. One good way to get started is to fill out a test form to identify any gaps in your current procedures. ✧

7 tips for a successful succession



As baby boomers reach retirement age over the coming years, most nonprofit organizations will undergo leadership transitions. A 2006 study by the Eugene and Agnes E. Meyer Foundation and CompassPoint revealed that 75% of executive directors (EDs) expected to leave their current jobs in the next five years. Yet only 29% had talked about a succession plan with their boards.

By the numbers

Here are seven tips for making your succession run more smoothly:

1. Put your plan in writing. A written succession document is critical to avoiding confusion or conflict when the time comes to go forward with your plan.

2. Look within. As baby boomers retire, there's a shrinking pool of management talent to replace them. It's more important than ever to develop employees who can move up the ladder when an ED or other senior manager leaves. But don't rule out hiring an outsider. Promoting from within can be difficult for smaller organizations with limited "bench strength."

3. Maintain a strong board. A qualified, active board can conduct or assist in the search for a successor and support the new ED through the transition period. At the helm, they can provide continuity and leadership during a challenging time.

A written succession document is critical to avoiding confusion or conflict when the time comes to go forward with your plan.

4. Beef up systems and procedures. Solid systems and strong, well-documented procedures help you leverage organizational knowledge and keep the organization running smoothly during the transition.

5. Expect the unexpected. Ideally, you'll go through a "planned succession," with plenty of time to identify and recruit a successor and conduct an orderly transition. If possible, your plan should provide for some overlap, allowing the outgoing leader to mentor his or her successor.

Unfortunately, we don't live in an ideal world, so develop an emergency succession plan for sudden departures. The plan should outline policies and procedures for communicating with donors, clients and the press, as well as steps the board should take to search for a replacement.

Your emergency plan also should contain provisions for handling an ED's responsibilities until a successor is appointed. You might hire an interim ED or consulting firm, or cross-train existing employees to handle aspects of the ED's job in a crisis. This resource also can help pinpoint potential successors from within. Some organizations even arrange for their ED to take a sabbatical or leave of absence to test out their backup plan.

6. Take a strategic approach. Don't assume the ideal candidate is as similar as possible to the outgoing ED. Organizations and their constituencies change over time. Succession planning provides a great opportunity for your organization to re-evaluate its strategies and identify the qualities a new ED should have.

7. Look beyond the ED. The ED may be critical to your organization's success, but a good succession plan should also address other key roles, including board members, chief financial and operations officers and leaders of important programs.

Succession planning provides a great opportunity for your organization to re-evaluate its strategies and identify the qualities a new ED should have.

No time like the present

When an organization loses an ED or other key leader, it risks declining contributions, lowered employee morale and disruption to its ability to carry out its mission. Create a well-designed succession plan now, and you can minimize these risks for your organization. ✧

Are alternative investments worth the risk?

In recent years, more and more nonprofits have embraced alternative investments such as hedge, private equity and real estate funds. These investments can produce above-average returns — especially in volatile or down markets. But they involve greater risk for organizations and more responsibilities for management and auditors.

Handle with care

Alternative investments require heightened due diligence, both when choosing an investment and monitoring its performance. These investments generally aren't publicly traded, so they're less liquid than traditional equity investments.

In addition, many alternative investments are loosely regulated by the U.S. Securities and Exchange Commission or National Association of Securities Dealers. Some aren't regulated at all. Before making an investment it's critical to research a fund's track record as well as the investment manager's qualifications and reputation.

Consult your advisors

As you consider alternative investments, consult your auditors and other financial advisors to discuss their potential impact on your financial statements. Unlike publicly traded securities, whose market prices are published daily, alternative investments can be difficult to value. Remember, your organization's management is responsible for determining the value of these investments. You can't simply rely on value calculations by fund managers or other third parties.

That doesn't mean you have to recalculate a fund manager's fair value estimates. But you do need controls in place to ensure that those estimates are properly prepared. Unfortunately, this can be a challenge because alternative investments often lack transparency, and fund managers may provide little detail about the underlying assets.

If detailed information about a fund's holdings is unavailable, your auditors will have to perform additional procedures to substantiate the investment's value. Depending on the portion of your portfolio allocated to alternative investments, an auditor might conclude that limited information about the underlying assets requires a qualified opinion.

Newsbits

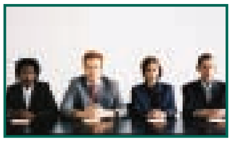
Dot the i's and cross the 990-Ts

Does your organization have unrelated business income (UBI)? If so, are you prepared for public disclosure of Form 990-T? Tax-exempt organizations with a gross UBI of $1,000 or more are required to file Form 990-T, but until recently the form wasn't open to public inspection.

Under the Pension Protection Act of 2006, all 501(c)(3) organizations that file a Form 990-T after Aug. 17, 2006, must make it available to the public in the same manner as Form 990. According to IRS interim guidance, the requirement applies to churches and other religious organizations that aren't required to file Form 990 or 990-EZ, as well as to state colleges and universities granted 501(c)(3) status. There's an exception, however, for 990-Ts filed solely to request a telephone excise tax refund.

It's likely that watchdog groups will scrutinize Form 990-T, so be sure that your UBI calculations are accurate. Also review your return for any items, such as insider transactions, that might raise red flags. ✧

Study finds board participation wanting



A study by the Urban Institute reveals that a significant number of nonprofit boards aren't very active in carrying out "basic stewardship responsibilities related to overseeing and supporting the organization and its mission." The study also raises concerns about "ethnic homogeneity," which may hamper some organizations' responsiveness to the communities they serve.

Key findings of the study include the following:

- Only 52% of more than 5,000 respondents said their boards are "very active" in financial oversight and organizational policy-setting.
- For most activities, only a minority of boards are "very active" — including fundraising (29%), monitoring programs and services (32%), and educating the public about the organization and its mission (23%).
- A substantial percentage of boards don't even reach the level of "somewhat active" for many activities — including fundraising (35%), monitoring programs and services (24%), and monitoring the board's own performance (45%).
- On average, 86% of board members are white, non-Hispanic; 51% of boards are composed *solely* of white, non-Hispanic members.
- Among nonprofits whose constituents are more than 50% black, 18% have no black board members; for those whose constituents are more than 50% Hispanic, 32% have no Hispanic board members.

The full report is available at www.urban.org/publications/411479.html. ✧

Google offers free software to nonprofits

Google recently announced that it's making the educational version of its Google Apps software available free of charge to 501(c)(3) organizations. The product includes e-mail accounts using your organization's domain name, a sharable calendar program, word-processing and spreadsheet applications, Internet-based telephone and instant messaging services, and Web page publishing applications. For more information, see www.google.com/a/npo.

In addition, with its Google Earth Outreach program, the company is helping nonprofits leverage Google Earth's satellite imagery to publicize the work they do. For example, an environmental or conservation group might create a "virtual visit" to a project to engage users and build support for its cause. Qualifying 501(c)(3) organizations can apply for a Google Earth Pro grant (a $400 value). See earth.google.com/outreach/index.html for more information. ✧

KATZ, SAPPER & MILLER

Certified Public Accountants

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- Transition Management
- Internal Control Review
- Process Improvement Review
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- Project Management
- Organizational Gap Analysis
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