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Nonprofit Observer

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Combating financial illiteracy

What your board members and employees need to know

Despite evidence to the contrary, many people still believe that what they don't know about personal finance won't hurt them. What individuals do with their own money is their business, of course. But it's your responsibility to ensure that everyone in your organization who makes major decisions on its behalf understands basic financial concepts — particularly your board of directors and managers.

FINANCIAL SAVVY BENEFITS EVERYONE

With so much competition for charitable dollars, nonprofits are under more pressure than ever to prove funding will be used to deliver viable programs to the communities or members they serve. Just as stock investors analyze a company's numbers before buying its shares, potential donors often look for evidence of funding-worthiness in your financial statements — which can tell them everything from the amount you receive in government grants to the dollars you spend on member retention.

If dues payment processing is delayed, how does that affect your nonprofit's ability to pay the rent or cover an event's expenses?

So money should matter to everyone in your organization, including not just the board and managers, but staff and even volunteers who are involved in financial decision-making. Even when staffers' day-to-day responsibilities don't involve accounting, they need to understand the larger financial picture and how they can positively affect it. Their good business decisions can help ensure there's enough money to support the mission and vision that drew them to your organization in the first place.

CORE CONCEPTS

Although the road to financial fluency can be long, there are some fundamental concepts that you can easily communicate to board members, employees and volunteers who make major decisions:

Accounting. Accounting is simply keeping track of an organization's money. When nonprofits are in startup

mode, many manage funds on a cash basis — writing checks and recording payments as they occur.

But as an organization grows, so does the sophistication of its tracking systems. Typically, more established nonprofits use accrual-based accounting, a method by which different types of transactions are treated differently. This method records cash disbursements, payroll, accounts receivable, sales and purchases in separate accounts. It recognizes costs as they're incurred rather than paid, and income as it's earned rather than received. Accrual accounting is generally regarded as the standard for all but the smallest nonprofits. When training new employees, explain to them which system you use and how it affects your operations.

Budgeting. Budgets, on a basic level, provide a strategy for managing money within an organization. The most effective and realistic budgets are created at the individual department level — they aren't simply handed down by accounting.

Your employees should know their budget parameters, of course. But they also need to understand how individual department budgets are related to one another and how changes in income from grants, donations and member fees alter your organization's ability to function. If, for example, dues payment processing is delayed, how does that affect your nonprofit's ability to pay the rent or cover an event's expenses?

Reporting. Financial statements provide an in-depth look at an organization's fiscal state over a specific period of time. In particular, the *statement of activities*

Discerning from the numbers

You can tell a lot about an organization by asking just a few questions about key financial statement items. For example:

Does the organization have adequate reserves? Typically, nonprofits should strive to keep a net asset cushion equal to six months of expenses.

What does it spend on programs vs. general costs? Charity Navigator reports that the majority of nonprofits spend at least 75% of their annual budgets on program activities.

How much cash is available? There should be enough money on hand to meet current financial obligations as well as keep the organization running smoothly into the near future.

Is the budget realistic? If budgeted expenses are substantially lower than actual expenses, cost containment measures may be in order.

(or income statement) shows how financial resources are coming in and going out.

Revenue might include grants, donations, member fees, sales of materials and client services. Revenues that are restricted by donors for a specific use or time period must be reported as temporarily restricted or permanently restricted. Expenses generally are reported as either program, management and general, or fundraising.

The *statement of financial position* (also known as the balance sheet) totals all assets and liabilities for an organization's net worth or net loss as of a particular date. Assets might include cash, accounts receivable or real estate. Liabilities could include accounts payable, unpaid salaries, loans and unearned revenue.

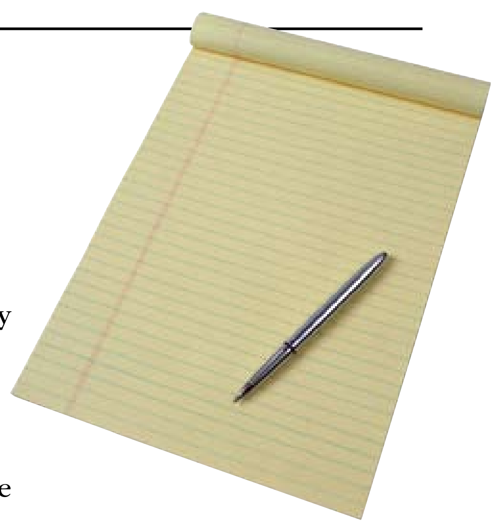
The *statement of cash flows* measures cash generated from and used for operating, investing and financing purposes, such as paying suppliers and repaying loans.

Finally, the *statement of functional expenses* shows the amounts spent on program services and general and administrative costs by expense classification, such as salaries and occupancy.

IN THE KNOW

Your board members have a fiduciary responsibility to regularly review your organization's finances to ensure proper management, so their financial literacy is essential. But employees and volunteers involved in financial decisions also can benefit from knowing what the numbers mean and how they affect your programs. So provide financial training to them, and offer refresher courses as often as they seem needed. ✱

Form 990: The next steps



After years of review and revision, the much-discussed redesigned Form 990 is no longer a theoretical entity that nonprofits will have to deal with "some day." Some day is now.

Most organizations have begun filing the new version for fiscal years that ended on or after Dec. 31, 2008. But there's a one- to three-year phase-in period for smaller nonprofits. (See "Form 990, 990-EZ or none of the above?" on page 4 for details.) If you haven't yet started preparing, put your records in order and get ready to offer the IRS — and the public — a deeper look into your organization's workings.

WHAT'S NEW

Changes to Form 990 enhance tax compliance and enable greater transparency into the workings of nonprofit organizations, both financially and operationally. It now consists of a core form with 11 parts, which all organizations that file must complete.

Four parts of the core form are brand new:

- Summary,
- Checklist of Required Schedules,
- Governance, Management and Disclosure, and
- Financial Statements and Reporting.

Form 990, 990-EZ or none of the above?

To determine whether you need to file the new Form 990 for 2008, can use the phase-in period or can skip filing altogether, consider whether your nonprofit:

Was previously exempt from filing a Form 990 (because, for example, you had gross receipts of less than $25,000 annually). If so, you remain exempt under the new rules.

Has gross receipts under $200,000 *and* assets under $500,000. If this is true, use Form 990-EZ until your organization's total assets or gross receipts exceed these thresholds.

Has gross receipts under $500,000 *and* assets under $1.25 million. In this case, you can take advantage of the phase-in period using Form 990-EZ until you file for the fiscal year ending on or after Dec. 31, 2010. For that filing, use the new Form 990.

Has gross receipts under $1 million *and* assets under $2.5 million. If true, begin using the new Form 990 for the fiscal year ending on or after Dec. 31, 2009.

Also, the section related to compensation is new for 501(c)(6) organizations, and Form 990 has 16 schedules that may be required, depending on the nonprofit.

Your tax advisor can help you determine which schedules you must complete, but you can start preparing on your own to complete the form's new sections. For example, Part IV of the core form asks a series of questions that will help you determine which schedules you will need to complete.

But be sure to consult with your advisor if you need help deciphering some of the IRS's arcane language. Guessing or hoping you're providing the right information is never a good strategy when it comes to IRS filings!

DON'T SLOUGH OFF THE SUMMARY

Also consider Form 990's new Summary section. As its name implies, the Summary aggregates information about activities, governance, revenue, expenses and net assets. Naturally, the numbers you provide must be precise, but so too should mission and key activities descriptions. Think of these four blank lines as an opportunity to promote the merits of your organization.

It helps to keep in mind that the audience for your Form 990 isn't just the IRS. Your summary also will be read by current and potential donors and volunteers when they weigh decisions about where they'll invest money and time. If they aren't impressed by your summary, you could lose their support.

GOVERNANCE AND REPORTING OPPORTUNITIES

Part VI, Governance, Management, and Disclosure, is more than a series of yes or no questions about how you manage your organization. It's an opportunity to identify operations that could benefit from improvements. For example, if your board hasn't previously reviewed your Form 990 return before it's filed, you might consider adopting a policy that addresses who, how and when it is reviewed.

Similarly, Part XI, Financial Statements and Reporting, asks about accounting methods and how financial statements are compiled and reviewed. "No" answers to questions about whether your statements are audited and other tactical issues can raise red flags with potential supporters.

On the other hand, if you answer affirmatively to questions regarding policies and procedures, be sure they were in place during the time period covered by your Form 990. If, for example, you add a conflict of interest policy in 2009, you can't report that in your 2008 Form 990.

TAKE TIME TO DO IT RIGHT

These changes mean you'll have to give yourself more time to complete Form 990 than you have in the past. Racing to meet your deadline is a sure recipe for mistakes or misrepresentations. But by taking a thoughtful, careful approach, you not only improve accuracy, but also the odds that your form will make a compelling statement about what you stand for and how you put your resources to work. ✱

It's OK to lobby ...

Just be sure to follow IRS rules

Lobbying can be a powerful strategy to raise awareness of your mission, mobilize members and attract media attention. It also can result in enhanced government investment in social programs and reform of laws and regulations that govern nonprofits. But you must make sure your nonprofit's lobbying activities don't exceed the scope allowed by the IRS.

LOBBYING VS. ADVOCACY

Lobbying is defined as a communication that attempts to change particular legislation. Advocacy, on the other hand, promotes general causes and issues. Nonprofits may do unlimited advocacy work, but the scope of their lobbying is limited by IRS rules.

Lobbying always involves advocacy, but advocacy doesn't necessarily involve lobbying. The key to determining whether an activity is considered lobbying or advocacy depends in part on *whom* you're trying to influence: Do they make the laws or simply follow and enforce them? Do you want your audience to vote a certain way on proposed legislation or simply be more aware of issues?

Promoting a point of view and providing public education aren't considered lobbying — even if you're speaking with a public official.

If your audience makes laws and you're attempting to change legislation by encouraging your audience to vote a certain way, it's lobbying. If, on the other hand, you're speaking with an administrative official or other non-law-making individual or group about a broad policy change, it's advocacy.

Keep in mind that promoting a point of view and providing public education aren't considered lobbying activities — even if you're speaking with a public official. The discussion crosses the line only when specific legislation is discussed or you urge a particular vote.

STATUS ON THE LINE

Nonprofits often shy away from lobbying for fear of losing their tax-exempt status. And some organizations worry they don't have the proper resources, time or qualifications to lobby.

But the fact is nonprofits can lobby without endangering their tax-exempt status and without major financial resources or expert assistance. The Center for Lobbying in the Public Interest suggests that even small nonprofits can make an impact by devoting as little as three hours a week to the endeavor.

IRS LIMITATIONS

The IRS evaluates lobbying based on whether a nonprofit chooses to report its activities under the 1976 lobby law or uses the "no substantial part" test. The lobby law provides nonprofits with a clearly defined set of rules, and requires organizations to file Form 5768, known as the "h" election. The "no substantial part" rule is much more vague and subject to interpretation.

If, for example, an organization chooses to use the lobby law, it may spend 20% of its first $500,000 in annual expenditures on lobbying tax-free. This percentage decreases as annual expenditures increase, and annual nontaxable lobbying expenses are capped at $1 million. An excise tax will apply as spending limits are exceeded.

If a nonprofit doesn't report lobbying under the 1976 law, it must meet the "no substantial part" test, which stipulates that nonprofits can spend only an insubstantial amount of their resources on lobbying. The specific dollar amount isn't defined, but courts have ruled that more than 5% of an organization's budget, time and effort is substantial. Most organizations, therefore, aim for a percentage below 5%.

GET YOUR VOICE HEARD

Whether you're talking directly to a legislator, conducting an e-mail or letter-writing campaign or organizing a rally, lobbying can be an effective way to further your cause. But be sure to choose your issues wisely and closely follow IRS guidelines. ✱

5 STRATEGIES FOR MORE EFFECTIVE MEMBER SURVEYS

You can't serve your members' needs unless you know what those needs are. Many organizations take the pulse of their membership with regular surveys but fail to conduct them strategically and end up with useless information. Instead, maximize your next survey's effectiveness by focusing on your objectives during every stage of the process:

1. Define. *Do* determine exactly what you want to learn. Keep a clear focus and sense of purpose. *Don't* ask members for information you can't or won't use — you must be prepared to take action based on the results of your survey.

2. Design. *Do* determine format (multiple choice or open-ended questions, or both) and medium (print or Web) upfront. Make sure your questions are as specific as possible — overly broad queries can result in too wide a range of answers to be actionable. Use consistent scales, avoid confusing terms and keep questions short and to the point. *Don't* ask for demographic information unless it's useful and actionable. People value their privacy and are more likely to provide honest answers when they remain anonymous.

3. Deploy. *Do* explain to participants how you plan to use the results. Set a deadline for responses and send reminders. *Don't* e-mail surveys on a weekend — people tend to pay more attention when information is received midweek.

4. Discuss. *Do* relay survey results to participants along with your action plan, sharing as much information as possible. *Don't* wait long periods before compiling and distributing results. If you fail to communicate at this stage, people will be less likely to help out in the future.

5. Demonstrate. *Do* use survey results to enact positive changes that will better serve your members. Regularly reassess your action plan to ensure the changes are effective. *Don't* forget to keep participants informed of your progress. Link your actions to survey results to demonstrate to your membership that you're accountable, responsive and actively engaged in meeting their needs.

403(b) plans: What recent changes mean for your nonprofit

If your nonprofit offers a 403(b) retirement plan to its employees, you need to be aware of new regulations that go into effect for plan years beginning on or after Jan. 1, 2009. These changes, based on revisions made by the Department of Labor (DOL) to the 2009 Form 5500, expand reporting requirements and require many previously unaudited 403(b) plans to be audited.

DO THEY APPLY TO YOU?

Like the 401(k) plans offered by for-profit companies, 403(b) plans allow participants to contribute money to a retirement investment account on a pretax basis and the earnings to accrue tax-deferred. 403(b) plans, however, have not always been subjected to the same scrutiny and oversight as their 401(k) counterparts. The DOL revisions aim to change that.

Does your organization need to adhere to new reporting and audit requirements? It depends on two factors:

1. Whether you're subject to Title 1 of the Employment Retirement Income Security Act (ERISA). If your nonprofit establishes and maintains its plan, you likely are subject to ERISA and, therefore, the new rules. There are exceptions, of course — for example, if your nonprofit sets up its plan so that it has no ongoing involvement in it other than serving as a conduit between the employee and the outside vendor that manages it. Also, in general, plans offered by governmental organizations or churches are exempt from ERISA regulations.

2. The number of plan participants you have at the beginning of the plan year. If you meet the ERISA standard *and* have at least 100 eligible participants, you are subject to the expanded reporting requirements. If your organization meets the ERISA standard but has fewer than 100 eligible participants at the beginning of the plan year, you can use the new Form 5500-SF (or short form), which requires less information and skips the audit requirement.

WHAT'S DIFFERENT

If your organization is required to file the new Form 5500, be ready to provide information you haven't in the past and to come into compliance with standards outside the scope of previous reporting. The Statement of Net Assets, for example, asks you to provide information not only for 2009 (the first reporting year) but also for 2008, so the two periods can be compared.

Auditors following the new guidelines will review plan documents, of course, but they'll also want to see records for individual participants. So talk with your plan custodian now to ensure individual records, net assets statements for the current and previous years, and other information will be available when you need it.

BE PREPARED

If your nonprofit is subject to the new 403(b) plan reporting requirements, it's important to start preparing now. Work with your plan custodian and accountant so that you're armed with the information you need, when you need it. ✱

The expertise you need. The service you deserve.

At Smith & Gesteland, LLP we know that running a successful not-for-profit these days requires more than just dedication and hard work. It takes the assistance of experts who understand the complex needs of these organizations and have the knowledge, experience and service commitment it takes to help them fulfill their missions.

Our Not-for-Profit Service Group consists of professionals focused on increasing the success of organizations like yours. For more than 50 years, our firm has served businesses, organizations and individuals throughout south central Wisconsin. We are delighted to currently work with more than 70 not-for-profits and to have recently been voted Madison's Number 1 accounting firm. We are ready to assist you with a broad range of services tailored specifically to your needs, including:

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- Fixed asset accounting
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AUDITS

- Financial audits
- Compliance audits
- A-133 audits

FINANCIAL MANAGEMENT

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- Budget assistance
- Cost allocation
- Financing
- Board of director assistance

INFORMATION REPORTING

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- Federal Form 990
- Unrelated business income
- Lobbying compliance
- Contribution issues
- For-profit subsidiaries

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- Network support
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We would welcome the opportunity to serve you. For more information about our services or the ideas presented in this newsletter, please contact us at (608) 836-7500 or mail@sgcpa.com.

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