

PROFITABLE SOLUTIONS FOR NONPROFITS



Assessing a potential merger

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a marriage doomed to fail?**

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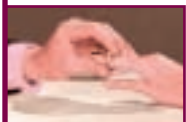
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Assessing a potential merger

A match made in heaven or a marriage doomed to fail?



Nonprofits face many of the same challenges as their for-profit counterparts, including shrinking resources, cash flow problems and competitive threats. To survive, many not-for-profits are following a cue from the corporate world and taking the plunge into mergers.

Take two environmental organizations that merged. Although they both focused on improving river water quality, their philosophies were different. But they were able to set aside their differences because they realized that merging could bring far more success — including increased public visibility and fund-raising power — than either organization could have achieved on its own.

Merge for the right reasons

When should you consider combining resources with another nonprofit? A financial problem stemming from steady declines in grants and donations is a legitimate motivator. Duplication and overlap of services and mission may be another valid merger trigger. Bringing organizations together can be a powerful way to build unity, accelerate mission achievement and use dollars more efficiently.

For instance, a smaller nonprofit with a solid program and good but modest record of achievement may seek a merger with a cash-rich larger organization that needs to strengthen its programs in the area of the smaller nonprofit's expertise.

You might also consider joining with another nonprofit to gain access to a larger skill set. Perhaps another organization has an outstanding and dedicated staff, while you have excellent fund-raising skills. Combining forces may enable you and the other not-for-profit to provide better services and maximize capabilities.

There may also be some good reasons to consider merging with a for-profit entity. Doing so can boost funding, raise the nonprofit's profile and reduce

administrative expenses. Keep in mind, however, that tax and legal complexities come into play. The main one is that an arrangement with a for-profit partner can't involve the nonprofit improperly transferring assets to its for-profit partner. The IRS has stiff penalties for transactions that improperly reduce a nonprofit's assets.

Look before you leap

If you're mulling a merger, think about what you really want to achieve. The more specific your goals and anticipated outcomes, the easier it will be later on. So develop realistic goals stated in measurable terms, such as striving for a 30% increase in donations or being able to serve an additional 500 people each year.

Also, assess your readiness to be a partner. You're a much better candidate for a merger if you:

- ✓ Know what you want to accomplish,
- ✓ Understand your strategic challenges,
- ✓ Have a strong board/management relationship,
- ✓ Are growth-oriented, and
- ✓ Have a history of successful risk-taking.

It's also important for your organization to be steady. Those in crisis mode probably don't have a good handle on their objectives, or even strengths and weaknesses.

Know what you may lose

Before you jump into negotiations, realize that mergers do have risks, and problems can arise. Common downsides of mergers include:

Time and costs. Few organizations realize just how much time is needed to successfully merge two entities. Depending on the size and complexity of the organizations, a merger can take up to two years to complete. Mergers can be expensive, particularly because outside experts, such as consultants, tax advisors and attorneys, are needed to assist with the process.



Legal or regulatory hurdles. Many states have specific procedures that must be followed and forms that must be

Combining forces may enable you and the other not-for-profit to provide better services and maximize capabilities.

filed when nonprofits merge. And you may need to get consent from donors to legally transfer gifts or grants.

Culture clashes. It may be difficult for individuals to set aside their differences and work in the spirit of cooperation. Fears, egos, politics and personal concerns

are all likely to be visible as everyone struggles with making major organizational changes.

Resistance. Potential partners must get buy-in from everyone, including funding sources, staff and other stakeholders. Disregarding concerns won't make the process any smoother and may jeopardize the merger.

Find the right fit

Ultimately, a merger will be successful only if both organizations conclude that the benefits of collaboration outweigh any drawbacks. If you and your potential partner both are confident you can work effectively as a unified force and resolve any differences, you'll be poised to enjoy a solid partnership. ✧

How the Pension Protection Act has changed nonprofit operations



The Pension Protection Act of 2006 (PPA) contains incentives to encourage donations to nonprofits. But it also imposes tighter controls on charitable giving and steps up federal oversight. As a result, your fund-raising efforts may increase, but you'll also need to be more accountable for how you treat your donors' largesse.

Charitable giving incentives

PPA allows taxpayers age 70 ½ or older to make tax-free distributions from their traditional or Roth IRAs — up to \$100,000 annually — to tax-exempt charities through 2007. This move is a significant step forward for nonprofits' fund-raising capabilities, especially for those organizations with access to wealthy donors.

PPA also gives not-for-profits greater opportunities to obtain land for conservation purposes. It allows land-rich, but cash-poor, contributors to donate land for conservation by increasing the charitable deduction limit from 30% to 50% of adjusted gross income (AGI) — 100% of AGI for farmers and ranchers. Both provisions are effective through 2007. There are some restrictions: for example, the donation can't prevent the use of the land for farming or ranching.

Charitable reforms

Even as your nonprofit benefits from increased donation opportunities, you'll likely also feel the effects of tighter rules for donations of cash, clothing and household items.

Under the new law, taxpayers must substantiate such donations with canceled checks, bank statements or receipts from your not-for-profit — otherwise, they can't claim the charitable deduction. As a result, some organizations are spending more time and money on administrative duties to help donors fulfill this requirement.

Also, taxpayers can deduct only household items in "good condition," and the law hasn't defined what this means. Examples of household items are:

- ✓ Furniture,
- ✓ Electronics and appliances, and
- ✓ Linens.

Keep in mind that the IRS doesn't consider food, paintings, antiques, artwork, jewelry, gems or collectibles to be household items.



In another change, nonprofits that receive partial interest in personal property must take complete ownership of the item within 10 years or upon the death of the donor, whichever is first. Additionally, the organization must take possession of and use the item for its exempt purpose at least once during the 10-year period — even if the donor remains alive.

Increased federal oversight

Because Congress was concerned that some bad apples were tainting the good name of U.S. charities, it decided to tighten federal oversight of all nonprofits. As a result, not-for-profits are treading carefully to avoid certain potentially expensive activities, such as making financial transactions that jeopardize their missions.



More food and book donations?

As a result of a provision of the Pension Protection Act of 2006 that extends enhanced tax deductions for food and book donations made by corporations through 2007, you may be receiving more of these types of contributions.

Under the food extension, a business may claim an enhanced deduction equal to the lesser of basis, which is inventory value, plus one-half of the item's fair market value in excess of basis or two times basis. Meanwhile, the book extension — which applies only to C corporations — provides similar deductions for books suitable for use in a school's educational programs.

For instance, if a company spent \$100 on food or books that would sell on the open market for \$500, it could deduct the lesser of two times the basis ($\$100 \times 2 = \200) or the basis cost plus half the excess fair market value [$\$100 + (0.5 \times \$400) = \$300$]. In this example, the deduction would be \$200 because it's the lesser amount.

For more on learning about basis and determining fair market value, check with your tax professional.

For example, a foundation will be penalized if it lends money from its endowment fund to one of its board members at a below-market rate. And PPA doubles fines and penalties for these activities. The rules are complicated and detailed, so it's important to consult a tax professional or attorney when considering such financial transactions.

Another oversight provision improves accountability for donor-advised funds (DAFs) — private funds administered by a third party and created for the purpose of managing charitable donations on behalf of an organization — and supporting organizations. Now, fundholders are banned from using a DAF to reimburse themselves or their advisors for any expenses related to the fund, including meetings (such as plane tickets and meals), printing expenses and fund-raising costs.

Organizations that aren't required to file a tax return because their gross receipts are less than \$25,000 are also under stricter scrutiny. They must now file annual notices with the IRS, providing basic information such as their names and addresses, taxpayer identification numbers and financial status. Those that fail to comply could lose their tax-exempt status.

Additional information

PPA is a complex law containing many more provisions that affect nonprofits. To ensure you understand the changes and can guide your donors on the new record-keeping practices, contact a tax professional or attorney. ♦

Holding grant recipients accountable for fund use



Deciding how to distribute grants and who will receive awards is only half the work involved in grant management. Foundations and other nonprofit grant-making organizations also need to ensure that recipients use funds for their stated purposes and that those purposes yield planned results.

Receipts and reports

To hold grant recipients accountable for how they use funds, make it clear in your grant award documents. Policies vary, but many granting organizations require recipients to provide detailed financial records, including a list of itemized expenses and accompanying receipts.

You might also request detailed project progress reports that demonstrate not only the status of the project but also the objectives that have been achieved. One source of information is supporting documents such as published newspaper interviews, video clips from television news reports or written statements from the community.

Finally, grant recipients should understand they are responsible for the reporting and financial compliance of subrecipients — third parties who perform a portion of grant recipients' research or other sponsored programs.

Reporting deadlines

It's important to make sure recipients adhere to reporting deadlines, because the timely receipt of financial records and supporting documents is necessary to effectively monitor performance. That way, you can address potential problems — such as when recipients fail to reach grant goals or complete required deliverables — early in the grant period and help keep recipients on course.

Grant award documents should clearly explain the consequences of failing to submit required reports. You might, for instance, include the following statement in your written agreement: "Failure to comply with the terms and conditions of this grant award, including reporting requirements, may result in the withholding of grant payments until the deficient situation is corrected."

Site visits

Once a grant has been awarded, you may want to schedule site visits to monitor recipients' activities and get a first-hand view of:

- ✓ Whether they are using sound project management practices,
- ✓ How grant funds will keep the program going,

- ✓ The results recipients are achieving, and
- ✓ How their communities are better places as a result of their efforts.

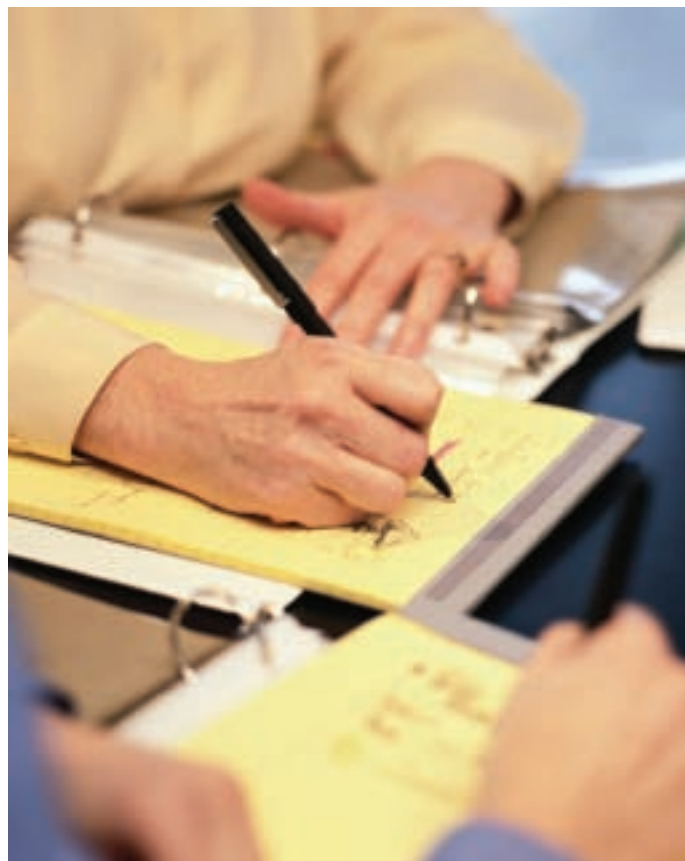
Before visiting, let recipients know what financial and related documents they will be required to produce.

Evaluations

When projects are complete, ask grant recipients to submit postproject evaluations comparing project deliverables with promises. Let them know that completing the evaluation is critical to remaining eligible for future funding. In the evaluation, recipients should explain what they achieved with the money, how much time they spent on their projects and what lessons they learned from the experience.

Some foundations take the extra step of surveying completed projects every three to five years, depending on the grant program, to determine the projects' ongoing effectiveness.

For example, National Park Service grant-program managers, with assistance from their state counterparts,



conduct postcompletion assessments that include site inspections to confirm that federally funded sites remain in recreational use in perpetuity.

Meanwhile, the Department of Health and Human Services' Community and Migrant Health Centers' grant programs use the number of visits to health centers and the results of regular surveys from health center users as measures of these programs' success.

Too much vs. too little monitoring

Oversight and monitoring mechanisms are important tools that can help you prevent grant misuse or waste. Improperly designed and implemented, however, they may prevent you from awarding funds at all.

If you impose too many requirements, for instance, candidates may decide it's not worth the effort to work with you and simply seek funding elsewhere. Those that do use your grants to initiate projects may find that onerous restrictions divert their attention from the work for which they have received funding.

The bottom line

Although you must pay attention to what recipients are doing with the grants you award them, too much attention can stifle progress toward your mutual goals. It's a balancing act that requires your time to perfect. ✧

Finders keepers

Recruiting the best board members requires planning

Finding desirable board members is difficult, particularly if you're in a time crunch. That's why your nonprofit should be scouting even when there are no immediate vacancies. This way, when openings arise, you'll have viable candidates lined up. Here are the three main steps to recruiting board members:

1. Determine what characteristics are important. A good board member is someone who is passionate about your not-for-profit's purpose, willing to work within a group, and in a position to make financial contributions or find others who will. Other desirable traits may depend on your organizational needs.

2. Look for prospects. Find candidates who already understand your organization's mission and goals and are willing to work, such as volunteers and donors. Active volunteers may be in a position to accept a greater role, and donors are committed to helping your not-for-profit thrive and usually willing to extend more than financial help. Don't forget about members of the public. You can recruit them during canvassing efforts, open houses, social events — any activities your organization sponsors.

And tap these other resources:

- ✓ Current board members who may be able to suggest friends or associates who have an interest in your not-for-profit,
- ✓ Business and community leaders who are used to producing results and are team-oriented,
- ✓ Religious leaders who may be able to recommend prospects from their own or other congregations, and
- ✓ Executive directors and board officers of other large, established nonprofits, such as the local United Way and Junior League.

You'll want to surf the Web, too. BoardNet USA (www.boardnetusa.org) is a free service that matches people interested in serving on nonprofit boards with organizations recruiting board members. In addition, many state CPA societies have Web sites that list board positions so that not-for-profits can match up with volunteers that have financial backgrounds.

3. Approach potential candidates. If you want to target only certain types of candidates — whether it's lawyers, accountants, bankers or those with lots of experience and passion for your organization's mission — outline the criteria in a job description. And be frank about what will be expected of them, particularly the fund-raising activities required and how much time they will be expected to volunteer.



Newsbits

Contributions to foreign charities require special considerations



U.S. taxpayers and private foundations can support charitable activities abroad, but they're subject to complex tax rules. Contributions are deductible if they go to U.S. charities that have programs overseas but usually aren't deductible if made directly to foreign charities.

Due consideration must also be given to various sanctions and best practices adopted in the aftermath of 9/11 that aim to prevent the funding of terrorism. It's important for U.S. grant-makers engaged in international philanthropy to assess the risk of such a diversion and follow policies and procedures under the U.S.A. Patriot Act. ✦

Start a planned giving program



Shrinking donations and increasingly tight budgets have forced many not-for-profits to depend more on planned giving. Offering potential donors simple ways to make relatively small commitments may encourage them to make more significant gifts when they create their estate plans. The key to a successful planned giving program is to match donors' interests, values and passions to your organization's mission and goals.

Bequests are among the lowest-cost, highest-value gifts that nonprofits can generate, and are a good place for organizations to start when launching a planned giving program. A bequest is an asset the donor retains and uses during his or her lifetime and that the nonprofit assumes use of after the donor's death.

But it's important to realize that there are many vehicles — some that are quite complex — you can use when developing planned giving programs. Be sure to do your homework on the best tools for your constituents before rolling out your program. ✦

Employee or independent contractor?



Organizations that rely on independent contractors need to be sure those workers aren't really employees. The distinction can be fine, but it's one on which the IRS places a great deal of importance. In fact, when the IRS audits a nonprofit, it focuses on employment records and the classification of any independent contractors. To avoid classification issues, your organization should establish whether you're hiring an independent contractor or an employee before work begins. The IRS recently replaced its longstanding 20-factor test with a new category test. This test examines the

worker-employer relation in three areas:

1. *Behavioral control* covers the amount of control the employer has over the worker in terms of where, when and how the job is done, among other factors.
2. *Financial control* dictates how much control you have over a worker's pay, business expenses and facility investment.
3. *Relationship type* is based on written agreements, employee benefits and length of relationship between the organization and the worker.

The IRS emphasizes that *all* factors of the relationship must be examined — not just a single area listed above. The test is new enough that it's not clear how much weight is given to each area or whether a worker has to meet the requirements of all three categories. ✦



Link, Murrel & Company

Helping nonprofits fulfill their missions

As a nonprofit executive, you know that operating your organization successfully today is a challenge, to say the least.

You not only have to deal with more intense competition for limited support, you also have to use your resources as efficiently as possible to stay in the black. And of course you have to make sure your organization complies with increasingly complex reporting requirements and regulations — and achieve your goals, too.

This is where Link, Murrel & Company can help. We specialize in helping nonprofits with a full range of accounting, audit, tax, consulting and compliance services.

Our nonprofit clients include a wide range of organizations in the greater Orange County area. Our emphasis on developing proactive, personal and value-added relationships with our clients has helped us build a strong reputation for quality, reliability and performance that exceeds expectations.

Link, Murrel & Company is a proud sponsor of the Volunteer Center of Orange County and supports their mission of being an “essential partner in improving the quality of life in Orange County by connecting community resources, increasing volunteerism, and building professional capacity in nonprofit organizations.” The Volunteer Center of Orange County strives to encourage people to become personally involved in making the community a good and welcoming place to live, work, and raise a family. They have developed ways for people to best use their valuable time and talents to help others.

The Volunteer Center of Orange County recently hosted the Inaugural Conference of the Center for Social Enterprise, which provided nonprofit executives, board members and social investors with information about the concept of social enterprises and attempted to increase their awareness and willingness to consider social enterprise strategies for sustainability. The Volunteer Center is dedicated to helping nonprofit organizations generate earned income in support of each organization’s mission.



Please visit their website at www.volunteercenter.org.

We hope you enjoy this issue of Profitable Solutions for Nonprofits and that it provides you useful information. Recommendations contained in this newsletter may not be appropriate in certain situations. Before implementing any of the ideas suggested, please contact our office for further inquiry.

We invite you to call Wm. Gary Crouch at (949) 261-1120 to answer any questions you might have about various nonprofit issues or to discuss how we can help your organization meet the challenges facing not-for-profit organizations today.



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