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Nonprofit Observer

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Add "un" to restricted

Freeing up funds to pay operating expenses

As many nonprofits without sufficient unrestricted funds have learned, it's possible to be flush with funds yet unable to pay the bills. If most of your organization's funds are restricted — earmarked for your endowment or a specific program — coming up with the cash to pay salaries, utility bills and other operational expenses can be challenging.

Selling prospective donors on unrestricted contributions isn't always easy. A few profligate — and well-publicized — nonprofits, not to mention campaigns against administrative "waste" by nonprofit watchdog groups, have made donors sensitive to the issue. They like to know where their money is going and how it makes a difference. So if you want to grow your unrestricted funds pool, you'll need to devote special attention to persuading donors, which includes educating them about all the good that unrestricted gifts can do.

WHY UNRESTRICTED, WHY NOW?

In a nutshell, unrestricted funds are stipulation-free, meaning their donors didn't contribute them to support a particular program, project or purpose. Board-designated funds are also considered unrestricted. Although the board has temporarily dedicated them to a specific purpose (for example, to maintain a certain level of operating reserves), they don't carry donor stipulations. When an organization is in a cash crunch, its board can undesignate such funds so that they may be used to pay administrative and other day-to-day expenses.

However, regularly relying on operating reserves and other formerly board-designated funds to pay monthly bills isn't a smart policy. You need a healthy pool of unrestricted funds from which to draw.

In recent years, donors — particularly foundations and government entities — have resisted releasing unrestricted funds. That's starting to change. In 2014, the White House Office of Management and Budget issued guidance stating that at least 10% of federal dollars awarded to nonprofit grantees should pay for indirect costs. And a coalition of the largest charity watchdog groups recently urged prospective donors to pay less attention to the percentage that nonprofits pay in administrative costs and more on such qualities as how nonprofits are governed and the effectiveness of their programs.

FINDING THE FUNDS

Nevertheless, obstacles remain for nonprofit fundraisers and boards. One solution is to provide checkboxes on all donation and grant application forms giving donors the opportunity to restrict or not restrict their gift. You can

steer them toward the unrestricted box with language such as "use my donation where it's most needed." Donors are more likely to choose this option if they think your organization is fiscally responsible. So be sure to use your Form 990 and other publicly released information to provide transparency about financial decisions and to communicate how donations contribute to positive results.

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When meeting with individuals contemplating making a major gift, go into details about your nonprofit's budget and how much it costs to run an effective organization. Donors who understand how your operations run and the challenges you routinely face will be more willing to give unrestrictedly.

CONVERTING FOR USE

What if you have a large amount of already-committed restricted funds you'd like to convert to unrestricted use? Consider what medical relief charity Doctors Without Borders did in the wake of 2004's Indian Ocean tsunami: It contacted donors and asked permission to redeploy their gifts. While not every donor will agree, with a strong enough argument you're likely to convince most of them.

Gifts earmarked for obsolete or never-completed projects may also be fair game. Individual state law varies, but in general, if restricted funds can't be used for their original purpose, nonprofits can modify or terminate the restriction. If you can't obtain a release from the original donor, you may need to seek judicial permission and meet other requirements.

Finally, the American Institute of CPAs' *Not-for-Profit Entities — Audit & Accounting Guide* states that organizations can adopt a policy to allocate a percentage of donor-restricted contributions to administrative costs. Talk to your financial advisor about whether this is an option.

COMMUNICATE YOUR NEED

Although it may mean making some changes to your fundraising strategy, committing to raising more unrestricted funds is energy well spent. As with most endeavors, the key is good communication — explaining why you need the funds and how you'll use them responsibly. ✱

Personal appeals are the most powerful

One of the most powerful fundraising tools is a personal appeal from a friend, family member or colleague. If you're a nonprofit executive or board member, you can leverage your address book most effectively by:

Telling your story. Say, for example, you serve on a board that raises awareness about heart disease. If you've lost a family member to a heart attack, you might share your personal experiences to illustrate why you support the organization's work.

Emphasizing benefits. Philanthropy typically involves both doing good *and* doing well. If you're trying to encourage a business owner's attendance at a benefit dinner, promote its networking opportunities — and public recognition if, for example, the event will be covered by local press.

Appealing in person. E-mail saves time, but face-to-face appeals are almost always more compelling. This is especially true if you offer prospective donors something in exchange for their attention, such as lunch or cocktails and canapés.

How COSO helps nonprofits bolster internal controls

For more than two decades, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) has provided for-profit companies with guidance on designing and maintaining internal controls, as well as assessing their effectiveness. A joint initiative of several professional accounting groups, COSO recently revised its original framework with the release of *Internal Control — Integrated Framework.*

Not all of the updated framework will apply to nonprofits. But this new guidance can provide a structure for organizations trying to establish, strengthen or assess their internal controls.

NOT MANDATORY, BUT ENCOURAGED

Neither for-profits nor nonprofits are required to follow COSO's advice, but the commission has suggested that organizations transition to the new framework by Dec. 15, 2014. Auditors generally rely on the framework's components when they assess internal controls. And you may need to implement the framework if your nonprofit receives federal grant money and is subject to OMB Circular A-133 audits.

Even if you're under no obligation to follow COSO, its framework has proven over the years to be an effective risk management tool for many different types of organizations. The updated version, which incorporates recent technological developments, the move toward increased globalization and the demand for better governance and transparency, is designed to help organizations apply internal controls more broadly to operations and reporting objectives.

CORE CONCEPTS

Both the original and revised COSO frameworks are built around five interrelated components:

1. **Control environment** — the set of standards, processes and structures that provide the basis for carrying out internal controls, such as ethical values and people management.

2. **Risk assessment** — the process for identifying and assessing risks related to achieving an organization's objectives.

3. **Control activities** — actions that help ensure that management's directives to mitigate risks are carried out, such as authorizations and approvals, verifications, reconciliations, and segregation of duties.

4. **Information and communication** — the flow of information necessary to support the internal control function, including communication between board members and executives as well as communication with external stakeholders.

5. **Monitoring** — an ongoing evaluation of the internal control system's performance over time and reporting of any deficiencies that are found.

COSO stresses that each of these five components must be in place and fully functioning for an internal control system to be effective.

To help organizations turn abstract concepts into actionable items, the new framework introduces 17 principles related to the five components. For example, three principles apply to "control activities":

- Select and develop control activities that mitigate risks.
- Select and develop technology controls.
- Deploy control activities through policies and procedures.

In addition to the 17 principles, COSO offers 81 "points of focus" in its report.

APPLYING THE FRAMEWORK

As with the old, the new COSO framework is principles-based. This means that your nonprofit's leaders can exercise their own judgment when determining which internal controls are appropriate for your organization and those — such as principles related to public company reporting — it can ignore.

But if governance is a particular concern, you might focus on directives about directors' independence from management and best practices for audit committees. A nonprofit that has suffered an occupational fraud incident can use the framework to assess current risks (such as poor hiring decisions), strengthen controls (such as segregation of duties), and communicate ethical expectations to staffers.

COMMUNICATING ACCOUNTABILITY

For help applying the COSO framework or reviewing your internal controls, contact your financial advisor. And be sure that, if your organization implements all or some COSO principles, your nonprofit's Form 990 reflects newly adopted or strengthened controls. Following COSO tells regulators, nonprofit watchdog groups and donors that your nonprofit is focused on good governance and accountability. ✱

Lifesaver or liability?

Limiting risk associated with volunteers

For many nonprofits on tight budgets, operating without the assistance of volunteers is out of the question. Unfortunately, nonprofits that direct and benefit from the actions of their unpaid workforce can be held accountable if volunteers are harmed or harm others on the job.

UNDERSTAND THE RISKS

Allegations of negligence, intentional misconduct and strict liability often motivate lawsuits against nonprofits. In strict liability cases, responsibility for harm is considered automatic whether there's negligence or misconduct. Nonprofits can also be held liable even when volunteers act outside the scope of prescribed duties or accepted procedures.

Still, most organizations have no choice but to manage volunteer-related risks as best they can, because operating without unpaid help would be impossible. But organizations can use volunteers with greater confidence by adopting certain practices to potentially reduce liability.

TREAT THEM LIKE POTENTIAL EMPLOYEES

Your volunteer recruitment process should be almost as formal and structured as your paid employee hiring process. Before seeking volunteers, develop job descriptions for open positions. These should outline the nature of the work to be performed, any required skills or experience, and any possible risks the job presents to the volunteer or your organization.

Once you have volunteer candidates, screen them according to the risks that might be involved based on your nonprofit's mission, programs and likely volunteer activities. Some positions will pose few risks. In these cases, the screening process can be relatively basic: Ask candidates to fill out an application and submit to an interview, and then check their work and character references.

Positions that carry greater risks — such as work involving children, the elderly and other vulnerable populations, or direct access to cash donations — should involve a more rigorous screening process. This might include criminal history and credit report checks and verification of driver's licenses, certifications or degrees.

Be sure to apply your screening process consistently and avoid exceptions — even for volunteers who've been referred by an employee or board member. And don't dismiss unusual findings without further investigation.

SUPPORT AND SUPERVISE

Once volunteers are on board, provide training, supervision and, if necessary, discipline. At a minimum, training should involve an orientation session to explain your nonprofit's mission and policies. Once volunteers have begun working for you, continue active supervision to verify that they understand expectations and are acting in line with them.

Nonprofits can be held liable even when volunteers act outside the scope of prescribed duties or accepted procedures.

To encourage professionalism and responsibility in your volunteers, consider devising performance plans that include goals — and rewards for achieving them. Such plans can also provide you with a framework to evaluate and dismiss volunteers who may be putting your nonprofit at risk by, for example, failing to follow safety procedures.

PROTECT WITH A POLICY

No risk reduction plan is complete without comprehensive insurance coverage. In addition to general liability, you may want to consider supplemental policies that address specific types of exposure such as medical malpractice or sexual misconduct.

It's also a good idea to have legal advisors periodically review policies and procedures pertaining to volunteers. An attorney can help you determine whether your organization is doing all it can to reduce risks.

SOUND PRACTICES

Whether you consider volunteers the backbone of your organization or simply an extra set of hands, they represent potential legal and financial risks. Protect them and your nonprofit by following sound "employment" practices and maintaining adequate insurance coverage. ✱

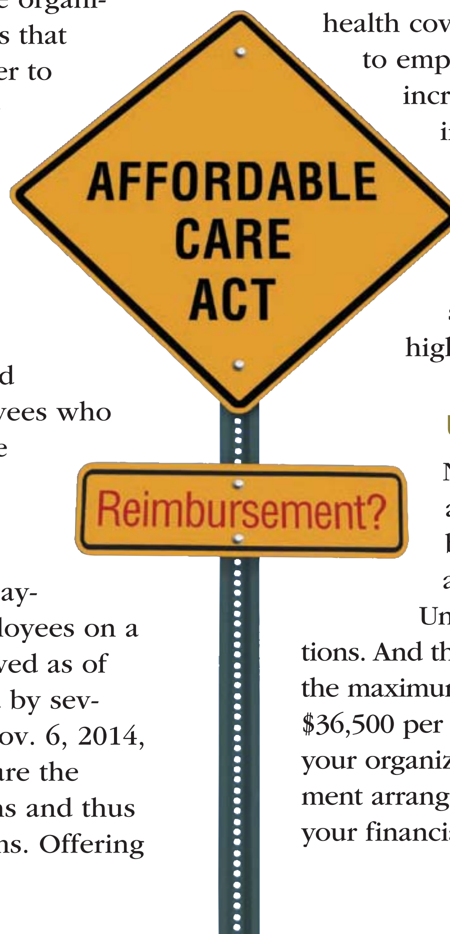
Your employee reimbursement plan may violate the ACA

Like their for-profit counterparts, nonprofits have been scrambling to ensure they're in compliance with the Affordable Care Act (ACA). Effective Jan. 1, 2015, employers, including nonprofits, with 50 or more full-time employees or the "equivalent" must offer an affordable, minimum level of health insurance coverage to all actual full-time employees — or risk financial penalties. (There are exceptions for midsize employers that qualify for transitional relief.) Smaller organizations aren't subject to this rule, but all employers are required to inform employees about their options for accessing health insurance.

Such mandates seem straightforward enough. Unfortunately, other elements of the ACA have proven confusing for some organizations. For example, employers that don't provide insurance but offer to reimburse employees for coverage obtained elsewhere, such as from a Health Insurance Marketplace, may not be in compliance.

WHAT'S CHANGED

For many years, the IRS allowed employers to reimburse employees who paid their own health insurance premiums and to exclude such amounts from the employee's gross income. But according to IRS Notice 2013-54, employer payment plans that reimburse employees on a pretax basis are no longer allowed as of Jan. 1, 2014. Guidance released by several government agencies on Nov. 6, 2014, stated that such arrangements are the equivalent of group health plans and thus violate the ACA's market reforms. Offering a reimbursement plan may trigger penalties, including excise taxes under Section 4980D of the tax code.



Employers are also warned to avoid schemes that attempt to skirt the rules. For example, some vendors are encouraging employers to replace their group health policies with reimbursement arrangements and have insurance brokers help the newly uninsured employees buy individual policies from the Health Insurance Marketplace. These vendors claim — wrongly — that the employees will then gain access to premium tax credits.

What you *can* do is establish an arrangement under which employees choose between cash and an after-tax amount to be applied toward health coverage. But these arrangements add to employees' taxable income, effectively increasing their cost of buying health insurance. Some nonprofits have scrapped reimbursement plans entirely and simply increased staffers' wages to allow them to buy their own policies. However, such scenarios also may result in higher income tax for employees.

UNRESOLVED ISSUES

Nonprofits may still be confused about how they can help employees buy health insurance without creating additional financial burdens. Unfortunately, there are no easy solutions. And the IRS has been threatening to impose the maximum penalty allowed by law of up to $36,500 per year, per employee on violators. If your organization has a noncompliant reimbursement arrangement, investigate other options with your financial and insurance advisors. ✱

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