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How to maximize the benefits of employee evaluations

News for Nonprofits

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Should you lease or buy your office space?

As nonprofits grow, they often reach a point where it makes sense to consider owning the space that they occupy, rather than continue to rent. Although property ownership could be beneficial to one organization, it could be a disaster for another. Before you make any decision, weigh the advantages and disadvantages of both options.

CONSIDER FINANCIAL AND TIME COMMITMENT

An obvious consideration in choosing whether to lease or buy is your not-for-profit's financial situation. Buying requires your organization to be strong financially because of the up-front costs, which can be significant. And, as any homeowner can tell you, owning your own building will bring unexpected costs.

On the other hand, leasing typically offers organizations a more predictable monthly cash outflow. Upfront costs are significantly less, and the landlord often pays for site improvements and unexpected repairs.

If you're receiving state and federal funding, check to see if there are usage restrictions. Some funders provide grants for renting facilities but not for buying them. Similarly, there may be grants available to qualifying organizations that rehabilitate historic buildings or invest in certain areas.

Beware: A not-for-profit leasing part of its property to another party could be subject to unrelated business income tax.

Also, consider the time commitment involved in owning and managing a building. You'll need to designate an employee to keep things running smoothly or hire a management company. Plus, if you rent out part of your facility, more time will be needed to deal with tenants.

ENSURE OWNERSHIP FITS WITH YOUR MISSION

Buying or building an office facility should also make sense from a mission perspective. If you, for example, bring clientele to your facility, owning your own building allows you to design it as best suits you. But if you don't use your site directly in providing services, ownership can be a detractor from your main program services.

Another important factor to consider is the stability of your nonprofit and its programs. If your organization has ever-changing programs or you're in a growth or downsizing mode, leasing may be better. Why? With renting, moving is a simpler process, and you don't have to worry about disposing of the old building.

TAKE CARE WHEN RENTING OUT YOUR PROPERTY

With any organization, it's difficult to determine how much office space you'll need in the future. If you buy a building, you can allow for room to grow and initially rent out part of the space. But beware: A not-for-profit leasing part of its property to another party could be subject to unrelated business income tax (UBIT).

Although the Internal Revenue Code has carved out rental income as exempt from UBIT, property doesn't qualify for this exemption if it is debt-financed.

For rental property that is debt-financed and sold, the gain from the sale of the debt-financed property is also subject to UBIT. Your financial advisor can help you determine any unrelated debt-financed income that's subject to tax.

REMEMBER UBIT EXCEPTIONS

Property isn't treated as debt-financed if at least 85% of its use is for a purpose substantially related to the organization's exempt purpose. For example, if your nonprofit's purpose is to provide temporary housing to indigents and you charge rent, the rental income won't be subject to UBIT because the property is being used in a purpose related to your organization's tax exemption — this is true even if the property is debt-financed.

Another exception is the "neighborhood land rule": If you own adjoining pieces of property and you plan to use them for exempt purposes within 10 years, UBIT doesn't apply.

APPLY DEDUCTIONS WHEN POSSIBLE

Keep in mind that rental income can be offset by expenses that are directly connected with the debt-financed property, such as property taxes, utilities, repairs and interest. Depreciation can be allocated, but it must be deducted on a straight-line basis.

It's imperative to keep good records to document the expenses that can be deducted against the rental income. For instance, keep copies of invoices directly related to the rented portion in a separate file, and set up separate accounts within your accounting system to allocate the direct rental expenses.

PLAN

Property ownership isn't necessarily in the best interests of your organization. However, in instances where it makes financial sense, buying space that you can "grow into" may be the best choice. With good planning, you can make property ownership financially feasible while limiting the tax impact. *

Keeping unrestricted funds coming in

Nonprofits that rely heavily on governmental funding to support their programming are finding that there is less unrestricted funding — which pays for ongoing overhead and administration — to go around. Meanwhile, other organizations may require more unrestricted funding because they have significant investments in property and equipment, manage multiple programs, or have current programs that are continually changing to meet constituent needs. To help keep unrestricted funds flowing in, your not-for-profit needs to employ specific strategies targeted at this goal.

COMMUNITY CHEST FUNDING

One widely used, sustainable source of unrestricted support is annual allocation-type funding, such as that provided by the United Way and Combined Federal Campaign, which is general in nature and can be used to help pay for overhead.

There are some requirements. Most important, your organization needs to be a candidate for this type of support. Generally, not-for-profits that provide health and human services broadly embraced by the community are eligible. And you'll need to regularly report your financial and governance practices and financial and programming outcomes.

Inform and encourage teamwork

Grant or donor requirements may allow for more than just direct program costs to be part of the grant budget. Your financial people can be helpful in interpreting those requirements to ensure more of your existing overhead is funded. That's why it's important for your grant writers, development staff and key finance people to have strong collaborative working relationships.

You'll want your grant writers and development director to know that obtaining grants that pay only for direct costs or accepting tightly restricted gifts tends to bring additional overhead costs that have to be funded by other sources. By the same token, the definition of direct costs allowable by a grant document may be more liberal than that used in your own internal financial reports. So each grant opportunity being considered needs to be carefully evaluated to determine what costs it can be used to fund.

These employees should also be aware that taking on additional programs may also increase your not-for-profit's working capital needs and training and equipment costs, which may not be part of the grant funding.

PROFIT CENTERS

Nonprofits, notwithstanding the name, can and should generate profits. After all, you can't operate at a deficit and remain viable. That's where a profit center comes in. This less conventional approach, which is an intentional revenue-generating operation of your nonprofit, is gaining acceptance.

Your profit center doesn't have to be tied directly to your mission, though it may be more readily accepted if it were. For example, a nonprofit serving people with mental health issues could operate a gallery selling items made by those suffering or recovering from mental illness.

Keep in mind that you may need to address issues of unrelated business income tax if the profit center is not related to your mission. The tax may be well worth it as long as the profit center generates healthy revenue.

To the extent that you charge fees for services, you may want to adjust your fee structure so that some services to certain clients create profits — for example, a nonprofit hospital charging market rates to wealthier clients and little or nothing to those with lower incomes. By doing so, you can subsidize other services that are provided at less than cost and cover organizationwide administration and overhead expenses.

CAPITAL CAMPAIGNS

Another indirect source can come in the form of donations restricted to capital campaigns. Over the last decade, many nonprofits took advantage of the relatively low interest rates to forgo leases and buy property to house their operations.

Some also recognized that it's generally easier to get donations that are restricted to use in obtaining property and equipment than to seek donations without restrictions. These organizations used capital campaigns to buy bigger facilities than needed for their programming needs and began renting out the extra space — creating an annual stream of cash flow in addition to their mission related revenue.

Although property management can result in additional management and tax issues, it's a proven way to secure more unrestricted funds while diversifying revenue sources. (See "Should you lease or buy your office space?" on page 2.)

ENDOWMENTS

Endowments, by definition, have the gift corpus (the original amount of the gift made by the donor) restricted. But if the donor can be convinced to make the use of any investment earnings unrestricted, endowments can be an excellent source of ongoing unrestricted income.

To bring in more endowments or other significant unrestricted contributions, focus your efforts. Contact current and past board members and significant contributors and volunteers.

DO ALL YOU CAN

To ensure your nonprofit has the funds for administrative and strategic expenses, you'll need to employ some or all of the strategies discussed here. In a time of increased competition for donor funds, you must do all you can to keep as much unrestricted funding coming in as possible. ❋

Not on the road again — at least for telecommuters

Telecommuting is very beneficial to employees because they can get rid of their daily commute. It allows them to have more personal time and eliminate the frustration of traveling to and from work. Who wouldn't welcome a break from the traffic jams or the other inconveniences of commuting?

But some not-for-profits remain skeptical. After all, what's the benefit to your organization? And how can you make telecommuting work for your nonprofit?

THE ORGANIZATIONAL ADVANTAGES

Telecommuting is becoming more popular with employees, and employers are recognizing the benefits. About 80% of hiring managers now have policies that allow employees to work remotely, according to a 2006 survey by the Society for Human Resource Management.

This upward trend isn't surprising because telecommuting benefits organizations in these areas:

Cost savings. You may be able to reduce your overhead costs, such as office space and parking. But you'll need to decide who will pay for liability insurance (in case accidents occur at employees' residences), home office equipment, and telephone, fax and Internet costs.

Telecommuting can help you stand out from other employers and attract more highly qualified candidates for open positions.

Supervisory management skills. Telecommuting fosters your supervisors' skills because they must learn how to manage by objectives and results, as opposed to by direct, face-to-face supervision. Managers must also ensure that telecommuters receive the same consideration as other employees with regard to raises and promotions — it's easy for them to fall into the "out-of-sight, out-of-mind" trap.

Recruiting and morale. Telecommuting can help you stand out from other employers and attract more highly qualified candidates for open positions. Morale and productivity can improve as well, because independent workers typically desire additional flexibility in their jobs. Telecommuting can be very satisfying to them and to any worker who wants to achieve better work-life balance or reduce urban pollution.

THE DOWNSIDES

Telecommuting changes the way in which your employees will communicate with each other — and it can be difficult to overcome issues in this area. Plus, on-site workers may resent telecommuters, feeling that your nonprofit is inconsistent in offering this benefit to its employees or that off-site workers are less productive. You can address these concerns by having an equitable application process and continually evaluating the impact on your organization.

Telecommuting also affects your operations. Your not-for-profit may need to invest in network infrastructure and hardware, such as a local area network and a reliable server that allows telecommuters the same network access as on-site workers. And your organization will have an increased dependence on information technology, which could subject you to new issues, including:

- Slow Internet connections, which decrease productivity,
- Potential loss of data confidentiality and integrity, and

* Inability of off-site workers to take full advantage of technology available in the office, such as IT support.

Fortunately, you can minimize the disruption to your nonprofit by developing a formal telecommuting policy.

A FORMAL PROCESS IRONS OUT WRINKLES

Before you allow telecommuting, your management should review each position and determine those that are suitable. For example, positions that require attending face-to-face meetings regularly and handling a considerable amount of sensitive documents may not be suitable for telecommuting.

Your policy should also outline expectations for telecommuters, such as their schedules, when they'll be required to come into the office and other logistical issues. Off-site workers will need to check in regularly with their supervisors, abide by zoning laws for home offices, and store company documents and digital files securely. Also, remind telecommuters that they'll be subject to the same policies and procedures as the rest of your staff.

If your organization already has telecommuting in place, management should review off-site employees' performance to ensure they're completing their job duties on time and efficiently.

GIVE IT TIME

Telecommuting can be advantageous for both employees and employers, but it can take time before the benefits are fully realized for your not-for-profit. So be patient and give everyone time to adapt to the new arrangement. ❋

How to maximize the benefits of employee evaluations

If your management and employees dread the performance evaluation process, something isn't working right. Perhaps the process is too time-consuming or focuses too much on the negative or only discusses salary increases — no matter what the reason, both your nonprofit and your staff lose out.

A successful evaluation process supports employees by providing them with information to build their careers. More important, it's advantageous to your organization because it coaches workers to develop the skills and direction needed to take your not-for-profit to the next level. Let's look at some ways to develop or enhance your evaluation process:

Hold reviews more than once a year. Many nonprofits review employees once a year, but doing so won't produce the best results. Ongoing performance management — with meetings held throughout the year — makes it easier for employees to improve, because efforts and issues are fresh. It also puts the evaluation process forefront in your organization and gives you an opportunity to change employee goals in light of new objectives.

Be comprehensive. Employees need to know what's expected of them, if they're achieving their goals and how they can improve. That's why it's important to give detailed feedback about past performance and clear expectations about what's expected going forward.

Make objectives measurable. Your organization should be evaluating employees on measurable, attainable and easily understood targets. For example, you can implement a performance goal that has a defined fund-raising target for those employees and supervisors who have direct fund-raising responsibilities. Another measurable target could be to have employees aim to service a certain number of people or organizations within a specific time period.

Put it in writing. To ensure there is no misunderstanding between a supervisor and employee, the evaluation should be written and signed by both as an acknowledgment of the meeting and topics discussed.

NEWS FOR NONPROFITS

CHARITABLE GIVING RELATED TO TAX LEVELS

Giving in the United States equals 1.67% of our nation's gross domestic product (GDP) — the highest of the 12 countries studied — according to *International Comparisons of Charitable Giving* by the Charities Aid Foundation. The United Kingdom was second with giving at 0.37% of its GDP, and France was last with donations at 0.14% of its GDP.

The report found that charitable giving tends to be a smaller percentage of a nation's GDP in countries with higher tax levels. In the United States, taxes account for 29.1% of all labor costs, the fourth lowest figure among the countries studied. The three countries with the highest tax percentages and the lowest giving rates are France, Germany and Turkey. ❋

ARE YOU MERGING WITH OR ACQUIRING ANOTHER NONPROFIT?

The Financial Accounting Standards Board (FASB) recently issued two Exposure Drafts intended to improve the accounting and disclosures of mergers and acquisitions by nonprofits.

The first proposal, *Not-for-Profit Organizations: Mergers and Acquisitions*, suggests that not-for-profits no longer be allowed to use the pooling-of-interests accounting method. Instead, FASB proposes that organizations be required to use the acquisition method.

Under the other proposal — *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition* — FASB suggests that nonprofits provide details if goodwill is weakened, and "consistent and comparable" information about intangible assets (such as patents, trademarks, and copyrights) acquired during a merger or acquisition.

For more information and copies of the proposals, visit www.fasb.org. ❋

HOW POSTAL REFORM WILL HELP YOUR ORGANIZATION

For the first time since 1970, the U.S. Postal Service (USPS) will receive an overhaul, which should be good news for not-for-profits. This overhaul comes as a result of the Postal Accountability and Enhancement Act that President Bush signed into law in December 2006.

The USPS now has more control to make rate hikes when needed, but increases must be kept below an inflation-based maximum. This will make rate changes much more predictable in the future.

Also, the USPS is required to create delivery standards for all classes of mail, measure its success and take action to correct any problems. This will be helpful to not-for-profits that have had problems with slow delivery of fund-raising mail. ❋

WEALTHY START-UP BUSINESS OWNERS AND VOLUNTEERS DONATE MORE

Charitable donations by the wealthiest individuals in the United States have grown over the past five years, according to the *Bank of America Study of High Net-Worth Philanthropy* by The Center on Philanthropy at Indiana University.

Almost nine in ten survey respondents say they give to meet critical needs and almost as many cite a desire to give back to society. Meanwhile, one in four report they're driven by their desire to leave a legacy.

People who amassed their fortunes by starting their own businesses gave an average of $232,206 per year compared to an average donation of $109,745 annually by those who inherited their wealth. Individuals who volunteer one to 50 hours each year donated an average of $31,092 annually, while those volunteering more than 200 hours each year gave an average of $132,086 annually. ❋

The support you need. The service you're looking for.

Succeeding in the not-for-profit sector today requires more than a strong commitment to your mission. It takes shrewd fiscal management, careful regulatory compliance, skillful use of technology and the assistance of advisors who know the issues nonprofit organizations face and how to address them.

This is where Sechler CPA comes in. Our team of experienced professionals cherishes the opportunity to support nonprofit organizations, meet their management challenges and fulfill their missions. We offer a variety of specialized accounting, tax and consulting services including:

- Audit intermediary services
- Budget and policy design
- Financial statement preparation
- Outsourced accounting/bookkeeping
- Tax form preparation (990, etc.)
- Strategic and management consulting
- Speaking on financial literacy and other topics
- Technology and virtual system design

RESPONSIVE QUALITY

We are committed to providing responsive, personalized service to the highest quality. We take time to truly understand your Organization so that we can customize our recommendations to your specific situation. Our goal is to make your processes easier, streamline your operations and ensure your success in reaching *your* goals.

We welcome the opportunity to discuss your mission and vision so that we may assist you with our expertise. Please call us at 602-230-2700 or e-mail carolyn@azcpa.com and let us know how we may support you. Be sure to visit our website at www.azcpa.com for additional tools and information, as well as our archive of this newsletter.

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