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Nonprofit Insights

A Newsletter for Nonprofit Decision Makers Fall 2023

Nonprofits and ESG

Should ESG Matter to Your Nonprofit Organization?

There's a good chance you've heard the term ESG, which stands for environmental, social, and governance. ESG is a framework used to assess how corporations are addressing various sustainability and ethical issues. The role of an ESG program is to ensure corporate accountability and processes to manage a business' impact in each of these areas.

The U.S. Securities and Exchange Commission (SEC) has proposed rule changes that would require SEC-registered companies to include certain climate-related disclosures in their registration statements and periodic reports. Final rules and an implementation process could be adopted later this year.

Even without formal regulations, many corporations are focusing on ESG in response to demands from their employees, investors, and other stakeholders. But what about nonprofit organizations? Should ESG matter to your nonprofit?

Going Beyond Endowment Funds

Many nonprofits today only think about ESG in the context of how their endowment funds are invested. But investments are just the tip of the ESG iceberg.

ESG provides a way to express your core values to donors, volunteers, and staff. As a result, focusing on ESG can bolster your nonprofit's reputation and increase donations. Many donors expect the organizations they support to embrace social causes like ESG and diversity, equity, and inclusion (DEI). Failure to do so could lead to a loss of donor support.

To see the impact that ESG could eventually have on nonprofit organizations, look no further than the passage of the Sarbanes-Oxley Act (SOX) in 2002. Passed in response to high-profile financial scandals at corporations like Enron and WorldCom, this legislation contains provisions intended to deter and punish corporate accounting fraud. Section 404 of SOX requires companies to publicly report on management's responsibility for establishing and maintaining an adequate internal control structure.

Most SOX provisions did not originally apply to nonpublic companies and nonprofit organizations. Over time, however, these provisions have become regarded as best practices generally accepted as good governance for both corporations and nonprofits. Some of the concepts that evolved from SOX were added to IRS Form 990 via a new section on governance, though they are not requirements.

There are other examples of regulations governing for-profit corporations that impacted the nonprofit sector. So it wouldn't be surprising if ESG regulations currently targeting public companies trickle down to private entities, including nonprofit organizations. This is especially true for nonprofits that serve as suppliers or vendors to public companies subject to SOX regulations.

ESG and Your Board

Nonprofit board members often fall into one of two camps when it

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Fundraising Strategies

What You Should Know About Donor Restricted Assets

Donor restricted assets present a good news-bad news scenario for nonprofit organizations. The good news is that these assets are real donations that your organization can use to further its mission.

One of the best ways to generate fraud tips is to establish a fraud or whistleblower hotline. "Tips via hotlines continue to be an important anti-fraud mechanism and contribute to the quicker detection of fraudulent acts," notes the ACFE report. Establishing a whistleblower hotline can also help limit potential liability for board members if fraud does occur.

The bad news is that the assets must be used for the specific purpose stated by the donor. Donors have the legal right to require that their gifts be used for limited and specific purposes. Once your organization accepts the assets, the donor stipulation is inviolate. If you accept the gift, you are legally required to follow the stipulation. Failure to do so could lead to financial penalties or even the loss of your tax-exempt status.

For example, suppose a major donor gives $500,000 to a nonprofit but stipulates that the gift be placed in an endowment. This money would be considered donor-restricted that is perpetual in nature and the organization couldn't use it for any other purpose. The donor could even require that the earnings received on the gift be used for a specific purpose, such as to fund a scholarship program.

Letting Donors Call the Shots

Restricted assets usually account for the largest donations to nonprofits. Many donors prefer them because it lets them call the shots in terms of how their gifts are used. This is especially true for major donors who are contributing large sums and want some level of control over how the nonprofit utilizes their gift. Grants may also be restricted to specific purposes.

Restricted assets can be perpetual or temporary in nature. Net assets with donor restrictions that are perpetual in nature cannot be spent directly on any project or initiative. Instead, they are placed in an endowment and the earnings received are used by the organization to fund programs or initiatives.

Donor-restricted assets that are temporary in nature are bound by time or a specific purpose. Once the time has expired or the purpose has been fulfilled, the assets are reclassified to net assets without donor restrictions. For example, suppose a donor gifted a nonprofit $100,000 to fund a new wing for their building. If the project was completed for just $90,000, the nonprofit could ask the donor to release the extra $10,000 as without donor restrictions.

Accounting for Restricted Assets

Nonprofits must use care when accounting for restricted assets to make sure that the funds are used for the purpose stipulated by the donor and not misallocated. Specifically, donor restrictions should be noted in the statement of activities and statement of financial position, as well as reflected in your budget.

The statement of activities is divided into three sections—revenue, expenses, and a reconciliation of net assets—to show how a nonprofit is allocating resources and how funding helps advance its core initiatives. The statement is further divided into three more columns—without donor restrictions, with donor restrictions, and a total column—to show which net assets the organization can use for operations and which net assets are restricted by donors.

The statement of financial position shows a nonprofit's assets, liabilities, and net assets. The net assets section separates funding into assets with and without donor restrictions. Based on this, you can calculate the number of months of liquid net assets available for use by subtracting non-liquid assets (e.g., property and equipment) from net assets without donor restrictions, and thus take restricted assets out of the equation.

When creating a budget, you should allocate funds based on restrictions and exempt any assets that are perpetual in nature. Otherwise, you could end up with a revenue shortfall at the end of the year.

Achieving the Right Balance

It's important to monitor your nonprofit's percentage of net assets with and without donor restrictions in order to remain nimble. If too many of your assets are restricted, this could place severe limits on your financial flexibility. One benchmark is to strive for no more than 50 percent of total assets to be restricted at any given time.

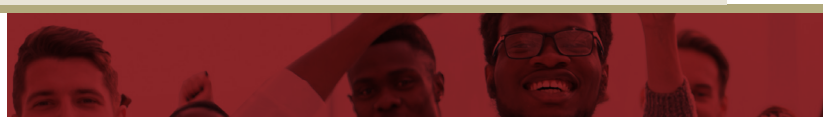
Work closely with your major donors to let them know how their gifts, whether donor restricted or not, can best support your organization. For example, you could create a wish list of needs that they could donate assets to support, such as new computers, vehicles, or buildings.

Give us a call if you have questions about donor restricted assets.

Restricted vs. Designated Assets

The terms "restricted" and "designated" assets might sound similar, but they're different. Restricted assets are assets given by a donor with specific restrictions on how they can be used. For example, a donor might give $100,000 to a nonprofit with the stipulation that the funds only be used to construct a new building or fund a specific program.

Designated assets are assets that have been designated by the nonprofit's governing board for a specific purpose. Unlike restricted assets, the governing board can reverse designations on assets at any time. This is why designated assets are classified as net assets without donor restrictions, even though the board has designated them for a specific use.



Should ESG Matter to Your Nonprofit Organization?

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comes to ESG: either all-in or hesitant. The latter may believe ESG isn't crucial to the organization's mission or that it won't materially impact its reputation. However, board members who understand the importance of ESG know that many supporters today care as much about how nonprofits operate as they do the results they are getting.

Here are a few questions to help get the ESG conversation going with your board members:

- What material issues do donors and stakeholders view as relevant?
- How can we create realistic ESG goals and incorporate them into the strategic planning process?
- How will we publicly report ESG initiatives and progress?
- What resources can help us learn more about ESG?

Planning for ESG

Here are four strategies that can help your nonprofit organization start planning to incorporate ESG into your operations:

1. Analyze what you're currently doing. Chances are some of your current activities fit within the context of ESG. Determine how you can measure these activities against a benchmark or list of ESG standards. For example, if your building is LEED certified, monitor and document your energy and water usage savings.

2. Examine your governance structure. How could your current governance structure be enhanced to provide oversight for certain aspects of ESG? What role should the board or board committees play in this oversight? Some metrics commonly tracked as part of ESG are already being overseen by the board or a board committee.

For example, the audit committee is probably overseeing risk management, including the internal control structure. If you want to establish a more robust ESG framework to track a wider range of metrics, you might need to make certain changes to your governance structure.

3. Think about your narrative. Is there a way to connect your organization's story to the ESG plans of for-profit corporations and other stakeholders? Think about how you can incorporate your ESG framework into corporate funding proposals. By aligning your organization with funders' corporate ESG priorities, you're demonstrating how partnering together can help them achieve their ESG goals.

Start by examining the ESG reports of your corporate funders—these will reveal what they value from an ESG perspective and where there may be gaps. You can then use this information to strengthen your funding proposal.

4. Maintain transparency. Make sure your ESG activities are transparent to your volunteers, staff, donors, and other stakeholders. For example, you could devote a section of your annual report to ESG, create an ESG dashboard and post it on your website, and include updates on your ESG efforts in newsletters and other stakeholder communications.

Demonstrate Your Values and Commitment

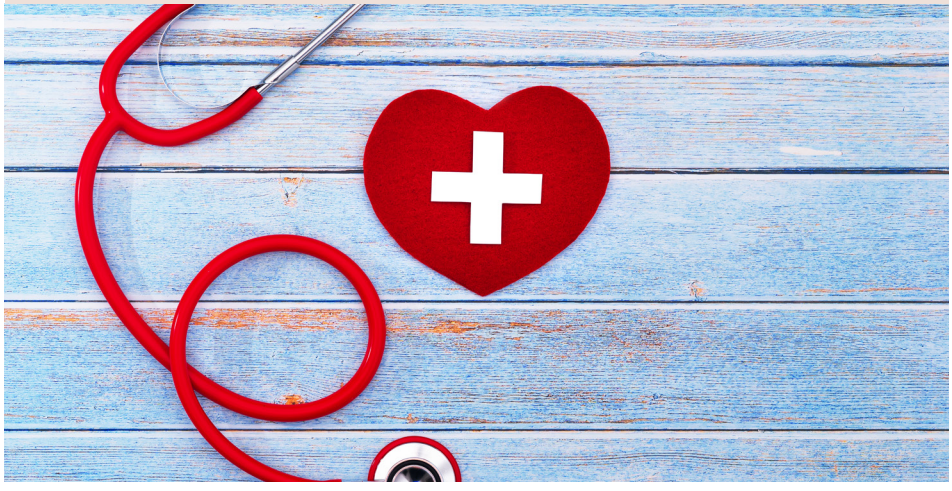
A growing number of donors today want to be affiliated with organizations that share their values. By focusing on ESG, you can demonstrate your values to stakeholders, along with your commitment to sustainability and ethical practices.

It's smart to start out small and then expand your ESG efforts over time as you get educated and grow more comfortable with the concept. This will enable you to make incremental progress in ways that align with your organization's mission and values.

ESG and the American Red Cross

With its mission of alleviating suffering in the face of emergencies worldwide, the American Red Cross has made a major commitment to fighting climate change in an effort to protect the communities they serve and the planet. This includes appointing a chief sustainability officer to oversee an organization-wide ESG program and approving an overall ESG framework.

The Red Cross published its first ESG report in late 2022. The report was prepared in accordance with sustainability reporting standards issued by the Global Reporting Initiative. It includes four pillars: environment, social-mission delivery, social-workplace and organizational culture, and governance.



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Add Gilliam Bell Moser LLP to your RFP list today!

Why You Need a Formal Gift Acceptance Policy

Gifts and donations are vitally important to nonprofit organizations. But not all donations are created equal, especially non-cash gifts and in-kind donations. In some circumstances, these kinds of donations can cause more problems than they're worth.

This is why nonprofits should establish a formal gift acceptance policy. In fact, Schedule M of Form 990 specifically asks: "Does the Organization have a gift acceptance policy that requires the review of any non-standard contributions?" These are any donations that would not directly be expected to satisfy the nonprofit organization's core mission, such as stock in a closely held business or rare and unusual items.

For example, suppose a donor wanted to give your organization a piece of real estate. But after accepting the gift, you discover that there's a leaky underground storage tank on the property that has contaminated a nearby stream. The cost of environmental cleanup and future inspections could be hundreds of thousands of dollars.

Or suppose a donor wanted to give perishable food items to a nonprofit that assists domestic violence victims. However, the organization doesn't have the proper storage facilities for the food or appliances for preparation. The nonprofit might be better off advising the donor to give the food to a local food bank instead.

A gift acceptance policy should include the following:

- A statement that the nonprofit will only solicit and accept donations that are in line with its mission
- A statement that the nonprofit must review any in-kind or non-cash donations of real and personal property prior to acceptance
- Which governing body will review the potential gift (e.g., the board of directors or executive committee)

Having a formal, written gift acceptance policy will make it easier to decline gifts that don't satisfy your core mission without leading to awkward conversations with donors and possibly offending them.

We can help you draft a formal gift acceptance policy.

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