

Developing Your Non-Profit's Investment Policies

Are non-profit organizations (NPO) investors or are they Traders? How do NPO's measure risk when they invest? These questions come up in non-profit organizations. As a rule NPO's are investors only.

by David Robertson C.A.

IN developing a sound investment policy an NPO has to look to its fundamental reason for being or its mission. Investment policy must be consistent with the mission.

Set Objectives

NPO's are often called upon to invest funds in large amounts. The investment market offers many varieties of investments. Some of these investment instruments carry a risk of losing some or all of the investment. The rule of thumb is the higher the return, the higher the risk.

An NPO must decide where in the spectrum of risk it wishes to be. The way to do this is to set clear investing objectives, i.e., acceptable levels of risk.

Often a NPO may have funds from a variety of sources. Each of these sources has a different level of acceptable risk for investing:

- Restricted funds held in trust for someone or some activity.
- Restricted funds that are held indirectly in trust for a program or activity.
- Unrestricted funds owned by the NPO which are designated by the Board for a specific purpose.
- Unrestricted NPO funds held but not designated.

As an example, an NPO Board may decide that trust funds may only be invested in risk free investments while undesignated NPO funds may carry a higher level of risk.

An NPO must establish the amount of risk - low, medium or high, that it is willing to associate

with each type of fund. This must be communicated clearly by the Board to management. If multiple levels of risk are to be accepted, a clear statement must be made matching risk levels to the appropriate funds source.

Protect Capital vs. Maximize Income

If *protection of capital* i.e., ensuring the original investment can never be lost, is to be the primary objective, then *maximization of income* becomes a secondary objective.

Protection of capital implies low risk, low yield investments.

Examples of low risk, low yield investments are term deposits, guaranteed investment certificates, treasury bills and government bonds. In this case limits must be clearly set.

Term Deposits and GIC's

Term deposits and GIC's are low risk investments. These investments are insured against loss. If funds are always to be insured against loss, the total can never exceed the \$60,000 Canadian Deposit Insurance Corporation (CDIC) or Ontario Security Deposit Insurance Corporation (OSDIC) limits per institution. An NPO must decide if it will exceed the insurance limit. For example it may accept going over the limit with a schedule A bank, given the level of capitalization of Canada's schedule A banks.

Treasury Bills and Government Bonds

Treasury bills are the most secure investment in Canada and offer a low yield. Government bonds are the next most secure but the risk varies by level of government.

May, 1999

**PRENTICE
YATES &
CLARK**
CHARTERED
ACCOUNTANTS

15 Toronto Street
Suite 700
Toronto, Canada
M5C 2E3

(416) 366-9256
1 (800) 265-7818
Fax: (416) 366-9171
news@pyc.net

You'll find our company directory
on the back cover.

Please save it for future use.

If funds are to be held in government bonds the NPO must establish what level of government is acceptable i.e., federal, provincial or municipal? Are some investments at each level acceptable while others are not? Look at the interest rate yields. Is there a premium being offered? Does this represent a risk premium?

Strip Bonds

Government bonds are usually sold at face value with interest coupons attached. A strip bond has had the interest coupons removed and the resulting face value is sold at a discount. The difference between the discounted purchase price and the maturity value represents income.

Be certain risk is defined and identified correctly for the investment. Risk rises if the bonds are traded before maturity.

Set trading restrictions. If strip bonds are to be purchased they can still represent unacceptable levels of risk if traded before maturity. If strip bonds are purchased, policy should be clear if they are to be held to maturity. This makes them risk free. If they can be traded before maturity they carry a higher level of risk. Market value will fluctuate with the interest rate market.

If *income maximization* is your primary objective riskier investments need to be purchased.



Limits must be defined for acceptable levels of risk. If some stocks and corporate bonds are acceptable investments, what kinds are acceptable and what are not? What are acceptable levels of each as a percentage of overall NPO investments? If stocks and mutual funds are to be purchased, is the use of a professional money manager necessary? All of these questions should be clarified in policy guidelines.

Responsibility and Accountability

Boards cannot always take responsibility for daily activities of the NPO. Responsibility for making investments may be assigned to management

The Board sets clear investment objectives. Management takes on the responsibility of investing the NPO's funds. The Board should accompany the objectives with accountability standards.

Detailed reports on the status of the NPO's investments should be available to the Board or to the responsible committee at designated times i.e., monthly, quarterly or semi-annually. These should be in addition to regular monthly financial statements.

A detailed investment report would include the following:

- amount held at cost
- amount held at market value
- stated rate of return if applicable
- type of investment
- restrictions (if any) or purpose of the investment is held i.e., trust funds
- maturity date
- re-investment alternatives - if maturing
- % equity, % bonds, % cash, % other

This report should include an analysis of whether risk objectives required by policy have been met. If not, the extra risk should be clearly identified.

It is then the responsibility of the Board or committee to allow management to administer the investing process and report to the Board with the results.

Feedback

It is the role of management to report to the Board if investment objectives are being compromised by market conditions. In this event the Board must decide if they need to change policy or accept market conditions, good or bad, as a natural consequence of the policy in place. ♦

David Robertson is a senior partner with Prentice Yates & Clark. He specializes in services for non-profit organizations including auditing, systems work and organizational solutions.

Prentice Yates & Clark is a full service firm of Chartered Accountants specializing in all aspects of service to the non-profit community, serving that community since 1943 across southern and southwestern Ontario.

Tax Debts

Many taxpayers have a balance owing to Revenue Canada when filing their corporate or personal income tax returns. And many know only too well that when a payment cannot be made, the outstanding tax liability increases as interest piles on. But there are some alternatives available when the taxpayer has difficulty meeting the required payments.

HERE are a few guidelines to help taxpayers understand Revenue Canada's credit policy.

Payment of Taxes on Income

Employees pay some, if not all, of their income tax through source deductions withheld and remitted by the employer. However, if an employee has a change in personal circumstances that has an impact on the source deduction and has not filed the appropriate form with the employer, the result could be taxes owing at the end of the year. In these instances, Revenue Canada does not usually charge interest or penalty on amounts that should have been paid over the year, provided the outstanding amount is submitted with the return when due.

Self-employed and certain other individuals are required to submit their income tax in quarterly instalments throughout the taxation year. Failure to make adequate instalment payments could result in interest and penalty charges.

Corporations normally make monthly instalment payments throughout the year. Revenue Canada charges interest on late or insufficient instalment payments.

When is Tax Due?

Individuals are required to pay any personal income tax owing to Revenue Canada no later than April 30 of the following taxation year, that is, the due date of filing last year's personal income tax return. While self-employed individuals can wait until June 15th to file, personal income taxes are still due on April 30th. Most corporations are required to pay any balances owing two months (or in some instances,

three months) after the end of the fiscal year-end. The payments are due even when the corporation has not filed its corporate income tax return.

When Tax is Not Submitted

Revenue Canada's collection policy is straightforward. Any amount owing is payable immediately at the time the tax amount is due, whether it's the bottom line on a tax return or an assessment or reassessment. When a taxpayer fails to submit the balance, the department will mail notices and make telephone calls to request payment. At each stage of the collection process, the taxpayer is encouraged to discuss the situation with a collection officer.

Responding to a Notice

The taxpayer has a specified number of days to respond to a notice. Basically, the taxpayer has three options:

- arrange for payment
- request relief under the Fairness Package if there are factors beyond the taxpayer's control, or
- file an appeal.

Requesting relief or filing an appeal are two actions that definitely require professional advice and support.

Usually, Revenue Canada will not initiate collection action to collect taxes owing until the period of time specified on the notice has elapsed without response from the taxpayer. However, it is important to note that this grace period does not apply to assessments for:

- scientific research tax credits
- GST/HST or Excise taxes owing
- taxes owing under various regulations for Canada

Tax Relief for Y2K Problems

Revenue Canada has provided a special tax credit to help small and medium sized businesses address computer compliance for the year 2000. It will allow accelerated capital cost allowance (CCA) deductions of up to \$50,000 for hardware and software purchases to upgrade or replace computer equipment that is not Y2K compliant. To be eligible, expenditures must be made between January 1, 1998 and June 30, 1999.



pension amounts, employee source deductions, employment insurance amounts or other deductions that are also considered to be trust monies collected on behalf of employees

- non-resident taxes, and
- any penalties imposed for late payment of withholdings.

If the taxpayer, other than a corporation that is subject to the large corporation tax, does not agree with an assessment and files a Notice of Objection, Revenue Canada usually delays any collection proceedings until such time as the appeal is settled.

Payment Plans for Outstanding Taxes

When alternative sources of funds are not available, Revenue Canada will discuss mutually satisfactory short-term payment arrangements based on ability to pay. In this instance, the taxpayer should discuss the situation with his or her chartered accountant and arrange to contact the collection officer as soon as possible.

As the collection officer reviews the data submitted and makes a recommendation for payment based on the taxpayer's ability to pay, the taxpayer should be prepared to provide as much financial information as possible. A statement of net worth and cash flow is useful for negotiating a payment plan. If the payment plan involves postponing the schedule until there is an ability to pay, keep in mind that these arrangements do not stop interest from accruing.

Taxpayers sometimes threaten bankruptcy and, of course, Revenue Canada has heard this many times before. Certainly, bankruptcy is a choice but not one to be taken lightly. If serious, the taxpayer should consult with a Trustee in Bankruptcy and with legal counsel before proposing this option. Even if a taxpayer does declare bankruptcy, the taxation authority may oppose a discharge for taxes owing and insist on terms for payment. Revenue Canada also has special powers to collect tax owing where there have been transfers to non-arm's length persons that sometimes allows them to collect a person's tax liability after bankruptcy. Of course, bankruptcy has other ramifications that should be considered before taking this route.

Legal Action

If a reasonable alternative cannot be worked out, the taxation authority will be forced to commence collection proceedings, including garnisheeing wages or other sources of income, seizing and selling assets, or offsetting amounts owing with amounts receivable from other departments. (For example, a GST refund could be withheld to offset an income tax liability). Obviously, it is in the taxpayer's best interest to work out a manageable payment schedule.

Revenue Canada, unlike other creditors, does not have to go to court to obtain a judgment. Both the Income Tax Act and the Excise Tax Act provide

for the registration of a certificate in the Federal Court of Canada for unpaid amounts. This procedure provides the same power as a judgment. If taxes owing are still not paid, Revenue Canada will obtain a writ or memorial to seize, advertise and sell the taxpayer's property. As with most judgments, the taxpayer is required to pay all reasonable charges and costs incurred to collect the amounts listed on the certificate.

An Ounce of Prevention

Maintaining adequate records, making sufficient source deductions or instalment payments and seek-

ing tax advice before making a major decision that could have tax implications are all ways that a taxpayer can avoid becoming a tax delinquent.

But if it's Too Late

Whether the taxed entity is an employee, a proprietor, a partnership or a corporation, if you are a delinquent taxpayer, you are well advised to seek professional advice. Your chartered accountant can not only assist in determining if the amounts owing are valid but also offer valuable support in negotiating a speedy and satisfactory resolution with Revenue Canada. ♦

Are You Covered?

Like retirement or personal financial planning, owner/managers sometimes leave business insurance planning for tomorrow's agenda. Too often a company's insurance needs are clarified only when a claim is made and the company discovers certain losses are not covered.

AS your business grows, make sure you adjust your insurance to ensure adequate coverage is in place for any new exposures.

Review your Coverage

Review your policies to determine the specific losses that are covered. Generally commercial property coverage is written on an "All Risk" basis and subject to conditions, provisions, restrictions, deductibles and exclusions. A policy may also include extensions that expire unless notification to the insured is made within a certain time period. Comprehensive general liability provides coverage for bodily injury and property damage payments when an insured person is legally required to pay compensatory damages.

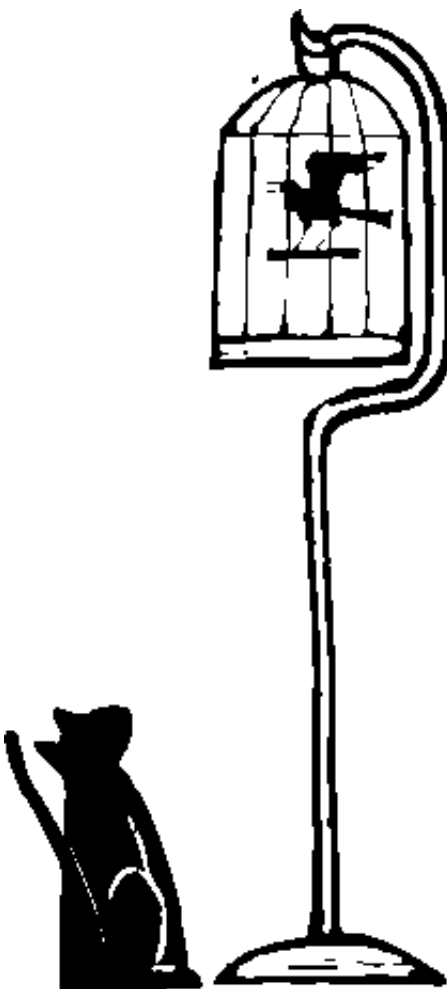
When discussing your insurance coverage with your broker, the key areas that need to be addressed include:

- direct loss (physical loss or damage)
- loss of use (reduction in income or profit)
- loss in the form of extra expense, and
- third party liability.

Make sure you understand the terms and value of the coverage for a claim should one arise. For instance, coverage for fire may be more extensive than coverage for water damage created by sprinklers but as far as the operations are concerned, the dollar damage could be the same.

Some of the questions to consider include:

- Are assets covered for replacement value, depreciated value or market value?
- Are off premises assets covered?
- What are the exclusions in the policy?
- Are movable assets covered? (e.g., trailers, portable welders, portable machine shops)?



- What is the deductible for each occurrence and is there a maximum to the number of claims that can be made?

- Is the property of others covered if stored on your premises?
- Are your lease costs covered in the event fire or water damage requires you to relocate operations for a period of time?
- If your business is in a high risk industry, located in an area that is well removed from police or fire services or vulnerable to vandalism, does the policy limit coverage, or provide coverage only if specific criteria are met to maintain security or safety? Make sure you are aware of any restrictions or criteria that could affect your coverage.

Business Interruption Insurance

If your capital assets, records and inventory were damaged or destroyed, would your business be able to continue? While costly, business interruption insurance can be purchased to cover extra expense, gross earnings or profit/loss to sustain operations in the event of a loss or damage to the insured build-

ings or contents. An insurance broker can advise which type of business interruption insurance is best for a particular business.

Extra expense insurance covers only those expenses required to "get up and running again". This type of coverage may be adequate for service or knowledge-based businesses, such as computer programming and certain product sales. In the event of a disaster, the insurance would cover furnishings and equipment, a temporary location, advertising the new location and costs of installing new services.

Gross earnings or profit loss insurance provides business with income replacement to ensure that the business is able to carry on after an event has, in effect, shut down operations. This coverage is designed for businesses where there is a specific purchaser, or special product and the purchasers would seek another source. The insurance proceeds would cover your business from the date of property damage to the date when the business is "back to normal."

Gross earnings coverage, on the other hand, should be considered if there is a continuing demand for the product that can be satisfied once the damage is repaired and production is back to normal. Of the two approaches, gross earnings will probably be the least expensive as coverage is from the date of damage to the date of repair, whereas the profit approach is from the date of damage to the date of "resumed profitability".

Update your Coverage

Keeping your insurance up-to-date can help you control insurance costs while minimizing losses. As capital assets are purchased, the customer base grows, work locations or liabilities change, review the company's insurance arrangements to make sure your coverage is keeping pace with these changes. You may discover that the coverage you set up even a year ago is no longer adequate. There may also be new insurance products available that can help you reduce your premiums. ♦

Prentice Yates & Clark, Chartered Accountants

Contact Information - Partners & Staff

(May 14, 1999)

Contact	Phone Extension	e-mail Address
Partners		
John F. Yates	239	john.yates@pyc.net
Ron J. Clark	238	ron.clark@pyc.net
David L. Robertson	234	david.robertson@pyc.net
Charlie A. Petralito	226	charlie.petralito@pyc.net
Lloyd K. Turner	235	lloyd.turner@pyc.net
Accounting Staff		
Barron, Carol	232	carol.barron@pyc.net
Bissessar, Kevin	241	kevin.bissessar@pyc.net
Ham, James	248	james.ham@pyc.net
Harris, Todd	229	todd.harris@pyc.net
Lozanova, Valentina	249	valentina.lozanova@pyc.net
Maio, Frank	245	frank.maio@pyc.net
McGivney, Tom	233	tom.mcgivney@pyc.net
Pauze, J.J.	230	jj.pauze@pyc.net
Samulewski, Daniella	231	daniella.samulewski@pyc.net
St. Louis, Carole	228	carole.stlouis@pyc.net
Torry, John (home office 920-7377)	300	john.torry@pyc.net
Vella, Anthony	246	anthony.vella@pyc.net
Administrative Staff		
Chapman, Kit	301	kit.chapman@pyc.net
Dandy, Alynda	242	alynda.dandy@pyc.net
McIntyre, May	236	may.mcintyre@pyc.net
Strickland, Robyn (Reception)	221	robyn.strickland@pyc.net



We hope that you find news@pyc.net a useful source of information. If you should ever have any specific questions or concerns regarding your own business or personal finances, please call us. We will gladly help in any way that we can. If you would like to contact us by e-mail, we can be reached at news@pyc.net.

Some of the articles appearing in this issue of news@pyc.net were prepared by the Canadian Institute of Chartered Accountants for the clients of its members.