



Profitable Solutions for Nonprofits

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Get your operating reserves in order

Recent tax law harshly affects the level of donations for many nonprofits. Combine that with uncertainties about government funding, and it's easy to see that operating reserves are more important than ever for long-term sustainability. Yet studies show that organizations often fail to maintain adequate reserves, which could potentially lead to financial disaster. If your reserves aren't up to snuff, now is the time to address the situation.

Why are reserves important?

Operating reserves — generally, unrestricted assets you can tap into easily — frequently are referred to as “rainy day funds.” But stable reserves are critical for far more pressing reasons than the metaphorical rainy day.

For starters, solid operating reserves demonstrate responsible financial stewardship to your stakeholders. They also increase the odds that you can achieve self-sufficiency, making you less vulnerable to unpredictable or cyclical revenue streams and government funding cutbacks.

Adequate reserves put you in the position to handle market-based swings in investment income, too, and enable you to cover unbudgeted expenses (for example, a roof replacement not covered by insurance). Reserves can protect against staff or program cost reductions that would cut into attaining your mission. And they can empower you to take advantage of sudden opportunities (such as the availability of new facilities). In the direst scenario, a financial cushion can allow you to wind down operations in a more orderly fashion.

Building an effective operating reserves policy

To ensure your organization maintains adequate reserves as a regular practice, it's wise to develop a formal policy approved by your board of directors. The policy should address several issues, including:

- › The minimum amount to be held in reserves at all times,
- › A plan for funding reserves — for example, from unrestricted net assets, budget surpluses, investment income or unrestricted contributions,
- › Where the funds will be held (options range from a low-interest savings account to equities, with a money market account somewhere in the middle),
- › Circumstances that warrant using reserve funds, such as a natural disaster, as well as any limitations, such as requirements for a board vote,
- › The evaluation process for determining if such circumstances exist,
- › Requirements for reporting reserves' use to the board, and
- › The process and timeline for replenishing reserves after using them.

Like most financial policies, you should revisit your operating reserves policy on a regular basis. Make sure that it remains up to date and relevant to your organization's current situation.



On the other hand, you generally shouldn't rely on reserves to make up for income shortfalls, unless you have a realistic plan to quickly replenish the fund. Reserves are better applied to income-timing problems than they are to deficit issues.

What's the right amount?

Every nonprofit's circumstances are different, so you shouldn't base your reserves level on a rule of thumb, such as three to six months of operating expenses. Six months of expenses may be too much for one nonprofit but too little for another. At a minimum, though, your organization should at least have enough reserves set aside to cover one payroll cycle.

Also look at organization-specific factors. If you're heavily dependent on government grants, public donations or fundraising events — each can experience dramatic shifts due to political or economic winds — your nonprofit should have robust reserves. But, if you have multiple, diverse revenue streams, you probably can get away with less substantial reserves.

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To determine the right amount of reserves for your organization:

Prepare a long-term financial forecast. Review your latest budget and how your strategic plans will affect budgets going forward. It's essential to develop a realistic financial forecast for all aspects of your nonprofit, including every revenue stream and expense. Is any revenue stream in jeopardy or uncertain? Is a new program launch expected to hike certain expenses? For how long?

Don't limit the financial forecast to a single year. Taking a longer view — say, five years — will help you recognize trends and key influences that might not stand out in a one-year snapshot.

Quantify your risks. Setting your operating reserves is one good reason to undergo a comprehensive risk assessment that identifies your risks, including those related to:

- › Your mission, sector and geographic location,
- › The economy, and
- › Pending or potential litigation.

Assess the likelihood and potential downside financial impact of each risk. These estimations of risk exposure can help you determine appropriate reserve amounts. Once the target level has been determined, develop a plan to fund your operating reserves.

Bear in mind that, while it might seem counterintuitive, your operating reserves can become *too* large. Your stakeholders want to see you using funds to achieve your mission, rather than accumulating stockpiles of money. Charity watchdogs often monitor nonprofits' reserves so potential donors can check on your financial stability. If your reserves are too high, donors may conclude that you don't truly need their money.

The reassurance of reserves

Successfully managing operational reserves takes time. However, the end result is worth it: a financial safety net and peace of mind for your stakeholders. ■

Financial reporting

How nonprofit accounting differs from its for-profit counterpart

Many effective nonprofit board members come from the for-profit world. They bring talent and organizational savvy that may help elevate your organization's overall performance. But, when it comes to understanding financial reporting in this new arena, these for-profit pros often need some training to help them properly oversee your organization's finances. You can start the process by explaining basic differences between for-profit and nonprofit accounting.

Purpose drives the differences

As the term suggests, for-profit companies are driven by the desire to maximize profits for their owners. Nonprofits, on the other hand, are generally motivated by a charitable or other tax-exempt purpose. From a financial perspective, they need adequate revenue to enable them to fulfill their mission now and into the future.

Their respective financial statements reflect this difference. For-profits report mainly on profitability and increasing assets, which correlate with future dividends and return on investment to owners. Nonprofits report to funders, board members and the community on their financial position, the amounts received or promised from various funding sources, and how funds are used for programs and supporting services.



Transparency and statements of position

For-profits and nonprofits use different financial statements to report assets and liabilities. For-profit companies prepare a balance sheet that presents the owner's or shareholders' equity, which is based on the company's assets, liabilities and accumulated profits or losses. The amount of equity determines the book value of a company's common and preferred stock.

Nonprofits, which have no owners, prepare a statement of financial position, which also looks at assets, liabilities and prior earnings. According to recently revised accounting standards (effective for fiscal years beginning after December 15, 2017), resulting net assets should be classified either as those *without* donor restrictions or those *with* donor restrictions.

Another key difference: Nonprofits are generally more focused on transparency than are for-profit companies. Thus, their financial statements and footnotes include disclosures about the:

- › Nature and amount of donor-imposed restrictions on net assets,
- › Amount, purpose and type of board designations of net assets, and
- › Availability and liquidity of assets to cover operations in the coming year.

For example, if a nonprofit has underwater endowments — where the fair value of the endowment is less than the original gift or amount required to be maintained by the donor — it must disclose the fair value of the funds, the original endowment gift or amount required by the donor's stipulations *and* the amount by which the endowment funds are deficient.

Reporting approaches to revenues and expenses

For-profits and nonprofits also take different reporting approaches to revenues and expenses. For-profits produce an *income statement* (also known as a *profit and loss statement*), listing their revenues, gains, expenses and losses to evaluate financial performance.

Nonprofits often rely on grants and donations in addition to fee-for-service income. So they prepare a *statement of activities*, which lists all revenue (less expenses) and classifies the impact on each net asset class. Also, they're required to categorize expenses by both *nature* (meaning categories

such as salaries and wages, rent, and utilities) and *function* (specific program services and supporting activities). This information must be expressed in a grid format that shows the amount of each natural category spent on each function.

Despite these different approaches, for-profit and nonprofit organizations share some financial reporting similarities. Both must carefully track transactions; maintain supporting documentation; and produce accurate, timely financial statements. Both organization types use financial statements to manage their businesses and make financial decisions. And both can benefit from the services of qualified financial professionals with sector-specific knowledge.

Looking ahead

The next time you recruit board members from the for-profit business world, help their transition to the nonprofit sector by filling them in on basics of nonprofit financial reporting. It will better prepare them for their oversight duties as they enter the world of tax-exempt missions, fundraising and program activities. ■

Tackling staffing shortages in a seller's market

With the economy near full employment, employers of all stripes are struggling to fill empty positions. Nonprofits, which frequently offer lower salaries than for-profits, are at a disadvantage. And if you've long relied on the appeal of purpose-driven work, you may now have to compete with so-called social innovators that seek both societal good and profits, offering similar opportunities at higher pay. The bottom line: It's time to take a more formal and aggressive stance when it comes to recruiting and retaining qualified staff.

Redirect recruiting

Employers have traditionally looked to job applicants to sell themselves, but the roles have flipped. In a flush economy, applicants often have multiple offers to choose from, so nonprofits must learn to market their organizations to potential hires.

It's up to you to make candidates understand just how exceptional your team's work, the specific position and your workplace's culture are. Fill them in on the first projects they'll encounter, as well as your organization's goals, so they can envision themselves on the job. Regardless of your mission — somber as it may be — remember that excitement sells.

At the same time, you still need to find good matches for your organization. One of the best indicators is a candidate's passion. Search for applicants who're passionate about your mission, not just nonprofit work in general.

When screening and interviewing, look for evidence of that passion, such as previous volunteer work in that area. Ask where else candidates are interviewing, or at least the *types* of organizations they're approaching. Also, pay close attention to their level of engagement: How quickly do they respond to your emails, calls or messages? Have they done their homework on your mission and programs? Do they have questions for you? You're generally better off finding a committed cultural match and cultivating the necessary skills than vice versa.

Finally, you may need to expand your usual search channels. It's not enough to post on industry job boards. Leverage social media and employee referrals. Consider veterans, individuals with disabilities and former convicts trying to rebuild their lives. (Some of these may earn you tax credits.) And look internally for employees ready for promotion or with high potential.



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Boost retention

Of course, hiring is only part of the battle — you also want to keep great staff onboard. One of the primary reasons today's employees move on, especially Millennials, is the lack of growth opportunities. Your nonprofit, therefore, should offer staffers ways to enhance their personal and professional development.

Mentoring is one solution. Whether through a formal mentorship program or informal relationships with more

experienced colleagues, mentoring is consistently considered a valued employer attribute. New employees like having a champion to turn to, and these relationships help build loyalty, too.

Your organization also can implement "stretch assignments." These are projects or roles beyond an employee's current skills or expertise. They could include:

- › Ongoing projects, where employees can assume greater responsibilities, or
- › One-offs, such as opportunities to represent your organization at a meeting or speak at a conference.

Stretch assignments can benefit both staffers and your nonprofit. Employees gain knowledge, experience and exposure to new areas. And organizations cultivate employees with the critical skills needed to take on other jobs and leadership positions down the road.

Digging deeper

There's no doubt that staffing poses a more daunting challenge for many nonprofits than it has in the past. However, you can continue to recruit and retain top-notch staff by adjusting your strategies. ■

NEWSBITS

Congress repeals UBIT on transportation benefits



As part of its year-end spending package in December 2019, Congress repealed the controversial tax on nonprofits established by the Tax Cuts and Jobs Act (TCJA). The TCJA provision, which

took effect January 1, 2018, made an organization's expenses associated with "qualified transportation fringes," such as certain parking arrangements, van pools and transit passes, subject to the unrelated business income tax (UBIT) rate of 21%. Many nonprofits have struggled with the increased administrative cost and compliance burden.

The repeal is retroactive for taxes paid after December 31, 2017. As of this writing, further details of the repeal hadn't yet been released, but nonprofits that paid the tax in 2018 or 2019 will receive refunds. ■

GoFundMe launches new services



GoFundMe, the for-profit crowdfunding platform, has unveiled a new fundraising service for nonprofits of all sizes, called GoFundMe Charity. Under one pricing plan, organizations

pay no platform fee, with an option for donors to leave a voluntary "tip" for GoFundMe's services. Alternatively, you can choose a 3% platform fee where donors are given the option to cover the fee on their donations. Processing fees apply to both options.

Nonprofits also receive data to help them track and measure success through GoFundMe's Report Center. The platform uploads data directly into common customer relationship management and marketing programs, such as Mailchimp and Constant Contact. ■

Why has charitable behavior dropped among young adults?



Although young adults show greater interest in community engagement, researchers at the University of Maryland's Do Good Institute have found a steady decline in their charitable behaviors.

Volunteer rates among young adult college grads fell from a high of 38% in 2003 to 31.2% in 2015. And giving dropped from a high of 59.8% in 2011 to 55.7% in 2015.

The researchers suggest that milestones traditionally marking the transition to adulthood, such as marriage, birth and homeownership rates, may impact the volunteering and giving rates of young adults. Attaining these milestones more slowly can impact young adults' ability to develop the strong community ties needed to become actively engaged civic contributors. ■

DAF donors get more impact-investing options



National Philanthropic Trust (NPT), one of the nation's largest donor-advised fund (DAF) sponsors, recently announced several new impact-investment portfolios that will allow donors

to achieve both social and financial returns on their DAF investments. According to the NPT, the portfolios address many of the United Nations' Sustainable Development Goals.

Donors can allocate their DAFs among portfolios focused on economic mobility, environmental stewardship, the advancement of women, conservation and health care access. Each portfolio can easily be converted to cash to fund donor grants. ■



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Understanding In-Kind Contributions for Nonprofits

Gifts-in-kind can be a substantial part of a nonprofit's support. If your organization is set up to accept in-kind donations, you must be able to determine their value and correctly record them on your financials.

Accounting for In-Kind Donations

Gifts-in-kind are donations of goods or services. Accounting for in-kind donations is not straightforward. Let's start with contributed services. Generally Accepted Accounting Principles (GAAP) require nonprofits to recognize contributed services on their financial statements when at least one of the following is true:

- The service creates or enhances a nonfinancial asset
- The service requires specialized skills that would have been purchased had they not been donated

Other noncash gifts include tangible personal property and other uniquely defined gifts – use of an asset at below market rates, gifts of media time or space, items to be sold at auction, and more.

When the resource provider transfers control of the asset to you, you should record in-kind donations at fair market value. Of course, there are some other considerations regarding how the gift is made.

Pledged Contributions

In general, you should record contributions when they are pledged. Pledges are originally measured at fair market value and then adjusted if that fair value has changed when you receive the donation.

Agency Transactions

Some nonprofits serve as intermediaries between donors and other charitable organizations. In this case, because the nonprofit does not have discretion over how the donations can be used, agency transactions are not recorded as contribution revenue. The organization should record an asset and a liability when they receive resources in an agency capacity, then reverse that entry when they deliver it to the beneficiary.

Variance Power

When a donor makes a contribution and directs the funds to another beneficiary, nonprofits should typically only record revenue when they have variance power over the donation, or the unilateral right to redirect the use of that asset.

Accounting Best Practices

To make your life easier, establish a system for accepting and recording in-kind donations. Although drafting your procedures up front may take some time, having clear instructions your staff can follow takes the guess work out of this process. For example:

- **Have a gift acceptance policy.**
Your organization may not want to accept gifts that it cannot use or value.
- **Update your accounting policies.**
Let your accounting department know how to record each type of donation.
- **Use contribution forms.**
Collect information about the donor and their donations like a description of the items, estimated fair market value, date of donation, condition of items, number of hours worked, and going rate of pay.
- **Track your gifts.**
Tracking gifts allows you to draft gift acknowledgement forms, properly record pledges, and evaluate the impact of in-kind donations over time.

If you have questions or would like to discuss your entity's contributions, contact Audit Director Mickey Simon at msimon@laporte.com.