

Spring 2008

# Nonprofit Observer



Alternative investments

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# Do potential gains outweigh the risks?

“No pain, no gain,” may be true when it comes to your fitness routine, but is it really a sound investment strategy for your organization’s nest egg? According to a Harvard Business School study, the answer could be “yes.”

## It’s not academic

An October 2007 research paper, “Secrets of the Academy: The Drivers of University Endowment Success,” found that between 1991 and 2005 the average college’s or university’s investments grew 268%. By contrast, the university endowments at a group of top-tier schools, including Harvard, Yale, MIT and Duke, saw their \$1 billion investments grow 488%. Much of this higher return is attributable to investments in alternative vehicles, such as hedge and private equity funds.

Even outside of academia, alternative investments are attracting the attention of nonprofits that want to maximize their return potential and diversify their portfolios. Research by the Commonfund Institute found that the organizations it studied put 23% of their investable funds into alternative investments in 2006 — up from 21% the prior year.

*Every investment requires you to do your homework; alternative investments just require you to do more.*

## Considering the alternatives

An alternative investment is defined broadly as any investment that isn’t publicly traded. Typically, investors participate in hedge, private equity or venture capital funds. Other alternatives include direct investments in real estate, energy, natural resources, private companies and the development of new technologies.

A typical nonprofit alternative investor has a considerable amount to invest — at least \$1 million to allocate to this part of its portfolio. You also must have a high tolerance for losses, including understanding that your organization could lose its entire amount in one of these investments. And, accept that these investments don’t receive the same kind of regulatory scrutiny — and aren’t held to the same



reporting standards — as market-traded securities. So they’re more vulnerable to fraud and illegal practices.

## The fine print

If the risks seem tolerable, consider these issues before joining the ranks of alternative investors:

**Liquidity.** Many alternative investments are thinly traded. You may be prohibited from removing money in the first year and, after that, able to sell or otherwise access funds only at certain intervals. Also, some alternative investments require a steady investment of new cash. Make sure you’re prepared to live up to the terms of the investment’s agreement.

**Transparency.** Alternative investments aren’t subject to the stringent reporting requirements of traditional investments, making it more difficult to track performance and current value. Your investment manager may report to you on only an aggregate basis, which can become a problem at audit time when alternative investment holdings must be confirmed on a security-by-security basis. You’ll likely have to research the investment details yourself. So be sure to include the time and cost required to find this information in your investment-selection process.

**Fee structures.** Alternative investment fee structures often are higher than those of more traditional investments. In a typical arrangement, the investment manager receives 2% of assets, plus a whopping 20% of returns each year.

## Don't invest blindly

Every type of investment requires you to do your homework; alternative investments just require you to do more. Don't even think about buying in until you have a thorough understanding of an investment's strategy and feel comfortable with its managers. Your research and analysis should cover the investment's:

- ❑ Trading policies, selection processes and risk-management practices,
- ❑ Performance record, particularly how well it has navigated the peaks and valleys of multiple business cycles, and
- ❑ Documentation, including offering letters, legal agreements and financial statements.

You also should meet face-to-face with the key players and visit their offices at least once. Ask

about management turnover and how personnel changes are handled. You need to know if the departure of a key strategist will result in a period of chaos and poor returns or a change in investment philosophy. Finally, check all references provided to you, and conduct an independent background check of the principals.

## Minimize pain, maximize gain

Any investment strategy you follow — whether alternative or traditional — should be designed both to maximize the upside and minimize the downside. Alternative investments probably aren't appropriate for smaller organizations, but they're worth investigating if you're willing to accept the risks and have the resources to conduct thorough due diligence. 🌐

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# Going green without breaking the bank

You'd like to reduce your nonprofit's environmental footprint, but fear that going green is too time- and resource-intensive. There are, in fact, many simple and relatively inexpensive ways to become more environmentally conscious.

## Baby steps

You can start your green makeover with small actions. For example, conserve paper by printing documents only when you truly need a hard copy. When you do print, use both sides of the paper. Also, try to reuse file folders and envelopes that are still functional. And make it easy to recycle: Place containers throughout your facilities to capture paper, glass, plastic and other materials that are accepted by your community's recycling program.

Extend this reuse philosophy to purchasing. Buy recycled printer and copy machine paper and other paper products, such as paper towels. Consider buying recycled ink cartridges, which not only conserve materials, but generally are cheaper than new ones.

## Make a big impact

Take a long, hard look at your processes for items that can be eliminated. For example, scrub your mailing lists of old and duplicate addresses to trim your printing and mailing burden. Or, even



better, switch some of your print communications to electronic versions. Ask your supporters if they want to continue to receive printed information. You may find that donors or members regularly throw away (or recycle) the bulk mail you send them.

Here are other simple ways of going green:

- Post signs by light switches and electrical appliances that remind employees to turn them off when they're not needed. And consider installing motion detectors in break and conference rooms, so that lights automatically switch off.
- Buy compact fluorescent light bulbs that use less energy. Compact fluorescents cost more initially, but they last longer than standard incandescent bulbs.
- Purchase newer, ENERGY STAR rated machinery. Donated equipment is great, but energy efficient equipment can greatly reduce your electric bill.
- Install a programmable thermostat to minimize energy use during nights and weekends. Also, set the thermostat a degree or two cooler in the winter or a degree warmer in the summer.

A more ambitious project to consider is weather-proofing your office space. You'll likely recoup



## Green resources online

The Web is full of useful tips and information for going green. Sites include:

**ENERGY STAR.** The site offer resources and information for all types of green projects (<http://www.energystar.gov>).

**EPA.** The EPA has an online clearinghouse of environmental information, including funding resources (<http://www.epa.gov/epahome/nonprof.htm>).

**Earth 911.** The site helps you locate by ZIP code places to recycle everything from newspapers to computers (<http://earth911.org/>).

**Green Pages.** Search the Green Pages for advice and direction for purchasing green products (<http://www.coopamerica.org/pubs/greenpages/>).

the initial cost with lower energy bills because weatherproofing prevents heat and air conditioning seepage.

## Paying for worthy investments

Many environmentally friendly changes require little or no financing to accomplish. But if like those of many nonprofits your budget is stretched too tight already, get creative. Distribute a “green wish list” to your supporters or ask board members to donate one compact fluorescent light bulb each time they attend a board meeting.

Funding sources exist to help you take on bigger green projects, such as trading in your current vehicles for hybrids. Many private foundations fund nonprofits’ green initiatives. The Kresge Foundation’s Green Building Initiative, for example, gives as much as \$100,000 per organization to support environmentally sound construction and building rehabs. And, depending on your project, you may be able to tap federal, state or local funding sources. The EPA has a list of available funding on its Web site. (See “Green resources online.”)

## Greener is good

Don’t let cost keep you from turning your nonprofit greener. A few changes in your habits and the products you buy can make a big difference in your energy and other resource consumption, your financial bottom line, and even the public’s opinion of your organization. 🌍

# Form follows function in the new Form 990

It's ironic that a tax form has emerged as one of the most powerful communication tools available to tax-exempt organizations. But IRS Form 990, *Return of Organization Exempt From Income Tax*, has become just that. For many donors and other interested parties, Form 990 is the primary information source about an organization's mission, performance and finances.

Recognizing this fact, the IRS unveiled a major redesign of Form 990 in June 2007, when it published a discussion draft for public comment. The goal was to enhance transparency, promote tax compliance and minimize the burden on filing organizations. On Dec. 20, 2007, the IRS released its final version of redesigned Form 990, incorporating comments it received on the discussion draft.

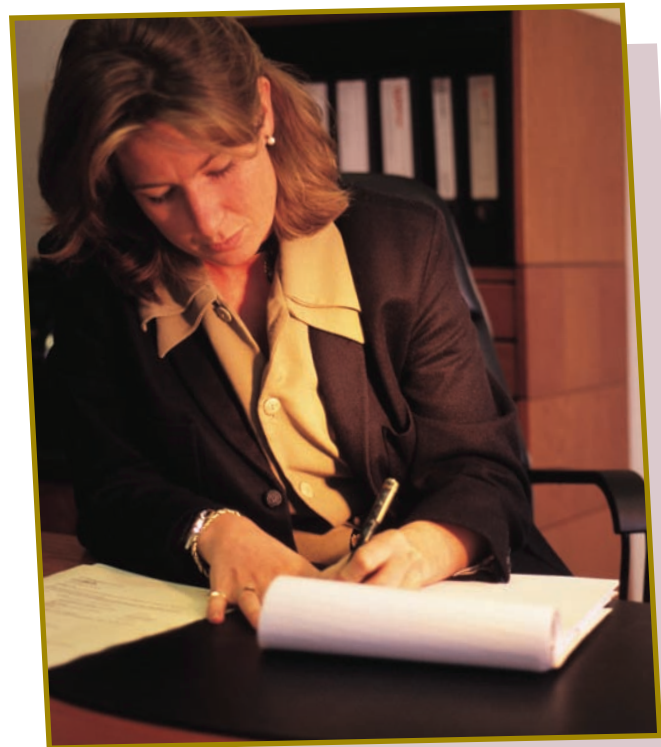
## The final version

The new form will be used by many for the 2008 tax year (returns filed in 2009), with phased-in filing for smaller organizations. (See "When are you required to file the new form?") Organizations that aren't required to file Form 990 must use either Form 990 E-Z or Form 990-N, the e-postcard.

The final form consists of 11 pages and 16 schedules. It contains a summary section where the nonprofit can provide a snapshot of key information; a governance section; more extensive reporting regarding compensation and related organizations; and new reporting requirements for tax-exempt bonds, foreign activities, noncash contributions and hospitals. Certain information relating to hospitals and tax-exempt bonds is optional for 2008.

## Simplifying matters

The December-released Form 990 significantly revises the summary and governance sections, as well as several of the schedules, to improve transparency and readability. The draft summary page, for example, asks filers to classify expenses by functional type — such as program service, management and administrative and fundraising — and specify each one's percentage of total expenses.



The final form calls for reporting by expense type, including grants and similar amounts, and salaries and compensation. Instead of percentages, the form requires the filer to compare expenses to those of the previous year. It also:

**Eliminates metrics from the summary section.** Critics had argued that financial ratios, percentages and other measures could be misleading or subject to manipulation. Some were also concerned that placing certain financial ratios (such as

## When are you required to file the new form?

Gross receipts or asset amounts determine when your nonprofit is due to begin using Form 990.

Tax year	Gross receipts exceed	Or assets exceed
2008	\$1 million	\$2.5 million
2009	\$500,000	\$1.25 million
2010 or later	\$200,000	\$500,000

fundraising expenses as a percentage of contributions) in the summary section would inappropriately imply that these measures were more important than those not reported in the summary.

*Critics had argued that financial ratios, percentages and other measures could be misleading or subject to manipulation.*

**Adds a “Checklist of Required Schedules.”** This guide helps organizations identify the schedules they must complete.

**Expands opportunities to provide supplemental information or narrative explanations.** The new

Schedule O, for example, gives filers two blank pages they can use to explain responses to specific questions or provide other additional information. The form also includes additional blank space in several schedules.

### Be prepared

Organizations required to file Form 990 should become familiar with the redesigned form and be sure they’re prepared to supply the information required well before the filing deadline. The form may seem complicated at first — but only because it’s unfamiliar. In the long run, the revamped form is likely to facilitate better information sharing between your organization and the IRS and with your constituents. 🌐



## Preventing your e-mail from landing in the spam box

E-mail marketing can be an inexpensive, immediate and environmentally friendly way to reach donors or members — if you play by the rules. It takes a little time and know-how to avoid being labeled a spammer and ending up in recipients’ junk mail folders.

To ensure the efficacy of your marketing campaigns and maintain your organization’s good reputation, heed the following e-mail dos and don’ts.

**Do:** Obtain permission to e-mail your audience. Ask visitors to your Web site to opt in to your mailing lists when they register, and request e-mail addresses on all correspondence and solicitations. Generally, it’s a good idea to separately confirm a recipient’s choice to receive e-mail from you.

**Do:** Use simple, straightforward subject lines that avoid common spam filter triggers. These include excessive punctuation or capitalization, and red flag phrases such as “act now,” “free offer” and “important information.” Many e-mail marketing software packages will analyze your content for potential spam triggers so you can edit before you hit the send button.

**Do:** Make it possible for recipients to halt unwanted e-mail from you. Include in your messages a link that allows them to quickly and easily opt out of your e-mail list.

**Don’t:** Obscure your organization’s identity in the “from” field, use the same address in the “to” and “from” fields, or leave any fields blank.

**Don’t:** Forget to ask recipients to add you to their “safe senders,” “safe recipients” or similar e-mail lists. Internet service providers (ISPs) such as AOL have “white lists” of legitimate mailers. Contact ISPs to request that your e-mail address be included in theirs.

**Don’t:** Bombard recipients with daily or weekly appeals and updates. This will likely annoy most of them. Instead, stick to a monthly or quarterly schedule and deviate from it only in the event of an emergency.

# New planned giving strategies

*Broaden your base to include younger donors*

Traditionally, nonprofits have directed their planned giving campaigns at older members and donors — folks in their 70s, 80s and beyond. Research, however, indicates that those in their 40s, 50s and 60s may also be potential candidates. The group includes baby boomers — not only a populous demographic, but a charitably minded one.

A study by Campbell & Company, a fundraising, communications and executive search consulting firm specializing in nonprofits, and the Indiana University Center on Philanthropy asked more than 2,000 individuals whether they would consider making a charitable bequest in their will. Among respondents 70 years and older, 15% said “yes.” When the same question was posed to people between 40 and 69, the affirmative response rate doubled to 30%. Clearly, there’s a large market that your organization may be ignoring.

*Broaden your solicitations to those 40 and up who already have a history of giving to your organization.*

## Shifting the focus

Planned giving encompasses everything from a simple bequest in a will to more complicated structures, including annuities, trusts, donor advised funds, pooled income and life estates. However different these various giving vehicles, they all require planning and donor effort.

Most charities target their eldest prospects in their planned giving campaigns because this group is more likely to be actively engaged in estate planning, making such appeals timely. And, because of these donors’ advanced age, the organization can expect to see the actual bequest the soonest.

But even if it means waiting longer, consider expanding your appeal. Those who make the financial commitment of a bequest — even when they have many years ahead of them — can be loyal and active participants in your programs, events and fundraising campaigns. They may also encourage friends and family members to get involved and make similar donations.

## Best practices

Give your organization the greatest chance of success when soliciting planned gifts by following these best practices:

### Pick appropriate prospects.

Broaden your solicitations to those 40 and up who already have a history of giving to your organization. Review donation records for donors who have given repeatedly and look for patterns. If, for example, an individual makes a gift every December, send your planned giving solicitation at the end of the year. And pay attention to the appeals donors have responded to. If they’ve reacted well to testimonial letters from charitable beneficiaries, mirror that approach for planned giving.

**Tailor the appeal.** Instead of combining planned giving solicitations with other appeals, develop specific planned giving materials, such as letters, brochures and a Web site section, that educate your audience. Use simple language and avoid jargon.

**Close the deal.** Always personally follow up with donors who indicate interest in planned giving. These arrangements can involve large amounts and be complicated to execute. You want to show that your organization will extend special attention to such donors — including working closely with them and their legal and financial advisors to craft and execute the gift.

## Broaden your base

Maintaining the traditional attention you pay to your oldest donors as planned giving prospects may yield acceptable results. Keep in mind, however, that you’re probably missing opportunities if you don’t consider younger donors as well. 🌐



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- Federal Form 990
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- Lobbying compliance
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- For-profit subsidiaries

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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](mailto:mail@sgcpa.com).

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