Profitable Solutions For Nonprofits

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Fall 2007

Playing for the majors

Winning strategies to score transformational gifts

Major gifts, also referred to as transformational gifts, can help nonprofits increase outreach, expand capabilities and greatly improve the odds for future success. But many organizations aren't doing everything they can to land these gifts.

Even the smallest nonprofits can benefit from identifying and cultivating major donors. Want to strike a home run in major gifts? Implement a major donor program that includes key strategies for success.

Establishing the rules

The first essential component of a major gifts program is a strong leadership team. The team should consist of effective and committed board members, current major donors, the chief development officer, the major gifts officer, the executive director and any other relevant staff. Have this team meet regularly to develop and modify strategies for identifying potential major donors, cultivating relationships and planning and implementing outreach and solicitation.

It's also important that your organization determine what it considers a major gift. The definition varies from nonprofit to nonprofit, but you need to be clear about it to effectively groom major donors.

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A large hospital, for example, may value a $2,000 gift, but wouldn't likely regard it as major. But a $50,000 gift could have significant impact, providing funding to upgrade the hospital's emergency room or purchase an advanced piece of equipment — both of which would produce value far beyond the dollar amount. On the other hand, a gift of $2,000 to an animal shelter might qualify as a major contribution. It could fund a public awareness program or underwrite neutering services for hundreds of strays.

Take a look at the dollar levels of annual gifts your organization has received in past years. Study the pattern of these gifts to determine the highest level your top donors have typically given within a year. Then set the beginning level for your major gifts at a dollar amount five to 10 times above that giving cap.

Identifying heavy hitters

Major donors usually don't appear out of the blue. In fact, they're probably already a part of your donor base — consistent contributors who've increased their gifts over time and are ready to be groomed into majors.

Most potential major donors:

- Have a strong interest in your organization's mission and a commitment to its success,
- Are involved with your organization and its programs and are aware of its fiscal responsibility and effectiveness, and
- Get a sense of pride and satisfaction from using their wealth to help your nonprofit.

Have your committee compile a list of existing and potential major donors. Then assign a committee member to each one. He or she will be responsible for implementing strategies to cultivate the relationship.

Prepping donors to give

Whether dealing with current major donors or potential ones, it's important to stay in frequent contact. Here are four rewarding ways to do that:

1. Keep them informed. Make sure donors are aware of your current programs, activities and events. Send quarterly leadership update letters from your executive director or board president to assure them that their gifts are being used properly.

2. Encourage participation. Keep donors involved by asking them for feedback and advice on programs, selecting them to serve on boards and inviting them to help plan activities and events.

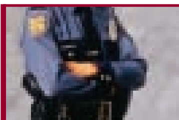
3. Maintain contact. Create a mix of group activities — such as a riverboat trip or a private tour of your museum's latest exhibit — and one-on-one meetings to stay in touch. Schedule quarterly calls from volunteers and the development officer, and send notes and cards to acknowledge family milestones.

4. Show appreciation. Host small annual events to showcase the programs and projects your donors fund. Express your gratitude by recognizing donor contributions at programs and events and in newsletters, annual reports and other publications.

Playing to win

It may take months or years to cultivate a donor and achieve a major gift, so start now. Design a major gifts program that addresses the interests and needs of your organization — as well as those of your donors — to create a win for everyone. ✧

Guard against improperly benefiting people in authority



Nonprofits hold their leaders to high standards of conduct. So does the IRS, which expects those in authority at nonprofits to avoid improperly benefiting from their association with the organization. Unreasonable compensation or unfair personal gain can cost them — and the nonprofit — dearly.

The IRS imposes harsh tax penalties not only on the individuals it determines received excess benefits, but also on the staff or board members who approved the benefits, and on the nonprofit itself. Ultimately, this can lead to a loss of tax-exempt status. Learning how to avoid improper transactions can keep your staff, volunteers and organization out of harm's way.

Who's at risk?

Under Internal Revenue Code Section 4958, the IRS can impose "intermediate sanctions," or tax penalties, on a "disqualified person" who improperly engages in "excess benefit" transactions with a nonprofit. The IRS also can impose intermediate sanctions on the organization, and might revoke its tax-exempt status, depending on the scope of the transactions. (See "How the IRS determines sanctions" on page 4.)

According to the IRS, a disqualified person is someone who has authority to exercise substantial influence over your organization within a five-year period ending on the transaction date. He or she can make and implement decisions for your governing body and oversee its management, administration, operations or financial assets.

This could describe your president, chief executive officer, chief operating officer, treasurer, chief financial officer or governing body voting members. Your major

contributors, founders and highly compensated staff members also could be considered disqualified. And certain members of a disqualified person's family, such as a sibling or spouse, join the disqualified category.

What's an excess benefit transaction?

A disqualified person risks IRS sanctions if he or she engages in excess benefit transactions. Excess benefits are those that exceed fair market value or aren't comparable to benefits paid by similar tax-exempt organizations.

The two types of excess benefits are:

1. Unreasonable compensation — such as luxury expense allowances and royalty payments, and
2. Unfair personal gain, such as use of the organization's real estate and other property, and reduced or withheld interest on loans.

For a disqualified person, the consequences of engaging in excess benefit transactions can be severe. The IRS imposes a penalty of 25% of the benefit amount, plus an additional 200% if the matter remains uncorrected after 90 days.

Those who approved the excess benefit, such as board members, are subject to a 10% penalty. And if the disqualified person also is a manager with the organization, he or she may be required to pay both the 10% and 25% penalty taxes.

Setting up safeguards

Prevention is the best medicine for excess benefit transactions. Once you understand what kind of transactions to avoid, set up a mechanism to ensure that all transactions between your organization and disqualified persons are reasonable.

To avoid impropriety, your governing body should follow strict procedures for every transaction involving a disqualified person. Some examples of transactions that can come under IRS scrutiny are travel reimbursement for members who attend board meetings and consultant fees.

Using appropriate comparability data, your governing body should approve each transaction's terms and ensure none of the participants have a conflict of interest. And it must document the basis for each determination it makes.

Avoiding trouble

To avoid penalties, or worse, loss of tax-exempt status, be sure you and your organization's employees understand what constitutes an excess benefit transaction. Then put in place procedures that will help you avoid impropriety — and even the appearance of impropriety. ✧

How the IRS determines sanctions

To determine its course of action in cases of excess benefit transactions, the IRS applies a "facts and circumstances" test that includes:

- ☑ The size and scope of the organization's regular exempt activities,
- ☑ The relationship between the size and scope of the excess benefit transactions and regular exempt activities,
- ☑ Whether the nonprofit has a history of engaging in excess benefit transactions,
- ☑ Whether it has adopted measures to prevent future intermediate sanctions violations, and
- ☑ Whether it has corrected the excess benefit transaction, or made a good-faith effort to seek correction.

Dollars and sense

Get the most out of noncash contributions

Donated services and noncash contributions (also referred to as in-kind contributions or gifts in kind) are critical to many nonprofits' sustainability. But some organizations fail to properly document and report these valuable gifts. It's important to understand the rules and implement a written policy for handling noncash contributions.

Rules for professional services

Contributed services are professional services that have been donated by someone outside of the organization with specialized skills such as those provided by doctors, nurses, lawyers and accountants. These services must create or enhance a nonfinancial asset or require specialized skills, be provided by persons possessing those specialized skills, and be of the type that typically would be purchased by the nonprofit organization if the service or skills were not donated.

For example, on a pro bono basis a graphic designer creates collateral materials to describe fundraising and development programs. Certain technical expertise is necessary to produce the materials, which otherwise would have been purchased. So this qualifies as a contributed service. But general volunteer services, such as working a booth at a fundraising event, typically aren't recognized as contributed services.

An organization generally recognizes as revenue the fair value of qualifying contributed services in the period received. Certain disclosures are required.

Recognizing in-kind contributions

Noncash contributions are donations that come in some form other than cash. They can be, for example, appreciated securities, equipment, works of art or merchandise donated for fundraisers.

Before recognizing an in-kind contribution, you must determine whether the item is to be treated as a donation or as an agency transaction. In this case, the determining factor is the donor's wish. If you are free to do whatever you want with the item, the gift should be recognized as a contribution at fair market value on the date received.

It's usually in a nonprofit's best interest to liquidate securities within a reasonable date of the donation.

Policies and procedures

Every nonprofit should follow certain procedures for the receipt of noncash donations. These procedures take the guesswork out of when to sell or when to hold a particular item. Generally, unless a donor specifies otherwise, most organizations will liquidate the gift and turn it into cash in the shortest amount of time possible to eliminate the risk of market volatility and decreases in its fair market value.

For example, suppose an organization receives a donation of a Pablo Picasso print. Its fair market value on the

date of donation is $150,000. The organization must first convert that art into cash for it to be used for operations. The same would hold true for donations of marketable securities. It's usually in the nonprofit's best interest to liquidate securities within a reasonable date of the donation to reduce the risk of exposure to market fluctuations.

Maximize donations

Establishing noncash contribution policies will help you get the most out of generous donations. Properly recording their value can also help enhance the public perception of your financial picture and how efficiently you are using these contributions. ✧

Lay the groundwork for a successful partnership with another nonprofit

Are you considering a partnership with another nonprofit? Partnerships can save money, expand and create markets, and enable the joined organizations to deliver new and improved services. But you have to effectively implement and manage the merger. Consider the following tips to double your organization's efficacy:

Be clear about what you want. Define what your organization needs or wants to gain from a partnership — such as greater outreach, access to new markets or enhanced programs. Determine whether a partnership would be more beneficial than completing the program or project alone.

Select partners with compatible goals. It's not necessary that you partner only with similar organizations, but you should seek organizations with mutual program and project interests. For example, if you're a youth education organization, you could partner with a museum looking to create an arts education program.

Create one vision. Outline what both organizations want to accomplish, such as decreasing motor vehicle accidents in your state or enhancing after-school programs. Then, both you and your partner organization will be able to see the long-term goal and map out how you each will contribute to achieving it.

Own the project. Define specific goals, objectives and roles for everyone involved. Give everyone specific tasks to help them develop a sense of ownership, while maintaining a spirit of teamwork.

Work smart. Determine how your organizations will work together. How many meetings will you hold? What decisions will require a vote? Identify program policies and work procedures, and train both staffs to follow them.

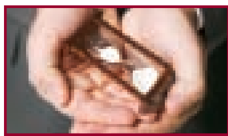
Create short-term, measurable goals. This will help determine whether the program or project is focused and on track. It also will show you where adjustments — such as adding more volunteers to an event or soliciting additional letters of support for a grant proposal — need to be made.

Expect some chaos. With any collaborative process, you'll likely encounter some disagreements. To help build trust and alleviate anxiety, strive to create an environment that encourages everyone to communicate openly and honestly.

Remember, there's no single way to create and manage a successful partnership. You'll need to experiment, but taking the time to explore may produce double the success for the members, constituents and nonprofits involved.

Newsbits

Dec. 31 deferred compensation rules deadline looms



The IRS has released final regulations for applying Section 409A of the Internal Revenue Code to nonqualified deferred compensation plans. The final regulations contain a number of significant changes affecting tax-exempt organizations. Employers have until Dec. 31 to bring their nonqualified plans into compliance.

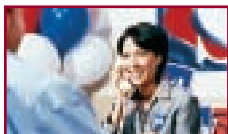
Under Sec. 409A, plans must be maintained in writing and must require participants to make deferral elections in advance. Plans can make payments only upon one of six statutorily defined events, and participants can't accelerate the disbursement of benefits.

If a plan doesn't comply by Dec. 31, participants will need to include all prior deferrals in gross income retroactive to the date of deferral. They'll also have to pay taxes, interest and penalties on the amount included, along with an additional 20% penalty on that amount. ✧

Ready to file e-postcards?

Beginning in 2008, all tax-exempt organizations must file annual information returns with the IRS. Small organizations that historically have been exempt now are required to file a yearly "e-postcard" (Form 990-N). Nonprofits that fail to file for three years may lose their tax-exempt status. ✧

Advocacy dos and don'ts during election season



As election year approaches, remember that the Internal Revenue Code prohibits nonprofits from disseminating propaganda or otherwise attempting to influence legislation. You must avoid the appearance of supporting or opposing candidates or the reelection of legislators based on their voting record.

While you can't participate or intervene in political campaigns, activities related to issue advocacy and public education are fine. You may evaluate votes as part of a continuing program to report on your lobbying efforts — with circulation limited to those who normally receive such communications. But include votes of all incumbents in your region, without indicating who is up for reelection or mentioning opposing candidates or their positions. ✧

Survey shows importance of accountability

More than 600 nonprofits responded to a 2006 Blackbaud Accountability Assessment survey on transparency, oversight and monitoring, internal controls, and best practices. Approximately 23% of respondents said they didn't have a consistent method for tracking restricted donations and 12.6% indicated that they didn't participate in audits conducted by outside accounting professionals. Among the other findings were:

- Half of all organizations had yet to establish an audit committee and couldn't readily explain the quantitative impact a donation would make,
- Approximately 20% didn't have documented internal controls, and one-third lacked integrated technology to automate many of the internal controls they had,
- 16% operated on the cash basis of accounting, and
- Nearly 20% didn't have a formal process for reviewing grant or donation restrictions prior to accepting them, and more than half were without a plan for dealing with postdonation requests by donors. ✧

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