

WINTER
2010

Nonprofit Observer



What makes governance "good"?

A checklist for nonprofits

Audits are essential to your organization's well-being

The pros of being proactive with the IRS

Managing payroll:
In-house vs. outsourcing

Smith & Gesteland_{LLP}

Certified Public Accountants & Business Consultants

Not The Same Old Bottom Line

8383 Greenway Blvd., Suite 400 • PO Box 1764 • Madison, WI 53701-1764
Phone 608.836.7500 • Fax 608.836.7505
mail@sgcpa.com • www.sgcpa.com

What makes governance “good”?

A checklist for nonprofits

“Good governance” is one of the hottest topics in the nonprofit world these days. Although the Sarbanes-Oxley Act of 2002 (SOX) was passed to regulate for-profit businesses, nonprofits have been strongly encouraged to adopt certain SOX regulations, including a conflict-of-interest policy and financial statement review guidelines. More recently, the IRS has revised Form 990 to include several questions regarding governance policies and board members’ roles in performing fiduciary activities. And the increasing power of charity watchdog groups means that nonprofits must try to put a responsible face forward to the public.

Some states mandate that nonprofits adopt practices such as forming an audit committee, but most good governance guidelines are only suggestions. It’s no surprise then that many charities have trouble defining the term “good” and putting it into practice.

GENERAL AND SPECIFICS

Your board is probably already aware of its basic responsibilities of creating a strategic plan and overseeing staff as it’s implemented; monitoring activities to ensure they contribute to the organization’s larger mission; hiring and evaluating the chief executive; ensuring adequate financial resources; and performing essential fiduciary duties of care, loyalty and confidentiality.

Following that general task list, however, doesn’t necessarily make a board effective. Good governance requires nonprofit boards — and executives — to go the extra mile and do some or all of the following:

- ◆ Write policies, including conflict-of-interest, whistleblower, document retention and destruction, gift acceptance, Form 990 review and related-party transactions.



- ◆ Form an audit committee made up of financially knowledgeable board members to oversee regular internal and external audits, and consider adding a paid or unpaid CPA if expertise isn't already available from within the board. (See "Audits are essential to your organization's well-being" on page 4.)
- ◆ Ensure that executive compensation is reasonable, which generally means setting it at "market level" based on current data. (See "Reasonable' is relative" at right.)

Form an audit committee made up of financially knowledgeable board members to oversee regular internal and external audits.

- ◆ Provide new board members with an orientation that covers your nonprofit's mission, policies, programs and goals, and regularly offer refresher courses to long-time board members.
- ◆ Regularly review risk exposure and ensure, for example, that insurance policies are up-to-date, internal controls are enforced and investment policies are followed.
- ◆ Develop emergency plans, including a leadership succession plan, procedures for handling urgent matters that require board input and a communications plan.
- ◆ Assemble a board that's demographically diverse, including diversity of gender, ethnicity, economic status, disability, profession and expertise.

Finally, try to be organized. Maintain an annual calendar of board meetings and require members to attend a certain percentage of them. Be sure to prepare agendas and any materials relevant to discussions and votes before board

"Reasonable" is relative

While you're struggling with the definition of "good governance," here's another tricky term: "reasonable" — as in reasonable executive compensation. The IRS defines reasonable compensation as the amount ordinarily paid for like services by like enterprises, whether for-profit or nonprofit.

To protect your nonprofit from IRS scrutiny and possible sanctions, your board needs to set and evaluate your chief executive's compensation by comparing him or her to others performing similar duties. The board also needs to take into account the size of the executive's staff, scope (local vs. national) of the job and size of the organization's budget. Other factors that may merit higher-than-market pay could include the executive's responsibility for more than one facility or entity, particularly long work days or weeks, unusual experience or expertise, or your nonprofit's unique management needs.

Finding a comparable position, however, isn't as easy as it sounds. Generally, the most accurate method is to hire a nonprofit-specializing accounting or consulting firm to design and conduct a survey. But trade associations and other organizations also offer compensation surveys for purchase.

meetings. When meetings are well attended and run smoothly, the board can focus on what's truly important.

MAKE IT A PRIORITY

There are, of course, many other practices you can adopt to strengthen your organization's governance depending on the type of nonprofit, the board's composition, local and state regulations, and other factors. As you strive to make good governance a top priority, discuss the specific steps you should take with your financial and legal advisors. ✱

Audits are essential to your organization's well-being

Increased public and government scrutiny of nonprofits, their management and their boards has made audits more important than ever before. Audits not only provide you with a fair assessment of your organization's financial health, but also can reveal vulnerabilities such as weak internal controls, insufficient cash reserves and poor investment policies. Perhaps most important, regular audits reassure your donors, members and other stakeholders that you run a tight ship that's unlikely to sink at the first sign of a storm.

INS AND OUTS

Audits come in two forms, serving different purposes:

1. Internal audit. This type of audit is a function of your board's fiduciary responsibility to the organization and is performed by an "inside" auditor, such as your CFO.

The auditor examines whether your financial policies and processes meet your standards and those of outside agencies, and may look at how well your nonprofit's accounting and financial policies accord with Generally Accepted Accounting Principles (GAAP) and applicable state and federal laws. The auditor also may review the accuracy of financial information, assess how efficiently your organization handles money matters and test your internal controls.

2. External audit. An external audit is conducted by a financial professional outside of your nonprofit. This type of audit is completely separate from an internal audit. Although external audits are optional for nonprofits in some states, they're required in others. Be sure you learn the rules in your state.

In an external audit, a CPA examines your organization's financial statements and issues

an opinion on whether those statements offer a fair picture of your finances and adhere to GAAP. To support this opinion, the auditor tests underlying records such as your nonprofit's bank reconciliations, accounts payable records and contribution classifications. The auditor also evaluates your organization's internal controls.

It's essential to choose an external auditor who has no ties to your organization. For example, a board member's spouse who happens to be a CPA — no matter how qualified the spouse may otherwise be to perform an audit — wouldn't be able to accept an engagement to perform your audit.

COMMITTEE WORK

Another major component of the nonprofit audit process is your organization's audit committee — financially knowledgeable people who provide oversight of your organization's reporting and internal controls. Some states mandate who can serve on an audit committee; others allow board members, as well as nonboard member volunteers, to serve. Depending on the size and complexity of the nonprofit, the committee generally has three to five members.

The audit committee's primary role, besides selecting external auditors, is to maintain open communication with internal and external auditors to discuss audit processes and results. The committee also should ensure internal controls are in place throughout the year. The key to a successful audit committee is its independence and ability to bring to the table financial expertise specifically related to nonprofits.

PREPARING FOR THE AUDIT

To help ensure you get the most useful results from an external audit, assemble relevant documents, including financial statements,



bank correspondence, budgets, board meeting minutes, and payroll, accounts receivable and accounts payable records. Your auditor also may ask to review records related to loans, leases, grants, donations and fundraising activities. Ask your auditor for a detailed list of required documentation.

Expect the auditor to ask questions during the review process. He or she also will want to question board or staff members about your internal controls — including procedures for fraud prevention and detection. Among the issues likely to be reviewed are how money and other resources are received and spent, what the organization does to comply with applicable laws, and how financial transactions are recorded.

Ideally, you should keep a running file of appropriate paperwork so you're prepared when the audit takes place. You also should communicate with your auditor as questions arise during the year about, for example, launching a program to sell items to raise funds or accepting a large grant. This ongoing approach can make the annual audit smoother and faster.

GOOD REASONS

Audits take considerable time and effort, but when they reveal serious issues, such as fraud, they're well worth it. If that isn't enough incentive, consider the government's growing interest in nonprofit audits. Although the newly revised IRS Form 990 doesn't mandate them, it does ask organizations to discuss their audit activities, as well as the role their board plays in them. *

The pros of being proactive with the IRS

Many nonprofit leaders observe a strict “don't ask, don't tell” policy when it comes to dealing with the IRS. As long as an examiner isn't knocking at the door asking specific questions, they don't volunteer information. In some cases, however, it could be to your advantage to do just that. If, for example, you or your accountant uncovers a mistake in a filing, taking a proactive stance with the IRS can help minimize potential hassles and penalties.

NONPROFIT SCRUTINY

Hard statistics aren't available, but most experts agree that the IRS is paying greater attention to nonprofit organizations these days. The redesigned IRS Form 990, for example, asks more extensive and probing questions about nonprofit governance than it has in the past. And the Pension Protection Act of 2006 stipulates that organizations automatically lose



their tax-exempt status if they go three consecutive years without filing appropriate returns.

At the same time, the IRS has announced that it's willing to work with struggling organizations to help them maintain their nonprofit status. In 2008, the IRS revealed to the *Chronicle of Philanthropy* that it's waiving heavy penalties to allow delinquent organizations to catch up on their filings. So if your organization has fallen behind, now may be a good time to appeal to the government.

EVERYONE MAKES MISTAKES

In addition to failing to regularly file, nonprofits may trigger an IRS investigation, fine or other consequence by compensating executives excessively or improperly using funds. But an innocent math or other filing preparation error can also stir up trouble. If you discover you've inadvertently made a mistake, act quickly and:

Get professional advice. The earlier you bring an error to the attention of your accountant and your attorney, the easier it is to make right.

Learn the facts. Don't brush off a potential financial compliance problem because you don't understand it or don't have time to deal with it. Burying your head in the sand is never a wise policy when it comes to the IRS.

Keep some perspective. Don't let embarrassment, guilt or fear prevent you from taking the

right steps. Innocent mistakes aren't character flaws and don't have to reflect badly on your organization. Getting caught trying to sweep mistakes under the rug, however, can bring your judgment — not to mention your nonprofit's reputation — into serious question.

WORK AS A TEAM

Accountants have experience working with the IRS, so listen carefully to your expert's advice and follow his or her lead in amending any errors. He or she can even accompany you if you need to meet with the IRS. Approach the meeting with an open mind and, once there, simply explain the facts. Don't act defensive, assume the government is "out to get you" or engage in other hostile behavior.

By taking the proactive path and approaching the IRS before it approaches you, you'll find that the agency is likely to be more amenable to finding a solution. Proactive — vs. defensive — steps can also speed up the process so that you can get back to running your organization.

TAKE COMFORT

Whether you, your accountant or the IRS uncovers an anomaly, the best advice is the simplest: Ask the experts and listen carefully to their proposed solutions. And for the sake of your peace of mind, don't panic. Financial reporting problems can, and do, get resolved every day. *

Managing payroll: In-house vs. outsourcing

At a time when many nonprofits are scrutinizing every line item in their budgets, you may have wondered whether you really need to outsource your payroll processing. But before you make the decision to bring payroll back in-house, study the situation from every angle. It's possible you'll save money, but you also may create new headaches for already-overwhelmed staff. And worse — you could increase payroll delays and errors.

Q&A

To determine whether processing payroll in-house is a good idea, consider the following questions:

Who will manage it? Scrutinize your staff to determine who has the required skills. Consider the services provided by your payroll vendor and whether staff members' expertise is equivalent and, crucially, up-to-date. Also, will these employees be able to handle payroll responsibilities on top of their current workload? If not, can they offload some of their existing duties to other staff members to free up time?

Do you have sufficient checks and balances?

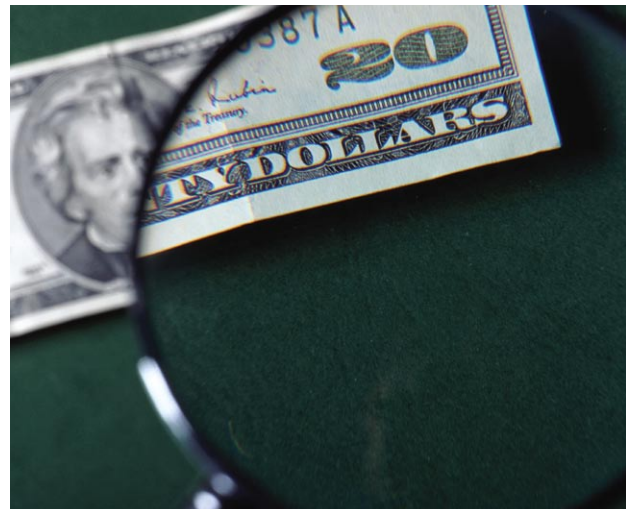
To prevent fraud, no one person should ever have complete control and responsibility for a financial task without a second employee's oversight. How would you accommodate this practice if you processed payroll internally? Which staff member — preferably a manager — is capable of providing a second set of eyes?

Do you have the technological capabilities?

If you haven't managed your own payroll in a while, you may not have the most current and efficient software and systems to handle the job. Be sure to include any potential technology expenditures when determining the cost-effectiveness of in-house payroll processing.

A SPLIT DECISION

When you review your internal capabilities and weigh the pros and cons, you may find that outsourcing payroll and processing it yourself are roughly equal. If so, consider the service your current vendor provides. Are you happy with its timeliness, accuracy, responsiveness and attention to detail? If not, you may want to change the terms of your agreement. For example, if you're paying for ancillary services you're not using, try to renegotiate the contract so you're paying only for what you use.



If you're nearing the end of a contract term, seek competitive bids from other vendors. Be sure to let your current vendor know you're shopping around — to keep your business, it may be willing to beat other offers.

SAVVY COST-CUTTING

Most nonprofits must make cost-cutting decisions in tough economic times. But before you decide that payroll is one of those costs, remember that payroll vendors provide expertise and experience you don't necessarily have in-house. *

ADDRESS SERVICE REQUESTED

The expertise you need. The service you deserve.

At Smith & Gesteland, LLP we know that running a successful not-for-profit these days requires more than just dedication and hard work. It takes the assistance of experts who understand the complex needs of these organizations and have the knowledge, experience and service commitment it takes to help them fulfill their missions.

Our Not-for-Profit Service Group consists of professionals focused on increasing the success of organizations like yours. For more than 50 years, our firm has served businesses, organizations and individuals throughout south central Wisconsin. We are delighted to currently work with more than 70 not-for-profits and to have recently been voted Madison's Number 1 accounting firm. We are ready to assist you with a broad range of services tailored specifically to your needs, including:

ANALYSIS AND DESIGN OF ACCOUNTING SYSTEMS

- ◆ General ledger accounting
- ◆ Functional accounting
- ◆ Fixed asset accounting
- ◆ Internal controls
- ◆ Outsourcing

AUDITS

- ◆ Financial audits
- ◆ Compliance audits
- ◆ A-133 audits

FINANCIAL MANAGEMENT

- ◆ Lease/purchase
- ◆ Budget assistance
- ◆ Cost allocation
- ◆ Financing
- ◆ Board of director assistance

INFORMATION REPORTING

- ◆ Tax-exempt applications
- ◆ Federal Form 990
- ◆ Unrelated business income
- ◆ Lobbying compliance
- ◆ Contribution issues
- ◆ For-profit subsidiaries

CONSULTING SERVICES

- ◆ Computer hardware and software selection & support
- ◆ Network support
- ◆ Strategic planning
- ◆ Human resources
- ◆ Policy development

We would welcome the opportunity to serve you. For more information about our services or the ideas presented in this newsletter, please contact us at (608) 836-7500 or mail@sgcpa.com.