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Nonprofit Insights

A Newsletter for Nonprofit Decision Makers

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An Inevitable Transition

Who'll Succeed Your Executive Director?

Of all the responsibilities your nonprofit board takes on, managing a successful leadership transition will likely be the most demanding—and the most important.

Selecting and integrating a new executive director involves much more than interviewing a few good candidates. In fact, the process should go to the heart of your organization's mission, both now and in the future. You can be sure the outcome will directly affect every aspect of your work, from staff retention and successful events to the number and generosity of your donors.

Face the Inevitable

A 2015 survey found that nearly half of nonprofit directors expected to retire within five years. Most organizations, however, have no methodical plan for leadership succession.

Sometimes the need for transition comes as a surprise, but not usually. Because all leaders move on eventually, your organization should create a thorough succession plan well before it's needed.

Change can create unease in the ranks, but having a careful plan already in place can calm it. A well-crafted process can turn a succession crisis into an opportunity to move the entire organization forward.

Features of an Effective Plan

Whether you expect a leadership succession in the next few years or further out, your plan should include some key elements.

Ask the board to lead. That may seem obvious, but many nonprofits report less-than-vigorous board engagement on this question. Beginning with your CEO, and relying on a committee for day-to-day organization, your board should discuss, create, and manage the planning process.

Consider future needs. Will your mission change over the next few years? Will your strategy to carry it out change? Now's a critical time for that review because the new tax law could negatively impact mid-level charitable giving, reduce government revenue, and, by extension, government spending. That means nonprofits may be asked to do more with less.

The ultimate impact of the new tax law is yet to be seen, but it should be taken into consideration for any future planning given your particular circumstances.

Create a pipeline of future leaders. Identify potential officers, along with their strengths and gaps, and then consciously help them develop higher leadership skills. Make this an explicit aspect of your hiring process as well, and establish it as part of your board's culture.

Track your progress. Your plan should include a time frame with benchmarks and a schedule to complete them. Also include one or more "drills" for a worst-case scenario—a discussion in your board about how well your plan would stand up in the event of a sudden resignation.

Approaching Transition

Whether you've completely planned a leadership transition, a smooth succession has several stages.

- Finalize a job description and compensation
- Search for candidates
- Interview candidates
- Integrate the new leadership

To manage these tasks, assign committees of your board—one for the overall transition and another to conduct the candidate search. Beware of a red flag: board members often underestimate the commitment of time and effort these critical tasks require.

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Charitable Deductions More Limited

The New Tax Law and Nonprofit Fundraising

On Dec. 22, 2017, President Trump signed the most far-reaching tax legislation since the Reagan era. The measure reduces taxes, and thus government revenues, by an estimated $1.5 trillion. It may also significantly impact the number and size of individual financial contributions to nonprofits.

U.S. government support for charitable giving has historically taken the form of tax deductions, and the new tax bill leaves those deductions nominally in place. For practical purposes, however, they will no longer be available to millions of Americans.

Fewer Deductions, Fewer Donations

Three-fourths of nonprofit donations come not from foundations or corporations, but from individuals, whose gifts are subsidized by the individual income tax deduction.

Last year the deduction permitted a donor who gave $1,000 to your nonprofit (and itemized deductions) to save around $200 to $300 in taxes, depending on his or her income. Your organization received $1,000 in real money, but your donor, with the tax break, was out only $700 to $800.

The U.S. Treasury took the hit, and for a century that's how U.S. society has promoted giving. But the new law doubles the *standard deduction*, making it more economical than itemizing for millions of households—including half of those who earn between $75,000 and $200,000 a year.

The new law also restricts other deductions, including those for mortgage interest and state and local taxes.

Consequently, the number of itemizers is expected to drop from the current 30 percent to 5 percent. Because a charitable gift can be deducted *only* if it's itemized, just one in 20 taxpayers will now have a financial incentive to donate.

The Urban-Brookings Tax Policy Center expects 33 million fewer people to deduct charitable gifts this year due to the increased standard deduction, and individual donations to fall by at least $12 billion or more. The National Council of Nonprofits (NCS) estimates more than a quarter-million nonprofit jobs could disappear.

The ultimate impact of the new tax law is yet to be seen. It will negatively impact the decision of those who donate primarily for the tax benefit.

Those who give to support the worthwhile missions of nonprofits and consider the tax deduction a secondary benefit should not be as negatively impacted. Only time will tell, but the importance of telling your story and explaining your mission to your supporters becomes even more important.

The top 5 percent of taxpayers will continue to itemize, take the deduction, and donate. Nonprofits will see a decline in gifts from midlevel earners—who tend to sustain social-service organizations over museums and colleges.

Bequests Will Fall Too

Bequests to nonprofits, which are exempt from estate taxes, will decrease. While the estate tax today affects only very wealthy families—those with estates over $11 million—the new tax law doubles that qualifier to $22 million, so only an even tinier portion of U.S. estates will benefit by making charitable bequests.

Taken together, the doubling of the standard exemption and the estate tax exemption could reduce overall charitable giving by up to $20 billion, according to the NCS.

Donor-Advised Funds and "Bunching"

For those who itemize, donor-advised funds (DAFs) will continue to be attractive because they offer the maximum tax benefits—an immediate deduction, no estate or capital gains tax, and tax-free growth.

But nothing requires any actual distribution of money from a DAF—so an inactive fund could attract and sit on money a nonprofit would spend on its mission.

Some investment managers also encourage "bunching." This advice encourages donors to itemize and give one year but take the standard deduction and not give the next year. For nonprofits, such alternation will create a long and stressful two years between the horns of plenty.

Do More with Less

In response to legitimate concerns about reduced giving, some have suggested that people will give more to charities if they have more money to give, which lower taxes will provide. That remains to be seen.

What's clear is that most nonprofits are concerned about a reduction in bequests and midlevel individual donations. How that will impact your nonprofit and your ability to meet your goals will be worked out over the next year. There are no easy answers, and success will require creativity and innovation across the board.

Is it time for a full review of your nonprofit's fundraising prospects? Our specialists can help you understand the new tax reform.

A Benefit to the Donor?

Revenue: Contribution, Exchange, or Both

Nonprofits should be aware of a new accounting standard: ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606).

It concerns revenue obtained from exchange transactions while contributions can still be reported under existing rules. Revenue that combines an exchange and a contribution in one transaction will require bifurcation, or separation.

The distinction turns on the values exchanged, if any. In an exchange transaction, both parties receive something of value. In return for a tuition payment, for example, a nonprofit school delivers academic instruction. Such revenue is governed by the new standard.

But in a contribution, one party donates freely without expectation of any benefit in return. A no-strings bequest to the same nonprofit school is a contribution and is not covered by Topic 606.

Nonprofits will need to review their sources of revenue to decide what portion falls under the new standard. Here are some of the most common types.:

Donations. When a donor writes a check to a nonprofit with no or minimal benefit, in return, it counts as a contribution.

In-kind contributions. A donor's gift of goods or professional services, if the donor derives no benefit, counts as a contribution.

Event sponsorships. An event sponsor may receive wide recognition and favorable light on their brand, but those are considered of only nominal value, and the sponsorship is a contribution if it is not considered advertising. The value of tickets to the event itself is not normally deductible.

Admission to events. A $20 ticket to a Little League fish fry is an exchange, but a $200-a-plate awards ceremony probably includes both an exchange transaction (cash for dinner) and a larger contribution.

Dues. If dues payers receive a quarterly newsletter and a ballpoint pen, which is considered minimal, that's a contribution. But admission to three performances a season may constitute an exchange.

Government grants. A grant to an organization to provide a public service is a contribution. But a grant for services provided to a government agency may be considered an exchange transaction.

Program fees. Fees for education, counseling, or other services are exchange transactions.

For most nonprofits that don't issue bonds, the new standard takes effect in reporting periods beginning after December 15, 2018.

Succession Planning

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Don't sugarcoat this work—spell it out beforehand. Then assemble committees that balance outlook, backgrounds, and talents. Some boards may also consider engaging an outside consultant to work with the committees, manage some tasks, or even oversee the entire process.

The job description should flow from your mission, goals, and strategic plan. It may be very different from the last one, depending on your current director's tenure and how the world has changed. A compensation decision, meanwhile, must factor in the job description, market conditions, and your own resources.

Your search for candidates might begin within the organization if your planning process has discovered and trained a gem or two. But even then, your search committee should conduct a broad public campaign of networking, advertising, and conversations with internal and external stakeholders. That's the only way to assemble a top-flight list and ensure objective evaluation.

Interviews and Selection

Use telephone interviews to sort your search committee's initial list of candidates, and narrow it down for in-person conversations. When you've identified the top contenders, ask each to meet with small-group sessions. One effective approach is to create small groups that include a board member, an officer, and staff from various levels within the organization.

Out of these interviews, you should be able to identify three or so finalists for formal interviews with the board. Don't leave those meetings to whim, but establish the same clear criteria and questions for each candidate. Then, vote.

When you've selected a new director, begin the last planned stage: the new leader's integration into the organization and its culture.

Our firm can help you develop a solid succession plan or polish up your existing one.

Should Your Nonprofit Offer Sabbaticals?

Only one-fifth of nonprofit organizations have a retention strategy for top leadership, which may help explain why at least a third of director-level executives plan on leaving within two years.

And turnover is expensive. When an employee earning $50,000 or more departs, the average cost to your organization is 20 percent of his or her salary.

Retention has several aspects, of course, and only a few nonprofits have tried offering sabbaticals. The idea is twofold: one, to help individuals recharge; two, to push your organization so junior staff can try more senior leadership responsibilities.

Burnout is widespread today, and nowhere more so than at nonprofits, where most people work for more than a paycheck. Commitment and passion can drive great results, but they can also expose employees in under-resourced organizations to anxiety and disappointment. The new tax law, explained on page 2, may exacerbate this situation.

Both executives and staff report a range of benefits from their sabbaticals, including better physical health, more confidence, and improved balance between work and home. Many were also surprised at the insights that emerged—especially after stress-free periods when their minds were free to wander.

For organizations, the gaps created by sabbaticals have resulted in stronger board engagement, improved organization, and greater confidence in succession planning.

A well-crafted sabbatical policy should address the following:

- Purpose. Go for reinvigoration, not professional development.
- Isolation. Don't require contact with your organization.
- Eligibility. Who can be considered? How much do performance reviews count?
- Stipends. A leave of absence isn't worth much without funding, so consider half pay.
- Outside income. Will you permit them to consult or give paid speeches?

Sabbaticals aren't for every nonprofit, but for some they're well worth considering.