

Transparency is More Than a Fad

You hear the word everywhere these days: transparency. Generally, the term refers to the need for organizations to make their financial statements more readily understandable, but it also suggests being open about all aspects of operations.

Although it has become something of a buzzword, the push for greater transparency is more than a fad. Enhanced disclosure — in both the for-profit and not-for-profit sectors — is becoming the norm, not the exception.

Revealing more about operations

As donors demand increased transparency in the charitable world and federal and state lawmakers explore ways to achieve this, you may wonder what you can do to be more forthcoming. Here are some ways:

Post financial statements and Form 990 online. Lawmakers have been mulling a proposal that would require exempt organizations with

websites to make all public documents available online, including financial statements for the last five years. Also under consideration: a proposal to add IRS Form 990-T, the *Exempt Organization Business Income Tax Return*, to the list of public documents.

In anticipation of possible new requirements, organizations that want to be proactive should adopt some or all of these proposed disclosure standards.

At a minimum, put your Form 990 on your site — this is an easy way to provide information to the public. Some organizations also make their audited financial statements available online or give a number to call for a copy.

Help donors understand financial data and other important information. Donors want to know how their money is being spent. They expect this information to be clearly conveyed before they give

(continued on page 5)

This Issue

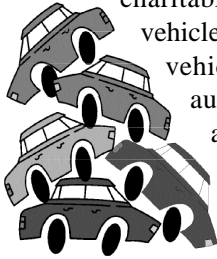
- Transparency is More Than a Fad
- American Jobs Creation Act of 2004 Brings More Reform in the Not-For-Profit Area
- Keeping Compensation in Line: IRS Probe Underscores Need to Review Practices
 - Consider Incentive Compensation
- Should You Buy or Lease Your Building?
 - Planning for Building Maintenance
- 3 Ways to Improve Interaction Between Your Board and Staff
- Newsbits
 - BBB Wise Giving Alliance Offers Online System to Evaluate Standards
 - Employment in Charitable Sector Decreases
 - IRS Releases New Publication on Vehicle Donations

American Jobs Creation Act of 2004 Brings More Reform in the Not-For-Profit Area

The IRS continues its reform in the area of tax-exempt organizations. The American Jobs Creation Act of 2004 has instituted new rules in the areas of charitable donations of vehicles, donations of intellectual property, and noncash contributions.

Charitable Donations of Vehicles

The 2004 Act has increased the substantiation requirements for charitable donations of vehicles. For contributions of vehicles (including automobiles, boats and airplanes) with a claimed value of more than \$500, the Act also limits the charitable deduction to the gross proceeds received by the charitable organization upon subsequent sale of the vehicle.



A charity that receives a vehicle donation must provide contemporaneous written acknowledgement to the donor within 30 days of:

- (1) the contribution of the qualified vehicle, or
- (2) the date of sale of the qualified vehicle by the donee organization if it sells the vehicle without any significant intervening use or material improvement.

The acknowledgement must contain the name and taxpayer identification number of the donor and the vehicle identification (or similar) number.

If the donee organization sells the qualified vehicle without any significant intervening use or material improvement, the acknowledgement must also include:

- (1) a certification that the vehicle was sold in an arm's-length transaction between unrelated parties;

- (2) the gross proceeds of the sale; and
- (3) a statement that the deductible amount may not exceed the gross proceeds.

If the donee organization retains the qualified vehicle for its usage, the acknowledgement must also include:

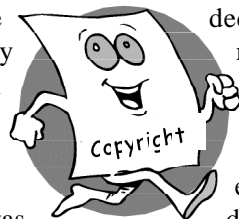
- (1) a certification stating the intended use of the vehicle or any material improvement intended for the vehicle, and the intended duration of such use; and
- (2) a certification that the vehicle will not be transferred in exchange for money, property or services prior to completion of the intended use or improvement.

A donee organization that knowingly provides a false or fraudulent acknowledgement, or that fails to provide a contemporaneous written acknowledgement containing the required information within the prescribed time frame, will be penalized for each such act or failure.

This applies to vehicle donations made after December 31, 2004.

Donations of Intellectual Property

For donations of patents, copyrights, trademarks and other intellectual property, the amount of the initial charitable deduction is now limited to the lesser of the taxpayer's basis in the contributed property or the fair market value of the property. The taxpayer



may also receive an additional deduction for revenue received or accrued by the charitable donee with respect to the contributed property in excess of the initial deduction. This is effective for contributions made after June 3, 2004.

A charity that receives a donation of qualified intellectual property must provide written substantiation to the donor each year with the following information:

- (1) The donor's name, address and taxpayer identification number (TIN)
- (2) A description of the qualified intellectual property contributed
- (3) The date of the contribution
- (4) The amount of net income properly allocable to the qualified intellectual property during the charity's tax year

Noncash Contributions

"C" corporations that contribute noncash property exceeding \$5,000 are now required to obtain a qualified appraisal for that property. Under current law, this already was required for individuals, partnerships, "S" corporations, and other entities. Also, for any contributions of noncash property exceeding \$500,000, the taxpayer is required to attach the appraisal to their tax return. This is effective for contributions made after June 3, 2004.

Senate Finance Committee

The Senate Finance Committee ("SFC") met in December 2004 and stated that they will continue to investigate donations of tangible property even after the new rules instituted by the American Jobs Creation Act of 2004.



The SFC also will specifically focus on scam charities, nonprofit and for-profit mixes, and excessive executive compensations. The SFC is currently in the process of drafting proposals on donations, credit counseling, and tax shelters. They anticipate that new discussion drafts will be introduced in February or March of 2005. ■

Keeping Compensation In Line IRS Probe Underscores Need to Review Practices

The executive compensation practices of about 2,000 charities and foundations are under scrutiny as a result of an IRS initiative announced in August. Although most not-for-profit leaders would agree that excessive compensation isn't a widespread problem, a handful of cases involving exorbitant pay and insider transactions have piqued the interest of government regulators.

Although the IRS initiative is limited in scope, it's a wake-up call to all not-for-profits to ensure that their compensation practices are compliant and effective.

Get your board involved

Charities reporting pay packages in excess of \$1 million were initially targeted in the probe. The IRS has since broadened its focus to look more generally at "outliers" — that is, out-of-range salaries or unusual dealings that set an organization apart.

To prevent abuses in this area, your board must be active in setting and approving all compensation and benefits for the executive director and other key employees. This requires developing competitive pay packages that offer good incentives without being excessive.

Steer clear of intermediate sanctions

The intermediate sanctions rules allow the IRS to assess penalties against individuals or board members who receive or approve excessive compensation; this is a priority enforcement area for the IRS. To avoid intermediate sanctions, you must:

- Use an independent committee or the board to set compensation,
- Compare compensation against similar organizations, and
- Document findings and conclusions.

The IRS requires you to consider total compensation in evaluating what is appropriate. Generally speaking, it considers compensation to include: regular salary and bonuses, retirement plan contributions, insurance, housing

allowances and payment of nonbusiness expenses.

Additionally, you must properly structure loans between your organization and so-called "disqualified persons" — such as board members or key employees who have influence over your not-for-profit's affairs. Otherwise, when determining whether pay is excessive, the IRS may treat the loans as additional compensation. You can protect your organization by identifying in contracts with disqualified persons all economic benefits you're giving to them.

Benchmark compensation

Benchmarking compensation is necessary to avoid possible penalties, but the practice also helps your board develop creative and competitive pay packages. In evaluating compensation, consider factors such as:

- Your not-for-profit's size and administrative complexity,
- Geographic location, service category and financial stability,
- Qualifications needed in the position, and
- Competitiveness of the package in relation to comparable organizations.

To assess how your offerings measure up, use salary surveys in the not-for-profit sector and review salaries for similar for-profit positions. Again, carefully document any findings that form the basis for compensation decisions, paying close attention to those that could be considered unusual.

Review transactions with insiders

Insider transactions are another area of interest for regulators. These can include loans, consulting agreements, or the sale, exchange or leasing of property to board members, trustees or key employees.

Because insider transactions require careful observance of laws and conduct codes, board members should review and

Consider Incentive Compensation

More not-for-profits are using incentive pay, including cash bonuses, nonqualified deferred compensation arrangements or supplemental retirement plans. To be effective, tie incentives to measurable performance goals agreed on by the board and chief executive. Many organizations create measures to gauge improvements in areas such as fund raising, program and service delivery, and financial and special initiatives management.

In addition, structure incentive pay to truly motivate performance. If packages incorporating bonus pay or other incentives remain heavily weighted toward base pay, you can weaken the pay-for-performance link.

For example, a not-for-profit executive receiving a base salary of \$120,000 with a bonus potential of 5% annually may be less motivated to achieve goals than a colleague with a smaller base salary and a larger variable pay component.

Regardless of the approach, your board should evaluate the executive director's performance each year. Regular reviews provide a reference point for setting and awarding annual compensation and demonstrating why pay is fair and reasonable. ■

approve any such arrangements to ensure they can withstand IRS scrutiny.

Ensure practices are sound

Although your compensation practices may never be subject to regulatory review, the IRS enforcement initiative offers a valuable blueprint of what you should and shouldn't do in this area. This is also an opportunity to conduct internal housekeeping and gain assurance about the integrity of your practices. ■

Should You Buy or Lease Your Building?

As the economy shows signs of improvement and charitable giving begins to pick up, some not-for-profits with stable donor bases and strong financials are interested in expanding their facilities.

Owning rather than leasing real property offers several advantages. Most notable: Charities exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code are generally exempt from property taxes, so their cost of ownership may be lower than that of nonexempt entities.

On the other hand, investing in real estate requires a significant financial commitment, both on the front end and over the ownership period.

Factors to consider

Owning real estate doesn't make sense for every organization. The decision to buy or lease depends on several business and tax issues. Here are some factors to consider when determining whether ownership is best for you:

Financial stability. If your not-for-profit has stable and ever-growing funding sources, your staff is probably increasing, too. Therefore, you may have both the

physical need for more space and the financial wherewithal to acquire it. Over time, it could be more cost-effective to buy than to lease.

One fast-growing charity found this to be the case. As the organization became internationally prominent and support for its mission expanded, it outgrew its existing quarters and was forced to lease space in two adjacent buildings to accommodate staff. The charity soon found that it made financial and administrative sense to buy a new building for headquarters and consolidate operations at a single location.

Debt financing. Many organizations considering a building purchase want room for future expansion and may want to lease unused space to recoup some of their expenses. Before doing so, look at the tax impact. If you borrow funds to buy a building and rent all or part of it to an unrelated organization, you may have to pay unrelated business income tax (UBIT) on the profit from rental income and report it on Form 990-T.

The rules surrounding UBIT are complicated and contain many exceptions. For instance, a common exception to the debt-financed rules is whether an

organization uses 85% or more of the building for its tax-exempt purpose.

If so, any rental income associated with the excess space is excluded from UBIT. Real property regulations aren't so clear; they're more dependent on assessor judgment. If you plan on leasing a portion of a building you're purchasing, consult with an advisor to learn more about the potential tax consequences.

Funding restrictions. If you're receiving state and federal funding, check if there are usage restrictions.

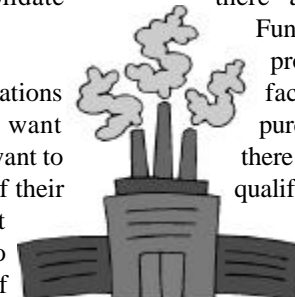
Funders have been known to provide grants for renting facilities but not for purchasing them. Similarly, there are grants available to qualifying organizations that rehabilitate historic buildings or invest in certain areas.

Fit with your mission. Buying or building an office facility sometimes makes sense from both a financial and a mission perspective. For example, Heifer International, a charity dedicated to ending world hunger, is building a new headquarters on a brownfield, a property that may have hazardous substances, pollutants or contaminants. The organization says the redevelopment is allowing it to practice what it preaches by encouraging sustainability.

Ownership structure. Consider whether any real estate you purchase should be owned by your not-for-profit itself or by a separate corporation, such as a single-member limited liability company. Creating a business entity may protect your organization from liabilities that can arise from owning and renting real estate. But there are additional tax and legal factors involved in these ownership structures.

Consider benefits and drawbacks

Owning real estate can be an attractive option for your not-for-profit. But before taking on such a commitment, carefully analyze the potential tax consequences and ownership pitfalls. ■



Planning for Building Maintenance



If your organization decides to buy or currently owns real estate, you'll want to develop a plan for projecting future maintenance needs and budgeting for them when you acquire the property.

Predicting the life span of a building's components is an inexact science, but you can use some strategies to improve the accuracy of projections and ensure you're adequately depreciating real property.

The first step is to break a building down to its individual components, much like a builder does when planning construction. A spreadsheet program can perform automatic calculations that assign an estimated useful life to each component and calculate years until replacement and projected cost to replace.

This type of analysis gives structure to planning for building upkeep and helps your organization set budgeting goals to pay for these expenses. A real estate or construction specialist, along with your financial advisor, can help you plan and calculate the costs of building maintenance. ■



3 Ways to Improve Interaction Between Your Board and Staff

You may have heard the saying, “The board leads and the staff manages.”

Although most people involved with not-for-profits would agree with this assertion, they might also note that the division of responsibilities is not always so well defined in practice. It’s not uncommon for board members and employees to be unsure of the boundaries of their respective roles — and that’s when problems arise.

To avoid confusion or misunderstandings, board members and workers should observe these guidelines:

1. Understand each group’s roles and responsibilities. A thorough orientation process helps board members understand their place in the big picture. Give them a written description of their responsibilities and offer specific examples that illustrate the scope of their duties.

A good exercise is to list various board and staff activities, such as approving the budget and providing direction to employees. Ask board members to identify whether an activity is a board or worker responsibility. Discussing the results will help them distinguish the separate but complementary roles of the board and employees.

Likewise, staff should have clear job descriptions and you should encourage them to ask their supervisors for guidance if they receive requests from board members.

2. Work through proper channels in making requests.

It’s true that workers are partners with the board — helping it to advance goals and strategies — but this doesn’t mean that board members have the authority to direct employees. The staff reports to the executive director, who reports to the board.

Therefore, if a board member wants an employee to compile a report, the request should go through the executive director, because he or she manages the workflow and knows of any competing priorities. Similarly, employees who have suggestions for the board should direct them to the executive director first.

3. Glean first-hand knowledge. Board members can improve their effectiveness by understanding the roles of various employees. One way they can enhance their knowledge is to “shadow” a worker as he or she carries out responsibilities. Program managers or other senior staff might also attend board meetings to discuss developments in their areas and answer questions.

By having direct interaction with staff — rather than receiving information filtered through the executive director — board members can get to know employees and gain insight into the challenges and opportunities facing the organization.

Every not-for-profit benefits by having clear boundaries between administration and governance. If your board members or employees seem confused about the rules of interaction, consider this a sign that your organization could enhance education and communication in this area. ■

(continued from page 1)

Transparency is More Than a Fad

to an organization or continue to give support. Tools that you can use include:

- Financial pie charts,
- Lists of frequently asked questions and answers,
- Third-party testimonials, and
- Informational inserts.

Review your mission and program disclosures in your annual Form 990 and determine if you’re providing information that will increase the public’s understanding of your financial position, operations and governance process.

Have an independent audit performed each year. You and your board have an obligation to be ethical and responsible stewards of your organization’s resources. For this reason, have a regular audit to assure stakeholders that financial data is accurate, accounting practices are sound and safeguards are in place, protecting assets.

Consider a third-party evaluation. The pressure on charities to use funds as efficiently as possible has created a growth industry in watchdog groups that rate not-for-profits on their performance and fiscal responsibility.

And whether one views these sometimes-controversial groups as a boon or a bane, their influence continues to grow. Many of their benchmarks are fast becoming industry standards and the public increasingly looks to them for guidance about whether an organization is worthy of support.

Organizations committed to increasing transparency may want to seek independent review of their practices from groups such as the BBB Wise Giving Alliance. Also, be responsive to inquiries from rating agencies such as Charity Navigator and GuideStar, as well as the media.

Supporting your mission

Your not-for-profit will have to become increasingly transparent if you want to continue earning support for your mission.

By accepting this new reality - and the challenge to become more accountable - you’ll reap benefits such as increased credibility and perhaps more donations. ■

BBB Wise Giving Alliance offers online system to evaluate standards

The BBB Wise Giving Alliance has introduced its Online Charity Reporting and Evaluation System, which will permit the charity-monitoring organization to automatically evaluate charity data and significantly increase the number of reports issued.

The online system will also make it easier for organizations to apply for the Alliance's new national charity seal program, which evaluates charities based on 20 voluntary standards including governance, effectiveness, finances and fund raising. According to the Alliance, about two-thirds of those evaluated meet its standards.

You can get more information about the online system at www.give.org. The site also provides details on donor giving, the charity seal program and accountability standards, as well as reports on more than 450 not-for-profits.

Employment in charitable sector decreases

The labor market in the not-for-profit sector has weakened significantly over the past year and a half, according to *Recent Trends in Nonprofit Employment and Earnings: 1990-2004* by OMB Watch, a nonprofit research and advocacy organization.

Among the report's findings:

- Employment grew by just 0.5% from July 2003 to July 2004; weekly earnings fell by 5.2% over the same period.
- The average workweek is now 29.8 hours, the lowest since the Bureau of Labor Statistics began collecting this data in 1990.
- State-level data confirms nationwide patterns. Overall, 17 of the 23 states which offer detailed employment information had not-for-profit employment growth below the 15-year national average.

You can get the full report at www.ombwatch.org.

IRS releases new publication on vehicle donations

As the IRS increases its scrutiny of car donation programs, charities may want to review their practices to ensure they're following proper procedures. IRS Publication 4302, *A Charity's Guide to Car Donations*, explains the ins and outs of four types of vehicle donation programs.

Your exempt status or the donor's ability to deduct the gift shouldn't be affected if your organization's program falls into one of these three categories:

1. Uses the donated vehicles in its programs,
2. Sells the vehicles and uses the proceeds to fund programs, and
3. Hires a for-profit agent to operate the car donation program.

The fourth type of program — when the charity authorizes a for-profit entity to use its name for the purpose of soliciting car donations — can pose problems for both charities and donors. Contributions are not deductible, even if the organization uses the money it receives to fund activities.

The publication, available at www.irs.gov, also addresses filing and reporting requirements.

Note that the 2004 American Jobs Creation Act will limit the amount individuals can deduct for vehicles donated to charities. The tax break will depend on how organizations use the items and will apply to vehicle donations made after Dec. 31, 2004.

**Not-For-Profit Services
at
Holtz Rubenstein Reminick**

As pioneers in this rapidly-growing financial service area, our comprehensive approach to the Not-For-Profit sector is virtually unmatched. In addition to the traditional CPA services of accounting, auditing and taxation, we provide data processing, rate reimbursement consulting, management consulting, and strategic planning.

Contact Us

For more information on any issues within these articles, please contact the Partners in our Not-For-Profit department:

Beatrix G. McKane

(631) 752-7400 x-350
BMcKane@hrrllp.com

Gordon M. Siess

(631) 752-7400 x-315
GSiess@hrrllp.com

Delivery Options

To change your contact information for issues of the HRR *Not-For-Profit Adviser*, or to sign up for an e-mail version, please contact us:

NFPAdviser@hrrllp.com.