nonprofit agendas

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News for Nonprofits

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Nonprofit watchdogs

Who are they and what are they looking for?

Nonprofit watchdog agencies are on the rise, becoming more prominent in the past five years than ever before. These independent organizations gather resources not only to help donors select fiscally responsible organizations for their charitable giving, but also to provide information to media, legislators and the philanthropic community as a whole.

Here's what you need to know about the leading watchdogs — the Better Business Bureau Wise Giving Alliance (BBB Wise) and Charity Navigator (CN) — and how they go about evaluating not-for-profits.

BRED TO SNIFF OUT THE SUBPAR

How did these watchdogs come about? Several scandals early in the decade, such as the alleged mismanagement of donations at the Red Cross after 9/11 and the perceived excessive lifestyle of executives at the national United Way office, have created public demand for more scrutiny of nonprofits of all sizes.

In addition, as the Sarbanes-Oxley Act has bolstered public company transparency, Congress and the press have begun to focus more directly on the activities of not-for-profits — particularly those receiving federal (or other government) funding.

With all of this recent attention, donors and funding sources of all types want to make sure their dollars are being spent responsibly. This is where the watchdog agencies come into play. Both BBB Wise and CN were developed to provide readily available resources to boost public trust in nonprofits. Their other aim is to guide the public in evaluating the financial health of nonprofits they might support.

BBB WISE GIVING ALLIANCE

BBB Wise was formed in early 2001 by the merger of the National Charities Information Bureau and the Council of Better Business Bureaus' Foundation. The agency sets standards for accountability in charities and evaluates not-for-profits that report against those standards on a voluntary basis. BBB Wise also educates donors by supplying information on intelligent giving practices. Its services are free of charge to both the charities and the public.

BBB Wise's Standards for Charity Accountability were developed with input from many stakeholders and measure a charity's 1) governance and oversight process, 2) spending and program effectiveness, 3) willingness to be transparent and disclose information, and 4) approach to fundraising.

As many as 2,000 national charities are listed on the BBB Wise Web site at www.give.org. Each charity provides the information voluntarily, and BBB Wise reviews it before adding the organization to its Web site. Included in the listing are contact information, BBB Wise comments, evaluation conclusions, a program description and financial information, governance details, fundraising methods, tax status, and a financial summary.

Donors use the Web site to evaluate their charity donation decisions. BBB Wise publishes specific

Making charities financially accountable

The BBB Wise Giving Alliance (BBB Wise) Standards for Charity Accountability's finance section outlines seven requirements. To meet the standards, your nonprofit must:

1. Spend at least 65% of its total expenses on program activities,
2. Spend no more than 35% of *related* contributions — donations, legacies and other gifts received as a result of fundraising efforts — on fundraising,
3. Avoid accumulating funds that could be used for current program activities — unrestricted net assets available for use should not be more than three times the size of the past year's expenses or three times the size of the current year's budget, whichever is higher,
4. Make available to all, upon request, complete annual financial statements prepared in accordance with Generally Accepted Accounting Principles (GAAP), and, if total annual gross income exceeds $250,000, have these statements audited in accordance with GAAP,
5. Include in the financial statements a breakdown of expenses (for example, salaries, travel and postage) that shows what portion of these expenses was allocated to program, fundraising and administrative activities,
6. Accurately report its expenses, including any joint cost allocations, in its financial statements, and
7. Have a board-approved annual budget for its current fiscal year, outlining projected expenses for major program activities, fundraising and administration.

information to answer questions submitted as well as the BBB Wise Giving Guide.

National charities also have the option to apply for the BBB Wise Giving Alliance Charity Seal, once they meet all of the Standards for Charity Accountability. This designation can be used as a part of their marketing materials for an annual fee.

CHARITY NAVIGATOR

CN's mission is to guide intelligent giving by providing information on more than 5,000 charities and by evaluating each one's financial health. Also founded in 2001, CN has become the largest evaluator of charities in the country and is a source of data and analysis for media, government agencies, nonprofit managers, grant makers and others.

The agency uses an objective, numbers-based rating system to assess each organization's financial health by evaluating how the charity functions:

Day to day (organizational efficiency). CN looks at the percentage of total expenses spent on programs, administration, and fundraising plus the amount spent to raise one dollar (its fundraising efficiency).

Over time (organizational capacity). CN measures the average annual growth of operating revenue and programs and services expense over the past three years and the working capital ratio to total expenses.

Each charity is rated on these points and is compared to similar organizations as well as its own historical data. Contact information, summary revenue and expense volume also are noted for each not-for-profit. Information is obtained directly from Form 990. It usually takes the IRS two to three months from the time your 990 is filed to forward it to CN and another month for the information to be updated.

As a result of the evaluation, a charity is assigned from zero to four stars. Charity Navigator doesn't accept funds from the not-for-profits it evaluates. Nor does it charge users a fee for the service.

The information is available at CN's Web site, www.CharityNavigator.org, which also presents articles on charitable giving and other issues important to the nonprofit community. Only included in CN's listings are nonprofits exempt under Internal Revenue Code Section 501(c)(3) that have more than $500,000 in public support and have filed Form 990 for the past four years.

DO YOU MEASURE UP?

These two watchdog agencies, along with a number of other smaller groups, focus on an organization's accountability, efficiency and capacity from a financial perspective. By measuring up to their standards, you can create an image you can use to your advantage in your organization's fundraising and marketing. ❋

Be reasonable

Procedures, documentation essential when setting compensation

Nonprofits often vie against for-profit businesses for the same talent pool; to acquire and keep the employees you need, you must be competitive in your offers. But this *offer-the-best-we-can* approach is shadowed by growing regulatory pressures to provide "reasonable compensation" for key employees — and nothing more.

WHAT'S REASONABLE?

Reasonable compensation is the amount that would ordinarily be paid for like services by like enterprises, whether taxable or tax-exempt, under like circumstances.

When determining reasonable compensation, count all of the economic benefits you pay that employee. The IRS, in a recent phone forum, identified several items often overlooked in considering the compensation amount:

- Personal components of business travel,
- Personal use of employer-owned property,
- Gifts and gift certificates,
- Expense reimbursements outside corporate policies,
- Spouse travel expenses,
- Nonaccountable expense allowances, and
- Items such as club memberships.

Your board has the ultimate responsibility over compensation, even if a compensation committee determines the amount. Either way, *disinterested parties* should set the compensation. And specific procedures should be in place for times when conflicts of interest arise. For example, committee members with a conflict could excuse themselves from the compensation discussion and abstain from taking part in the decision.

It's critical for the board or committee making compensation decisions to properly document their steps. For instance, keep the data used for comparability, an analysis of the employee's qualifications, and documentation of the discussions leading to the final decision.

WHAT ARE THE PROPER STEPS?

The committee making compensation decisions should compare the position with others sharing similar duties. Consideration also should be given to whether the position is national or local, the number of subordinates the employee manages and the size of the budget overseen.

Another factor in the compensation decision is whether the employee will manage multiple functions, facilities, departments or entities. For example, you would expect much higher compensation for an executive director who oversees an organization with a $100 million budget and multiple entities than one who leads a $5 million organization and a single program.

It's also important to consider the number of hours the employee works. A $100,000 annual salary would probably be unreasonable for someone working two hours a week.

HOW CAN YOU FIND COMPARABLES?

The use of comparables is important in establishing compensation. You can use both for-profit and not-for-profit comparables. It is advisable to have at least three comparables — for larger organizations, more are recommended. Comparables should be obtained for a geographic area similar to your organization's. For example, a suburban not-for-profit preschool could use salary information from both for-profit and not-for-profit preschools in the same or an economically similar suburb.

Commissioning a custom survey is probably the most accurate method of obtaining comparables. An accounting or consulting firm can design a survey to match the specific position being compared.

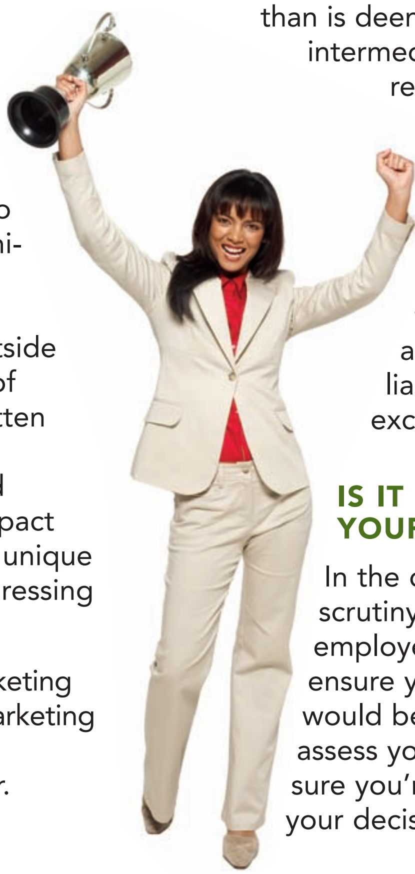
You also can glean this information from trade association surveys, telephone polls and Internet research. Because the information is public record for nonprofits, it should be readily available. A useful Internet resource is GuideStar.org, which publishes an annual Nonprofit Compensation Report.

Regardless of how your organization gathers comparables, the process should not be carried out by the employees themselves.

WHAT WARRANTS ABOVE-AVERAGE COMPENSATION?

When awarding above-average compensation, the organization must clearly justify it. Some factors to consider are 1) the ratio of the organization's revenue and/or expenses to the proposed compensation, 2) the executive's track record with and outside of the organization, 3) the difficulty of replacing the executive, 4) other written offers the executive has received, 5) competitive market pressures, and 6) special circumstances that may impact the decision, such as the executive's unique talents, which will be valuable in addressing your not-for-profit's specific needs.

For example, your hospital's new marketing director has experience not only in marketing but in hospital marketing and also has worked as a hospital administrator. Additionally, she received a job offer from another hospital that you needed to match or surpass.



WHAT IF THERE'S EXCESS COMPENSATION?

If the IRS determines there's excess compensation (that is, a key employee receives more compensation than is deemed fair market value), it can impose intermediate sanctions. The employee must repay the excess compensation to the organization, with interest, and a 25% penalty tax. If repayment isn't made in a reasonable amount of time, the employee is subject to a 200% penalty.

In addition, an officer, director or trustee of the nonprofit, who knowingly approved the excess benefit, can be liable for an excise tax of 10% of the excess amount.

IS IT TIME TO REVIEW YOUR PROCEDURES?

In the current environment of heightened scrutiny of nonprofits' compensation of key employees, it's more important than ever to ensure your documentation is complete. This would be a good time to ask your accountant to assess your compensation procedures to make sure you're doing everything you can to support your decisions. ❋

Internal vs. year end financial statements

Do you prepare internal financial statements for your board of directors on a monthly, quarterly or other periodic basis? Later, at year end, do your auditors always propose adjustments? What's going on?

Most likely, the differences are due to cash basis vs. accrual basis financial statements, as well as reasonable estimates proposed by your auditors during the year end audit. By understanding the differences between the two statements, you may be able to minimize them.

THE SIMPLICITY OF CASH

Cash basis financial statements are just that — based on cash. More specifically, under cash basis accounting, you recognize income when you receive payments and you recognize expenses when you pay them. The cash "ins" and "outs" are totaled by your accounting software to produce the internal financial statements and the trial balance you use to prepare the periodic statements. Cash basis financial statements are useful because they're quick and easy to prepare and they can alert you to any immediate cash flow problems.

The simplicity of this accounting method comes at a price, however: Accounts receivable (income you're owed but haven't yet received, such as pledges), accounts payable and accrued expenses (expenses you've incurred but haven't yet paid) don't exist.

THE VALUE OF ACCRUALS

With accrual accounting, accounts receivable, accounts payable and other accrued expenses are recognized, allowing your financial statements to be a true picture of your organization at any point in time. If a donor pledges money to you this fiscal year, you recognize it when it is pledged rather than waiting until you receive the money. Or, if you receive printing services for brochures this month, you recognize the expense now, rather than waiting until the invoice arrives next month.

Generally Accepted Accounting Principles (GAAP) require the use of accrual accounting and the recognition of contributions as income when promised, and often year end audited financial statements are prepared on the GAAP basis. Also, to allow for consistency and comparison with other organizations, the accrual method is preferred.

THE NEED FOR ESTIMATES

Another difference between your internal and year end statements may be resulting amounts that need to be estimated to present an accurate picture. Your auditors also may propose adjusting certain entries for reasonable estimates. This could include a reserve for accounts receivable that may be ultimately uncollectible.

For instance, perhaps your organization consistently receives pledges for donations, and a receivable for these amounts is recorded accordingly. Historically, however, a small percentage of those pledges is never received. Or you believe a specific pledge is not fully collectible. This can result in the auditors proposing a reserve, which would lower your pledges receivable amount.

Another common estimate is for litigation settlement. Your organization may be the party or counterparty to a lawsuit for which there is a reasonable estimate of the amount to be received or paid. This may be booked as a receivable or a payable at year end, depending on the anticipated outcome.

MINIMIZING THE DIFFERENCES

These accruals and estimates can be booked each month so that internally prepared financial statements are consistent with the year end audited financial statements. If your organization is not on the accrual system for both cash receipts and cash disbursements, take a close look at your accounting software. Chances are, your software has built-in modules for you to easily convert to accrual accounting.

At month end, these modules should inherently roll up to your internal financial statements, if you print them directly from the software. If you prepare the financial statements outside of the software, such as in Microsoft Word or Excel, you can easily print reports of these amounts and adjust your financial statements accordingly.

Estimates are a little more difficult. You can always take a look at the adjustments your auditors proposed last year and inquire as to how they came up with those estimated amounts. You can then make your own assumptions each month and book adjustments to the estimates as necessary.

COMMUNICATING TO THE BOARD

Minimizing the differences between internal and year end audited financial statements should be a goal, because it will save time, and maybe audit fees, in the future. But if it isn't cost-effective or feasible, then being able to communicate what differences do exist will help your board — and staff — better understand the financial statement process. ❋

NEWS FOR NONPROFITS

SMALL PORTION OF DONATIONS BENEFIT THE POOR

Of the $250 billion in charitable donations from U.S. households in 2005, less than one-third of the money actually benefited the economically disadvantaged. According to a recent study conducted by the Center on Philanthropy at Indiana University and financed by Google, only 8% of the donations were given to charities to meet the basic needs of the poor.

The largest amount of donated money was given to religious organizations to fund congregational operating expenses (40%), and the remainder was given mostly to private schools and universities (education — 18%), hospitals (health — almost 9%) and arts organizations (9%). Combined purpose funds receive contributions that are then allocated to a number of different types of charities, including United Way (almost 16% total) and others at about 8%.

In addition to these findings, the study also revealed that a donor's income is a good indicator of how much that person will be willing to donate to the needy. Households with an income of less than $100,000 gave an average of 36% of their donations to help the poor. Those with an income of $1 million or more averaged only 22%. ❋

YouTube HELPING NONPROFITS

If your nonprofit is looking for a way to broadcast your message to a larger audience, the YouTube Nonprofit Program might be just the vehicle. Through the 2007/2008 Clinton Global Initiative commitment, YouTube is offering a free Internet channel to 501(c)(3) organizations that register for the program.

The premium YouTube channel can act as your not-for-profit's connection with YouTube users through videos. You also can get enhanced channel branding features and increased upload capacity. You'll be designated as a nonprofit on YouTube's "Channels" page and can opt to receive the ability to use a Google Checkout donation button on their pages. Google has promised to process all donations through this Checkout for free through at least the end of 2008.

To apply, visit http://youtube.com/nonprofits. ❋

ELECTION YEAR REMINDER

As the presidential elections approach, the IRS has issued a reminder to charities and churches about the ban on political campaign activity. Federal law prohibits these organizations from becoming directly or indirectly involved in political candidates' campaigns.

Issued by the IRS, Revenue Ruling 2007-41 gives a number of scenarios to provide guidance on the ban. For more information, visit http://www.irs.gov/pub/irs-irbs/irb07-41.pdf. ❋

NEW INCENTIVE CAN HELP RECRUIT AND RETAIN NONPROFIT WORKERS

The recently enacted College Cost Reduction and Access Act includes a provision that would forgive the federal student loan debt of nonprofit workers. The employee must make qualifying loan payments for 120 consecutive months (generally starting after Oct. 1, 2007) and during that 10-year period must be employed full-time for a "public service job," which is defined as one with a 501(c)(3) organization. After the 10-year period, any remaining debt, including both principal and interest, will be forgiven.

While this law won't provide assistance for another 9½ years, it's a helpful tool for not-for-profits to use as a recruiting and retention device for future employees with college debt. ❋

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We truly care about our clients' mission and success—perhaps that's why many of them have been partnering with us 10, 20 and even 30 years. We believe we can make a positive difference in your organization's financial life, and we hope you will give us an opportunity to serve you.

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