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What social impact investing means for your nonprofit

Social impact investing has taken both the financial and philanthropic worlds by storm in recent years. According to a 2015 study by financial asset manager U.S. Trust, approximately one-third of high-net-worth individuals either already participate in social impact investing or want to. Yet the study found that many potential social impact investors are confused about what these philanthropic investments involve, the returns they produce and how their social impact is measured.

If your charity wants to attract social impact investors, it's important to understand this emerging hybrid model and be able to explain how your programs match investors' dual objectives.

DONORS REDEFINED

Social impact investments are made to generate a measurable social *and* financial return. Investors may put money in projects sponsored by for-profit companies, nonprofit organizations and investment funds. Instead of making outright gifts and grants, social investors generally participate via equity, debt and other market instruments.

The recipients of such investments usually are expected to repay investors, often with interest. Depending on how the investments are structured, investors may receive modest returns (in exchange for community and other social benefits) or returns that are competitive with non-social-impact investments.

One popular instrument is the social impact bond. Investors pay upfront costs for providing social services and are repaid by government agencies — but only after a third-party evaluator determines that the services achieve agreed-upon outcomes.

INVESTING IN ACTION

Rather than profiting directly, many social investors "recycle" their returns for greater charitable effect. For example, the Greater Cincinnati Foundation's impact investing donor advised fund uses a variety of methods to leverage participants' donations — including reinvesting financial returns in the fund — to support a portfolio of community nonprofits.

Be prepared to prove that your nonprofit has the management and financial experience and expertise to achieve your objectives.

One of the best known social impact investments is the Rockefeller Foundation's 100 Resilient Cities initiative, which provides urban centers around the world with leadership, technology and specialized expertise to build "resilience" to current and future social, economic and environmental challenges. A city suffering from "energy poverty" might receive foundation assistance to build an electrical grid, and then repay the foundation once it's up and running. The foundation expects that its involvement in such a project will attract other participants — such as energy service companies, private capital and nonprofits — and generate new economic activity that benefits everyone in the region.

TAPPING A DESIRABLE DEMOGRAPHIC

Social impact investors are a desirable demographic. High-net-worth individuals, women and younger donors — those who prioritize "doing well by doing good" — have expressed disproportionate interest in social impact opportunities. And because minimum investments are typically high, family offices and private foundations frequently participate in social impact initiatives.

Unfortunately, not all nonprofits will be able to attract social impact dollars. If, for example, your nonprofit provides basic human services such as food assistance or shelter for the homeless, you'll probably have a hard time making the case to investors. Your programs' social returns may be high, but the financial ones are probably nil.

If, on the other hand, your organization builds low-income housing or community health clinics, provides seed money for minority business startups, or funds the development of environmentally friendly products, you may offer what social impact investors are looking for. Keep in mind that you'll need to provide social impact and financial return projections that are both attractive and realistic. (See "IRIS makes the double-bottom line easier to read" for help preparing financial statements.) And be prepared to prove that your nonprofit has the management and financial experience and expertise to achieve your objectives.

Reaching these investors isn't always easy, though. Most charities gain access to social impact dollars through community foundations or professional investment advisors, so it's important to foster good relationships with these intermediaries.

STEEP LEARNING CURVE

For nonprofits accustomed to dealing only with traditional donors, the learning curve for social impact investing can be steep. So you should work with financial advisors who are knowledgeable about this brave new world of philanthropy. They can help you craft a compelling social impact offering and find potential investors. ✱

IRIS makes the double-bottom line easier to read

Transparency is critical to attracting social impact investors to your organization. These types of donors — and intermediaries such as community foundations and financial advisors — won't make any commitments until they know how you measure, monitor and report social and financial outcomes.

The nonprofit Global Impact Investing Network has initiated the Impact Reporting and Investment Standards (IRIS) project to help ensure that investors, nonprofits and other stakeholders will all be on the same page. Like Generally Accepted Accounting Principles (GAAP), IRIS is a common accounting language that enables comparison of different organizations or investments. Unlike GAAP, it features a double-bottom line to record both financial and social results. IRIS's metrics catalog suggests specific ways to measure social returns, such as "number of volunteer hours," "energy conserved as a result of energy-efficient construction" and "percentage of students advancing from one level to the next." You can view the entire catalog online at iris.thegiin.org/metrics.

So you've received an audit letter from the IRS ...

You're probably already aware that the IRS has increased its scrutiny of nonprofits in recent years. In fact, the agency audited 8,000 nonprofits (out of 1.6 million tax-exempt groups) in 2014. So if your organization is chosen, you're in good company. Here's what to expect.

WHAT IS AN AUDIT?

An audit begins with the initial contact from the IRS and continues until audit findings are discussed in a closing conference and a closing letter is issued. An officer of your nonprofit, your representative (such as a CPA) and the agent will discuss the agent's conclusions at the closing conference. Both the conference and the letter will explain your appeal rights.

Audits can cover many areas. For example, the IRS may want to learn whether your organization filed all returns and forms as required by law and whether they're complete and accurate. Or it might delve into whether your activities were consistent with your tax-exempt purpose, or whether any tax liabilities such as employment taxes or unrelated business income tax were properly paid.

During the audit the IRS will request various records. These include Form 990 returns, employment tax returns, Form 1099 informational tax returns, governing documents, board minutes and internal financial records. The request will detail the time period that will be covered in the audit, but three years is typical.

FIELD VS. CORRESPONDENCE

If your initial contact letter schedules an agent to visit your premises, the IRS is conducting a field audit or in-person examination. Field audits are performed at your location, your representative's office or an area IRS office.

Field audits fall into two categories:

1. General program exam, which typically is conducted by a single IRS agent, or

2. Team Examination Program audit, which focuses on large, complex organizations and may involve a team of examiners.

If your initial IRS letter asks you to deliver documents to an IRS office by mail, the agency is conducting an office or correspondence audit. An agent generally will perform the audit via letters and phone calls to your officers or representative. Although a correspondence audit may seem less stressful, it can expand to become a field audit if the issues grow more complex or your nonprofit doesn't respond. Both correspondence and field audits can grow in scope to include prior and subsequent tax years.

COMPLIANCE CHECKS

The IRS might also contact you to announce a compliance check. This isn't an audit; it's a determination of whether your organization is adhering to record-keeping and information reporting requirements. Compliance checks often relate to a specific issue, such as Form 990 disclosures and whether your nonprofit's activities are consistent with its tax-exempt purpose.

Compliance checks are simpler and less burdensome than audits and don't directly determine a tax liability for any particular period. They can, however, lead to an audit — particularly if you don't cooperate.

AUDIT TRIGGERS

Nonprofits are chosen for audits for several reasons. The igniting spark might be an IRS examination initiative or project, or the agency might receive complaints about potential noncompliance at your organization.

Other reasons include:

- Risk modeling from the nonprofit's Form 990, including an evaluation of governance policies in place,
- The incidence of fraud, as reported on the organization's Form 990,
- Related examinations of other taxpayers, such as business partners, clients or vendors, whose returns were selected for audit,
- Document matching — when payer records, such as Forms W-2 or 1099, don't match the information you've reported, and
- Certain claims for refunds or requests for abatements.

In general, Form 990 plays a strong role in the selection process.

RELY ON AN EXPERT

Receiving an audit letter can be scary. But your nonprofit doesn't need to go through the audit process alone. Contact your CPA as soon as possible, and this expert can help you assemble the necessary documentation and represent you at meetings with IRS agents. ✱

Making a corporate volunteer program work for your nonprofit

Approximately 60% of the world's large companies provide some form of paid volunteer program for employees, according to the Committee Encouraging Corporate Philanthropy, a coalition of CEOs dedicated to corporate societal engagement. It's easy to understand the appeal of volunteer programs for companies. Volunteering in their communities boosts their reputation, raises their visibility, provides employee team-building opportunities and has even been shown to reduce absenteeism and improve retention.

Nonprofits also generally benefit from corporate volunteer programs — but not always. So if you're considering this type of partnership, make sure that it really will be mutually beneficial.

ADVANTAGES ARE CLEAR

For organizations that are always short of volunteers or that have put off large projects for lack of helping hands, a corporate volunteer partnership can be a boon. These partnerships offer other benefits as well.

Teaming up with a well-known company can raise your nonprofit's profile with potential donors and the media. And employees who participated may decide to become permanent volunteers or financial supporters of your organization.

MUTUALLY BENEFICIAL RELATIONSHIP

The best volunteer partnerships generally are those where the nonprofit's mission and the company's core business correlate. For example,

an athletic shoes manufacturer is a perfect match for an afterschool basketball program.

Many businesses seek one-day volunteer opportunities that can accommodate all of their employees. If your organization is painting the walls of schools, stocking food pantry shelves or setting up for a fundraising event, short-term assistance from an army of volunteers can be a lifesaver. But you shouldn't create work where it doesn't exist, particularly if coming up with activities or managing volunteers will put a strain on staff resources.

Also be wary when companies offer volunteers on short notice. To be successful, corporate volunteer days take planning. For example, you may need to arrange such logistical details as meals or prepare training instructions and educational materials.

OPPORTUNITIES ABOUND

If you have to turn down an eager corporate volunteer, do so carefully. Explain how the offer may, in fact, cost your nonprofit time and money. Then propose other volunteer opportunities.

Group volunteer days aren't the only way to take advantage of employees who want to help. Many companies provide paid time for staff to volunteer for the charity of their choice. Others make financial contributions to organizations where employees volunteer. For example, Campbell's Soup Company donated approximately $50,000 in 2015 to the charities where its employees volunteered during the company's "Make a Difference Week."

FINDING YOUR MATCH

Several organizations help nonprofits find companies with volunteer programs, including the Points of Light Foundation (pointsoflight.org), VolunteerMatch (volunteermatch.org) and HandsOn Network (handsonnetwork.org). Regional organizations such as Boston Cares (bostoncares.org) and Chicago Cares (chicagocares.org) can help you find companies in your community.

Once you have a volunteer partner, get to know its corporate responsibility administrator and stay in touch with that person even after the volunteer activity has taken place. The goal is to turn a one-day event into an ongoing arrangement — and to ensure that your organization will be seriously considered for any corporate gifts that may be available. ✱

Are you doing enough to manage risk?

No matter what your mission, your nonprofit must protect financial and physical assets, human resources and relationships, and all the intangibles that keep your organization going, such as community goodwill and your reputation. And if you don't have comprehensive risk control procedures and strong internal controls, you aren't doing enough to prevent financial and other serious losses.

WHAT ARE THE BIGGEST RISKS?

Nonprofits are susceptible to risk in every area — from staff hiring to volunteer recruitment; from proper spending of donations to investing reserve funds. Risk management is the only way to spot and head off many potential disasters before they happen.

The first step in risk management is to identify potential perils, starting with people — employees, volunteers, donors and clients. Your organization's assets, including physical property and such financial assets as cash and investments, are another major area of risk. And don't forget your goodwill with donors, volunteers, clients and the community, or the activities that allow you to generate revenue and raise funds. Finally, as the IRS increases its scrutiny of nonprofits, remember that your tax-exempt status is always potentially at risk. (See "So you've received an audit letter from the IRS …")

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HOW IS YOUR ORGANIZATION SPECIAL?

Those are general risks, but your nonprofit also likely has specific ones. For example, your budget may rely heavily on the success of an annual fundraising event or clients may use your services primarily because of your association with other local nonprofits.

Identify the one or two strengths that define your reputation in the community. Then ask: What would we do if forces beyond our control challenged them? Could we develop new funding sources or continue at a new location?

WHAT'S THE PLAN?

After you've identified the risks that create the greatest challenge to achieving your mission, develop a risk-management strategy that suits your organization. If yours is like most nonprofits, managing and protecting financial resources is a major concern. So address any acts that could contribute to the loss of financial assets by establishing management and accounting controls. In general, the biggest threats to financial assets are theft or fraud; misuse of funds by not following the donor's restrictions; poor investment decisions; and inappropriate selection of partners and affiliates.

Your internal controls should address proper oversight by senior management and board members, authorization and transaction documentation, the physical security of assets and early fraud detection.

WHO'S RESPONSIBLE?

To develop risk-reduction policies and internal controls, appoint a team that includes management, board members, various program managers and outside financial and legal advisors. For the most critical risks, the team should create procedures to avoid them completely, modify your nonprofit's exposure to them or, in a worst-case scenario, recover from them.

If, for example, you determine that your IT network is at risk for hacking, you might decide to:

- Consult with an IT security expert,
- Upgrade software and equipment,
- Limit staff members with network access, and
- Begin storing data offsite.

Remember that risk management is an ongoing process, so the team must continually review procedures and address emerging risks.

WHO CAN HELP?

Risk management is one of the major challenges of running a nonprofit — but you don't have to do it alone. If you don't have the internal resources, talk to your financial advisor. ✱