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Better Ways ▲ Better Results

A NEWSLETTER FOR NONPROFIT DECISION MAKERS

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BALANCING RISK AND RETURN It Starts with an Investment Policy

The days of “set-it-and-forget-it” investing are gone. In these uncertain times, it’s essential for charitable organizations to carefully review their investments – and establish a written investment policy.

Like anything else, an organization’s assets – whether it’s a substantial endowment or simply certificates of deposit salted away for a rainy day – require sound governance. Typically, this entails a board-appointed investment committee and, often, experienced outside counsel, such as investment consultants, professional money managers and accounting professionals. The challenge is that any investment strategy requires maintaining a balance between often-competing goals:

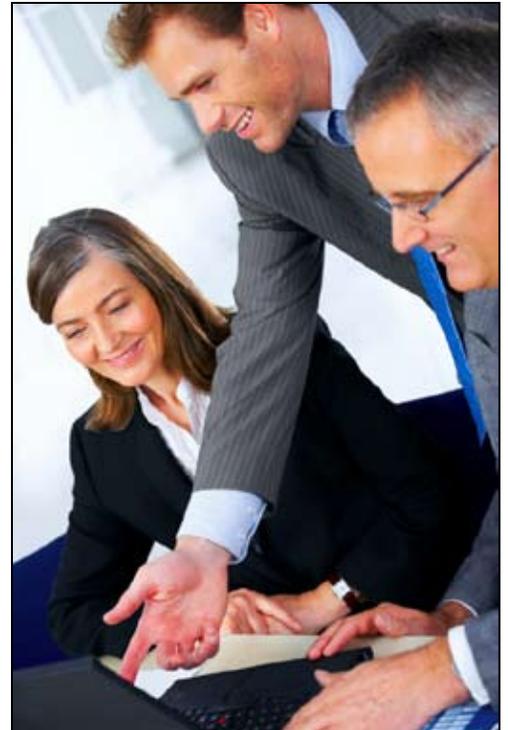
- Minimizing investment risk
- Ensuring access to the funds
- Earning a reasonable rate of return

This is where a well-planned investment policy can provide crucial guidance. In general, an investment policy outlines the philosophy and attitude that will guide the management of organizational assets. At its most basic, it accomplishes the following:

- Establishes a clear understanding of the investment goals and objectives.
- Defines and assigns the responsibilities of all involved parties.
- Offers guidance and limitations regarding the investment of organizational assets.

What Goes Into A Plan?

A solid investment policy is specific enough to provide clear-cut guidance, yet flexible enough to be practical in the face of changing situations. Guidance is typically provided in these general areas:



Investment goals – Taking your organization’s mission, operations and financial needs into context, the investment policy should outline your broad investment goals (e.g., preservation of capital, long-term growth, capital growth with some focus on income). Drilling down further, the policy might stipulate that over the established investment horizon, an absolute rate of return of 6 percent to 9 percent is desired.

Investment horizon – Looking at your organization’s short-term and long-term goals, the policy should establish a time period over which the investment objectives are expected to be met (e.g., three to five years).

Risk tolerance – This section should reflect your organization’s willingness (or lack thereof) to accept risk. Here,

Don't Lose Out in the Fight for New Leaders

Much has been said about the nonprofit sector's looming leadership crisis. At the same time a mass wave of baby boomers is retiring, growth in the size and number of nonprofits is exploding. In fact, nonprofits are expected to need as many as 600,000 new leaders and staff over the coming decade.

Unfortunately, many nonprofits are only now reacting to this need for new leadership. When surveyed, the vast majority of nonprofit leaders admit they do not have succession plans in place.

The consequences of not having a succession plan can be disastrous. Unless well documented, many years of organizational knowledge may simply walk out the door when leaders leave. Missions and values that were once clearly understood may become muddled, and organizations can lose their effectiveness ... even fizzle and fail.

With this in mind, consider these succession planning traps — and the pitfalls your organization can avoid with a focus on strategic succession planning:

Trap: Considering an individual to be the succession plan. Placing all your faith in an “heir apparent” is dangerous. What if he or she leaves, or is found to be unsuited for the position? Just as common is the behind-the-scenes grooming of a successor by the executive director, who considers him or her a shoo-in. A power struggle could ensue if the board feels otherwise and opts for a full-blown recruiting effort in which the favorite competes against other candidates.

Action: As a high-potential successor is groomed, the board should be engaged to independently determine the candidate's qualifications and begin preparing him or her for success. The executive director and board can then set performance benchmarks for the candidate to meet in the years

leading up to the leadership transition. The board should also set a date to decide whether to go with the groomed candidate or proceed with an external search.

Trap: Not developing an emergency succession plan.

It's easy to focus on long-term, strategic plans, but what about those temporary absences due to sickness or emergency, or even a permanent leadership vacuum caused by a death?

Action: Identify key functions carried out by the executive, as well as existing staff best qualified to step into the executive role in an emergency. Define and document key information (location of files, keys, passwords, etc.). Follow up with the cross-training necessary to prepare the back-ups to cover the leadership functions.

Trap: Failure to look beyond the executive director. An organization that doesn't have a deep talent pool cannot sustain services through the loss of one or more administrators. Focus also on incorporating emerging leaders on boards of directors.

Action: Be willing to fund leadership and training programs to develop your organization's leadership capacity. Support succession planning, coaching and other kinds of professional development. In fact, consider adding the task of identifying and training a successor to the job description of each department head or key employee.

Trap: Failing to react to an announced retirement. When a long-term leader announces his or her departure date two or more years in advance, denial and delay can set in. Everyone assumes that “there will be time” to react. Unfortunately, that day can come all-too-quickly if you are not prepared.

Action: Utilize a “construction project”



schedule and work backward from the transition date. Identify key activities and when each of these steps needs to be completed to meet the target date. Consider having the out-going executive help interview and select his or her successor.

Trap: Failure to seek out next-generation leaders. Many organizations are afraid to step out of their comfort zone and recruit leaders from other age groups and backgrounds. Forgoing these emerging leaders, they shut out the potential for new ideas and fresh perspectives.

Action: Position your organization as one that is welcoming to next-generation board members. Work with a consultant or local advisors to learn about trends in emerging leadership and prepare your organization for next-gen leadership. Finally, post board openings on networks where emerging leaders visit, like <http://YNPN.org>, <http://Idealist.org>, Facebook and LinkedIn.

Make It Happen

Organizations that engage in succession planning will certainly reap the benefits in coming years. With diverse and talented leaders at the helm, they will have the skills and capacity to meet whatever challenges may arise. ■

a thorough understanding of the relative risk of various instruments and an acknowledgment of your time horizon come into play. For example, your board may be comfortable with investing funds from a permanent endowment in a portfolio that entails some degree of risk in return for higher long-term return. On the other hand, they may be averse to taking those same risks with grant funds that will be needed during the next quarter.

Asset allocation – Based on your organization’s time horizon and risk tolerance, your investment committee may choose to establish target percentages for different asset classes, such as 60 percent in U.S. and global equities and 40 percent in fixed income investments.

Be sure to include requirements to periodically rebalance portfolios back to original policy targets. This section might also include authorized investments – for example, saying “yes” to United States Treasury securities, commercial paper and mutual funds, but “no” to junk bonds.

Investment restrictions – At the other extreme, your investment policy might

specifically prohibit or limit high-risk investments like commodities, real estate, futures and options.

Liquidity requirements – Of course, your investment policy should direct that cash be employed productively by investing in short-term cash equivalents. However, if your organization faces large demands for cash, your policy may need to specifically direct that a portion of the portfolio be maintained in investments that provide same-day liquidity. At the very least, there should be active secondary or resale markets for any securities held in the portfolio.

Standards of care and ethics – An investment statement should establish the standard of care to be used by investment officials (e.g., the “prudent person” standard). It should also spell out ethical expectations, such as specifying what to do in the event of any potential conflicts of interest.

Performance review – Establish mechanisms for regular portfolio reviews as well as benchmarks for measuring portfolio performance. Likewise, establish a periodic review of the services offered by any of the

organization’s outside investment managers and/or brokerage firms.

Ride The Stream

Healthy nonprofits with sound investment strategies can enjoy a steady income stream from their investments. Even smaller nonprofits can put their cash to work in interest-bearing checking and money market accounts and/or federally insured certificates of deposit. A variety of sample investment policies specific to the nonprofit sector are available online and can easily be modified to your organization’s particular needs. In addition, several useful publications outline the steps for establishing sound investment policies, including:

- **Nonprofit Investment Policies: Practical Steps for Growing Charitable Funds** by Robert P. Fry on Amazon.com
- **Minding the Money: An Investment Guide for Nonprofit Board Members**, a booklet from <http://boardsource.org/>

Our experienced professionals can provide valuable guidance on establishing a sound investment policy for your organization.

Play It Safe

While a solid investment policy statement is a good start, the ultimate responsibility for safeguarding organizational assets lies with the board of directors. Here, some basic management and accounting controls can help protect your investments:

- **Control access.** Investment instruments such as bearer bonds are cash equivalents, so store them securely, preferably in a safety deposit box. Securities (stocks, bonds, mutual funds) can be left in the custody of the securities firm or financial institution in what is known as “street name.”

- **Segregate duties.** Never concentrate authority with one person. Whoever is authorized to purchase or trade investments on behalf of the organization should not be the same person responsible for documenting investment transactions and reconciling statements with the internal accounts. Likewise, the person responsible for soliciting investments from donors should not have any of the above duties.
- **Perform a reality check.** Create an inventory of all the investments that you hold and where they are located. Have a second set of eyes periodically compare the list with statements from your broker or

trustee. Likewise, check published sources to compare market prices and dividend income with what is displayed on statements.

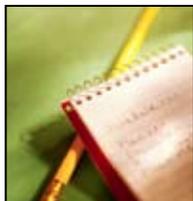
- **Oversee the investment manager.** If you are working with an outside investment firm, assign an officer (such as your treasurer) to oversee the investment manager. This trusted person can be empowered to review account statements, approve transactions above a certain monetary level, and ensure that any donor restrictions are observed. He or she should also provide regular reports to the board outlining the investment manager’s performance.

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Nonprofit Notes

A Word About Confidentiality

First, let's dispel a myth: The general public cannot find out who contributed to an exempt organization simply by looking at the nonprofit's Form 990. Donor information (listed on Schedule B) is considered confidential. In fact, when either the IRS or a charity releases a Form 990, donor names and addresses are specifically marked out.

However, contributors to a 501(c)(3) private foundation, 4947(a)(1) non-exempt charitable trust or 527 political organization are named.

Donor information for a private foundation or charitable trust is listed on Schedule B of Form 990-PF. Donor information for a 527 political organization is listed on Form 8872.

That said, privacy does matter to donors. Especially in this age of identity theft, people are apprehensive about losing control over their personal information. In fact, Better Business Bureau and Charity Navigator are among the consumer organizations that now disclose whether a charity has a written privacy policy.

If you haven't already, consider establishing procedures for protecting the privacy of your donors. Follow these steps to begin.

- **Establish a privacy policy.** The Privacy Rights Clearinghouse gives details about privacy issues that nonprofits face at <http://privacyrights.org/fs/fs28-nonprofits.htm>.

View a model privacy statement created by Better Business Bureau at http://bbbonline.org/privacy/sample_privacy.asp.

You'll want to outline what information is collected, how it is used, how donors can review their information, and how they can opt out of having their names shared.

- **Back up your words with action.** Train staff on the importance of protecting donors' privacy and security (and have them sign a confidentiality agreement). Work with computer-security professionals to make sure your Web site and online payment system are secure. ■