

Insights

for Not-for-Profit Organizations

Fall 2009

Prudent Investment Management in Today's Challenging Environment



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Based upon the significant feedback we received to our spring newsletter where we addressed the general areas that require attention in this historic economic environment, we will dedicate the cover article of our fall edition to the specific issues of investments.

Whether you are establishing, maintaining or growing your investment portfolio, it is essential to be rigorous in the approach you take to the management and oversight required in today's environment. Prudent investment management is an essential part of an organization's general governance responsibilities in any environment. Against a backdrop of an economic downturn, a volatile investment market and donor cutbacks, the importance of prudent investment management continues to grow.

In this article, we have outlined the five key areas that should be included in every organization's investment management approach.

approach required minimal involvement, as portfolios were consistently yielding strong results, especially if the agency was invested in alternative investments. There was an assumption that investment returns would continue with double-digit returns. Unfortunately, the downturn of the financial market in the last two years requires that all organizations reassess what type of returns an organization can reasonably expect and what type of return is necessary to fund programs and compare that with a realistic understanding of the appetite for risk. Many organizations comfortably migrated toward a more aggressive investment portfolio over the last few years—it may be time now to revisit expectations and make adjustments based upon the current environment.

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I. ASSESSMENT OF INVESTMENT POSITION AND POLICIES

This is a necessary time to review your investment policies, spending policies and the structure of your investment committee. It was not so long ago when the investment

This is also a good time to take stock of the investment committee composition and role. The investment committee should have the knowledge and expertise to address issues relating to investment valuation, understand the implications of the information provided

and be structured to meet on a frequent enough basis to ensure that modifications or adjustments can be made in a timely fashion.

II. DETERMINATION OF SPENDING NEEDS

It is essential to determine what your spending needs are, both short- and long-term, and compare those needs to anticipated portfolio returns so that shortfalls may be identified and addressed. Part of this review should include an assessment of the following:

- Funded vs. unfunded programs—including the unfunded administrative overhead that was previously funded by investment returns.
- Review of mission statement to determine whether the organization is still operating within the original parameters or if adjustments have to be made.
- Spending rate should be revisited to ensure that the organization will not be spending down principal when the rolling average will include the years that had negative returns.
- Spending rate should be based on a long-term approach to the market's performance. The spending rate should allow for long-term growth within the portfolio. The growth should represent an inflationary hedge.
- Determine whether it is necessary or prudent to spend investment principal. (In a period of negative return, unspent investment income may be depleted, resulting in an invasion of investment principal.)

III. REEVALUATION OF ASSET ALLOCATION

Once your investment policies have been reestablished and spending needs determined, it becomes important to revisit current asset allocation against the changing environment. In this market climate, we have found that most organizations do not have a tolerance for the level of risk that they perceived they did. There are many tools available to board members and investment committees to calculate their true risk tolerance. Most investment advisors can provide these tools (there are also many tools available on-line). Key questions that may help to gauge risk are:

“What is the maximum downward fluctuation your organization can tolerate?”

“What is your time horizon as to when you may need the principal?”

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IV. INVESTMENT MANAGER

The selection of and ongoing relationship with an investment manager can be one of the most important focus areas of the organization. Organizations should review the past performance of the investment manager as a means of gauging what the future performance may be, as well the investment manager's performance as compared to the overall market—these are essential areas of review. However, recent investment scandals and ongoing volatility in the marketplace have underscored the importance of monitoring other areas, including:

- Benchmarking of fees
- Information received
- Responsiveness
- Contract review
 - > Side pockets
 - > Gates

V. CONTINUOUS MONITORING AND REBALANCING OF PORTFOLIO

Now more than ever it is imperative to monitor your portfolio on a continuous basis to ensure that the current portfolio is performing in accordance with set policies and that an open and transparent flow of information exists between management, the investment manager, the investment committee of the board, and the external auditor. Monitoring should include a regular review of results, including actual vs. expected, as well as whether investment policy is being adhered to. Particularly with the lessons that have been learned recently throughout the investment marketplace, it is also important to “kick the tires” and look beyond a monthly investment return statement. This might include site visits, asking for

underlying financial information and determining the valuation of a fund. It may be helpful to establish a due diligence checklist to ensure that any investment risk areas are reviewed initially and on an ongoing basis.

Additionally, with some segments of the market outperforming others, it is important to discuss periodically rebalancing your portfolio to ensure that your asset allocation is in step with your investment policy.

In today's challenging environment, ensuring adequate internal controls over your investment portfolio is one of the most important areas of focus. Additionally, in this environment, donors are asking more questions about the financial stability of the organization and, moreover, demanding that organizations can demonstrate ample stewardship over endowment funds before committing financial resources to organizations.

For more information, please contact Monica Fraczek, CPA, Partner, at mfraczek@loebandtroper.com.

403(b) Readiness

ERISA-covered 403(b) Retirement Plans with 100 or more eligible participants, generally, will be required to file audited financial statements beginning with their 2009 Form 5500 filing. In short, 403(b) plans will now be treated like 401(k) plans from a reporting perspective.

The increased administrative procedures are expected to create an additional burden on the plan sponsors, particularly in the first year.

In order to be prepared, there are key steps that should be taken before December 31, 2009. We are recommending that organizations begin this process as soon as possible.

For more information about preparing your organization, please visit our website at www.loebandtroper.com for a copy of Loeb & Troper's 403(b) Readiness Guide.

If you have any questions, please contact Harold Gelernter, CPA, Partner Designee to the AICPA Employee Benefit Plan Audit Quality Center, at hgelernter@loebandtroper.com or 212-867-4000.

Creating Strategic Cost Efficiencies

With the ongoing recession, our clients, as well as all not-for-profit organizations, are experiencing challenging times. Contributions are down, governmental grants are more difficult to tap into, and program revenues are declining.

While staff retention has improved significantly and, thus, may be beneficial to your programs, financially it places an even greater burden on your bottom line.

In an environment where only 16% of not-for-profit organizations anticipate being able to cover their operating expenses in the current year or two,* it is prudent to assess where there may be strategic opportunities to reduce expenses.

Through a professional operational review or an internal assessment, some of the areas and techniques that our not-for-profit clients have utilized to reduce costs include the following:

- **Greater use of technology**
 - > Reduce manpower
 - > E-mail communications vs. hard copy mailings
- **Use of benchmarking to compare and improve:**
 - > Salaries
 - Full-time equivalents, by department
 - Specific salaries
 - Controlling overtime
 - > Fringe benefits
 - Reduce or eliminate
 - Moving from a defined benefit plan to a defined contribution plan
 - New York State Unemployment Insurance – percentage basis vs. reimbursement to New York State
 - Workers' compensation audits
 - > Other costs
 - Utility audits (electricity, gas, telephone, water, real estate, etc.)
 - Food costs
 - Program costs
 - Meeting expenses (location, food, etc.)
 - Special enhancement programs (cost versus fees)
 - Rent — time to renegotiate

- > Fundraising events (journal vs. scroll of honor), site, food costs, “giveaways,” etc.
- **Strategic partnerships/alliances**
 - > Creating efficiencies via pooling resources
 - > Obtaining grants together
 - > Reducing costs via increased buying power
 - > Outsourcing
- **Debt**
 - > Negotiating better interest rates
 - > Length of payout
 - > Have available lines of credit

We would also caution organizations not to employ a hard-line cost-slashing exercise. In an environment

like this, it is essential to ensure that key governance areas are not compromised, that access to specialized external expertise is utilized and that your organization stays top-of-mind with constituents, donors and regulators.

Loeb & Troper LLP has worked with many organizations in conducting operational reviews, designing customized benchmarking reports and in assessing areas for creating efficiencies without compromising key program or governance areas.

To discuss cost efficiencies for your organization, contact Mel Zachter, CPA, Partner, at mzachter@loebandtroper.com.

**Nonprofit Finance Fund Survey: America's Nonprofits in Danger, April 2009.*

SHORT SUBJECTS

SPEAKING ENGAGEMENTS

New York State Rehabilitation Association, Inc. (NYSRA): The Rehabilitation Summit

“Clinic Services to Meet the Needs of People with Disabilities”

Stephanie Fiedler, CPC, ACS-EM, Senior Health Care Consultant — Discussion Moderator

September 23, 2009

Albany, NY

New York Council of Nonprofits, Inc. — Camp Finance 2009

“Corporate Compliance: Guidance and Practice”

“Budgeting Basics: Form and Function”

David M. Rottkamp, CPA, Partner

“The New IRS Form 990: Technical Session”

Allan M. Blum, CPA, Partner

October 1 and 2, 2009

New Paltz, NY

American Institute of Certified Public Accountants (AICPA) — Governmental and Not-for-Profit Training Program

“NPO Tax Update”

Frederick H. Rothman, CPA, JD, LLM, Director of Tax Services

October 26 and 27, 2009

Atlanta, GA

Agudath Israel of America: Tax Conference

“Qualified Tuition Plans; Cafeteria Plans; 403(b) Plans”

Mel Zachter, CPA, Partner

Allan M. Blum, CPA, Partner

October 27, 2009

Foundation for Accounting Education — Annual Non-Profit Conference

“Unrelated Business Income Tax (UBIT)”

Frederick H. Rothman, CPA, JD, LLM, Director of Tax Services

December 10, 2009

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