


Accounting for Your Mission:
Tools & Concepts to Enhance
Decision-making in Nonprofit Organizations


Presented by
Williams Benator & Libby, LLP



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Housekeeping

- Please turn off your cell phone or switch to vibrate
- Please take calls outside the room
- Emergency exits are located...
- Restrooms are located....




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Please introduce yourself

- Your name
- Your role
- Your organization
- How long have you been with your current organization? Involved with nonprofits?
- What do you want to learn today?




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Goals of Presentation

- Gain a greater understanding of the **roles and responsibilities** related to nonprofit financial statements
- Gain a greater understanding of the **details in nonprofit financial statements**
- Gain a greater understanding of the **risks nonprofits face and what controls can address those risks**
- Gain an understanding of how to **leverage financial information to improve your organization**



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Agenda

9:00-9:25*	Welcome and introductions ✓
9:25-9:40	Understanding financial reporting roles and responsibilities
9:40-10:00	Understanding your basis for financial reporting
10:00-10:15	Break
10:15-12:00	Understanding the basics of financial statements
12:00-12:45	Lunch
12:45-1:20	Measurements and metrics—Tools to benchmark performance
1:20-2:20	Using 990s as a financial planning tool
2:20-2:35	Break
2:35-3:00	Audits—What to expect and benefits to gain
3:00-3:45	Risks & Internal Controls
3:45-4:00	Wrap-up and questions

* Times are approximate




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FINANCIAL REPORTING

Understanding roles and responsibilities




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Financial Reporting

What is it and why is it important?

- Representation of the financial performance and position of your organization
- Internal—strategic decision-making
 - Fundraising
 - Capital expenditures
 - Human resources
- External—demonstration of your success relative to your mission
 - Donors
 - Lenders
 - Government
 - Other organizations and business partners


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Financial Reporting

Who is responsible for financial statements?

- Controller, with support from internal personnel or external consultants, prepares monthly* financial statements
- Executive director/business manager reviews financial statements
- Board of Directors approves financial statements
 - Audit or finance committee
 - Full Board

* Monthly is recommended, although some orgs report quarterly



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Financial Reporting

What does Controller need to prepare/review?

- General ledger detail
- Journal entries detail
- Supporting schedules
 - Bank reconciliation
 - AR and AP aging schedules
 - Property and equipment schedules
 - Account reconciliations and details
- Monthly financial statements
 - Budget vs. actual analysis
 - Current year vs. prior year
- Financial measurements (key ratios)
- IRS Form 990





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Financial Reporting

What does Executive Director need to review to ensure accuracy?

- Ask for the following to accompany financial statements:
 - Budget vs. actual comparison
 - Current year vs. prior year comparison
 - Journal entries detail
 - Bank reconciliations
 - Cash restrictions
 - Support for budget changes, as applicable
 - Explanations for variances in monthly activity
 - Key ratios/measurements
 - Debt covenants calculation



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Financial Reporting


What is the Board's responsibility?

- Review
 - Financial statements approved by management
 - Budget vs. actual analysis
 - Current year vs. prior year
 - Financial ratios/metrics
- Approve monthly financial statements
 - Document approval in Board minutes
- Leverage accurate financial information to make strategic decisions


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UNDERSTANDING YOUR BASIS FOR FINANCIAL REPORTING



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Financial Reporting

How should my nonprofit be maintaining its books?

- To whom are you reporting?
 - Internal (monthly reporting)
 - Management
 - Board
 - External (quarterly or annual reporting)
 - Financial institutions
 - Donors
 - Grantors
- Needs of different audiences determine format
- Monthly and annual formats may differ


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Financial Reporting

Types of Financial Reporting

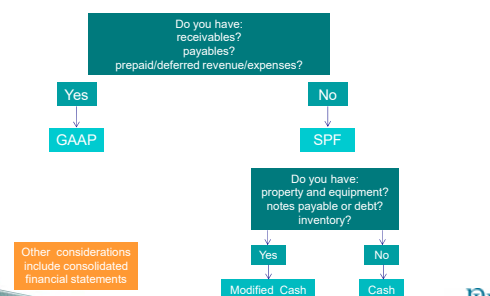
- Generally Accepted Accounting Principles (GAAP)
 - Most widely known/used
 - Accrual basis of accounting
 - Activity recorded in year it occurs
 - Includes accounts receivable, payable, other revenue and expenses incurred but not received/paid
 - Accepted and familiar to banks, donors, other orgs
- Special Purpose Framework (SPF)
 - New term for what was known as "other comprehensive basis of accounting" or OCBOA
 - Accounting done on cash or modified cash basis

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Financial Reporting

What type of financial reporting is right for your organization?



```


    graph TD
      Q1[Do you have: receivables? payables? prepaid/deferred revenue/expenses?] -- Yes --> GAAP[GAAP]
      Q1 -- No --> SPF[SPF]
      Q2[Do you have: property and equipment? notes payable or debt? inventory?] -- Yes --> MC[Modified Cash]
      Q2 -- No --> Cash[Cash]
      Note[Other considerations include consolidated financial statements]
    
```

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BREAK!

15 minutes: synchronize watches, please.

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UNDERSTANDING THE BASICS OF FINANCIAL STATEMENTS


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Financial Statements

What needs to be in your financial statements?

- Statement of financial position (balance sheet)
- Statement of activities (income statement)
 - Functional expense statement is required for voluntary health & welfare organizations only
 - Optional for others
- Statement of cash flows
- Footnotes and reporting disclosures, as applicable


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Financial Statements

Statement of financial position

- Financial snapshot—limited to a specific date and time
- Includes
 - Assets
 - Current assets
 - Property, plant and equipment
 - Liabilities
 - Net assets (total assets – total liabilities)




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Financial Statements: Assets

Statement of financial position: cash & cash equivalents

- Cash
- Cash equivalents
 - Financial instruments with original maturities of 3 months (time to maturity can be defined differently by each org)
 - E.g., money market accounts, CDs, etc.
- Restricted
 - Created by donors, financial institutions
 - Restrictions due to purpose or timing of availability of assets
 - Affects liquidity/availability of cash
- Unrestricted assets for general use in operations




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Financial Statements: Assets

Statement of financial position: investments

- Financial instruments that aren't cash or cash equivalents
 - Stocks
 - Bonds
 - Mutual funds
 - Alternative investments
- Reported at fair value or cost basis
 - Fair value is used most often
 - Cost is used when assets are held to maturity, e.g., bonds (and other exceptions)




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Financial Statements: Assets

Statement of financial position: receivables

- Accounts receivable
 - Amounts due as a result of general operations (i.e., tuition)
 - Typically due within one year
- Pledges receivable
 - Commitments from donors not yet collected
 - Typically collected over multiple years
 - Amounts due > one year should be discounted to present value
- Allowance for doubtful accounts
 - Conservative estimate of the amount you expect not to collect
- Record only if you have a reasonable expectation of collection




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Financial Statements: Assets

Statement of financial position: prepaid expenses

- Amounts paid in advance for services that will be rendered in the future
 - Prepaid insurance
 - Prepaid rent
 - Deposits and down payments (i.e., events)
- Amortize prepaid expenses for realization over multiple periods




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Financial Statements: Assets

Statement of financial position: property and equipment

- Physical assets used in operations
 - Building
 - Land
 - Equipment, furniture and fixtures
 - Leasehold improvements
 - Construction in process
 - Capitalized interest cost
 - Donated assets
- Historical cost of property and equipment is capitalized on the balance sheet
 - Expense recognized over multiple years through depreciation
 - Each org defines its own depreciable asset lives
- Property and equipment line item is presented net of accumulated depreciation




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Financial Statements: Assets

Statement of financial position: intangible and other assets

- Typically long-term assets
 - Amortized over useful life OR
 - Held until termination of agreement
- Includes
 - Web site costs
 - Capitalized loan costs
 - Deposits on leased facilities
 - Goodwill
- Intangible assets line item is presented net of accumulated amortization



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Financial Statements: Liabilities

Statement of financial position: notes and bonds payable

- Amounts borrowed from individuals and financial institutions payable over specific periods of time
 - Period of time determines classification as short term vs. long term
 - Amounts due within one year = short term
 - Debt covenants can also affect classification
- Notes and bonds payable typically include:
 - Lines of credit
 - Bonds payable
 - Loan from an individual
 - Long-term loan from financial institutions



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Financial Statements: Liabilities

Statement of financial position: accounts payable and accrued expenses

- Accounts payable are costs incurred but not yet paid to vendors for services or goods
- Accrued expenses are other obligations incurred but not yet paid
 - Payroll
 - Bonuses
 - Unpaid leave/vacation
 - Employee benefits
 - Deferred rent
- Agency funds
 - Variance power
- Amounts are typically due within one year



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Financial Statements: Liabilities

Statement of financial position: deferred revenue

- Cash received in advance of obligation being met
 - Tuition
 - Camp enrollment
 - Fees for service
 - Membership fees
- Recognized as revenue once service is provided
- Can be recognized over multiple periods
- Amounts due > one year should be discounted to present value



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Financial Statements: Net Assets

Statement of financial position: net assets

- Considered equity for nonprofits
- Can be categorized as:
 - Unrestricted (available for operations)
 - Board-designated—available for operations at discretion of Board
 - Temporarily restricted (donor-restricted for time or purpose)
 - Permanently restricted (restricted in perpetuity by donor)
- Includes endowment funds
 - Corpus—original contributions
 - Only the donor can permanently restrict
 - Board-designated is unrestricted
 - Earnings can be unrestricted (Board-designated), temporarily restricted or permanently restricted



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Financial Statements: Revenue & Expenses

Statement of activities

- Long-term view of financial performance (typically one year)
- Includes
 - Revenues
 - Expenses
- Reconciliation of activity impacting net assets
 - Categorizes activity based on restriction
 - Represents difference between beginning and ending net assets on statement of financial position


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Statement of activities: revenues

- Income earned to support organization's mission
- Cash and non-cash
- Can be categorized as:
 - Unrestricted
 - Temporarily restricted
 - Permanently restricted

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Statement of activities: contributions

- Unrestricted: general gifts with no donor restrictions (time, purpose)
- Temporarily restricted: restricted by donor (time, purpose)
 - Conditional gifts
- Permanently restricted: gift from donor to be held in perpetuity
- A note on restrictions:
 - Pursue unrestricted contributions
 - Establish a gift acceptance policy

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Statement of activities: expenses

- Costs incurred supporting organization's mission
- Program services
 - Major programs
- Supporting services
 - General and administrative
 - Fundraising
 - Facilities
- Fund accounting
 - Option for organizing expenses by program (for internal purposes only)

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Statement of cash flows

- Operations
 - Reconciles net income (or net loss) from statement of activities
- Investing
- Financing
- Includes information on non-cash related transactions

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Notes and disclosures of financial statements

- Detailed explanation of organization's:
 - Mission
 - Key accounting policies
 - Tax exempt status
 - Major line-items in financial statements
- Purpose is to help reader better understand financial statement
- Can include supplementary information

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Sample statement of financial position


- Can be classified or non-classified
 - Current vs. total assets and liabilities
 - Either way, has to be presented in order of liquidity
- Gross vs. net
 - Accounts and pledges receivable can be shown on a net basis, i.e., allowances for doubtful accounts and net present value
 - Amount must be disclosed in notes or on face of financial statements

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Financial Statements

Sample statement of financial position (cont'd)

- **Property & equipment**
 - Shown as single or detailed line items
 - Details must be disclosed in notes or on face of statement of financial position
- **Net assets**
 - Must show all classifications of net assets
 - Do not have a separate statement (as in for-profit)
 - Roll forward activity is shown in statement of activities



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Financial Statements

Sample statement of activities

- **Format**
 - Must separate activity by net asset classification
 - Can be shown "across" or "down"
- **Report expenses on major program basis**
 - Show by program
 - Statement of functional expenses optional (except for health/welfare org)
 - Fundraising costs must be shown separately
 - Employee salaries/benefits allocated to all programs



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Financial Statements

Sample statement of functional expenses

- Requirement for voluntary health and welfare organizations
- Even if not required, can be useful tool to understand details of activity in programs
 - Can be on face of financials or in footnotes



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Financial Statements

Sample statement of cash flows

- **Format**
 - Direct vs. indirect
 - Either way, must reconcile net income/loss to cash provided by/used in operations
- **Categories of activity**
 - Operating
 - Investing
 - Financing
- Supplemental cash flow information disclosed



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Financial Statements

Footnote disclosures

- General accounting policies and description of mission
- Individual footnotes relating to line items
 - Investments
 - Types of investments by cost and fair value
 - Breakout of investment income/loss
 - Classification by level 1, 2, 3
 - Pledges and other receivables
 - Can break out by campaign
 - Allowance for doubtful accounts and discounting
 - Future collections expected on outstanding receivables
 - Conditional pledges disclosure



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Financial Statements

Footnote disclosures (cont'd)

- Individual footnotes relating to line items (cont'd)
 - Bonds and notes payable
 - Terms
 - Debt covenants
 - Future obligations due
 - Net assets
 - Classification by restriction categories
 - Releases of restrictions details
 - Endowment net assets roll forward and disclosure of terms
 - UPMIFA disclosure
 - Related parties
 - Must disclose details of all significant activities
 - Agency funds



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Financial Statements

Footnote disclosures (cont'd)


- Individual footnotes relating to line items (cont'd)
 - Employee benefit plans
 - Existing plans and organization's obligations
 - 403(b), 401(k), 457(b), etc.
 - Commitments and contingencies
 - Major contracts and obligations
 - Outstanding legal matters
 - Subsequent events
 - Material activities undertaken after financial statement year-end
 - Must disclose date through which subsequent events were evaluated


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LUNCH!

45 minutes


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MEASUREMENTS AND METRICS

Financial tools to benchmark performance



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Measurements and Metrics

Budgeting: key strategic planning tool

- Helps to identify and analyze trends
 - Organizational challenges and opportunities
- Creates a roadmap for achieving mission
- Involves and aligns management to mission
- Timing is critical to developing annual strategic plan
 - Ideally completed six months prior to year-end
 - Enables each department to develop tactical plans
- Be conservative and realistic



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Measurements and Metrics

Budgeting: key oversight tool

- Opportunity for management to take snapshot of organizational performance
- Best practice: monthly analysis of budget vs. actual
 - Evaluate performance
 - Monitor validity of actual results
 - Help identify issues early
 - Manage expenses
 - Manage Board's expectations



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Measurements and Metrics

Key metrics to evaluate organizational performance

- Certain metrics are key to benchmarking and monitoring organizational performance
- Used to evaluate trends over years, not at one point in time (current year vs. prior years)
- Many metrics to choose from; tailor to your organization's goals
- Board and management should ask for these if they're not already seeing this information



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Measurements and Metrics

Key metrics (cont'd)

- **Metric:** current ratio
- **How it's calculated:** current assets ÷ current liabilities
- **What it measures:** ability to cover your immediate cash-flow needs (short-term stability)
- **What trend do you want to see:** increase in the ratio



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Measurements and Metrics

Key metrics (cont'd)

- **Metric:** liquidity ratio
- **How it's calculated:** liquid assets (cash, receivables, inventories, short-term investments) ÷ total liabilities
- **What it measures:** liquidity of the organization (financial strength/staying-power)
- **What trend do you want to see:** 1:1 or greater



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Measurements and Metrics

Key metrics (cont'd)

- **Metric:** debt to net assets ratio
- **How it's calculated:** total debt ÷ total net assets
- **What it measures:** long-term stability
- **What trend do you want to see:** decreasing ratio



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Measurements and Metrics

Key metrics (cont'd)

- **Metric:** fundraising efficiency ratio
- **How it's calculated:** total contributions (excluding government grants) ÷ fundraising expense
- **What it measures:** relative cost to obtain contributions
- **What trend do you want to see:** increasing ratio



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Measurements and Metrics

Key metrics (cont'd)

- **Metric:** program service expense ratio
- **How it's calculated:** program service expenses ÷ total expense
- **What it measures:** efficiency; relationship of funds spent toward mission to total expenses incurred
- **What trend do you want to see:** increasing ratio (at least 60%)
 - Donors pay close attention to this



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Measurements and Metrics

Key metrics (cont'd)

- **Metric:** program to assets ratio
- **How it's calculated:** program service expenses ÷ average total assets
- **What it measures:** efficiency, relationship of use of assets toward mission to total program costs
- **What trend do you want to see:** increasing ratio (benchmarked over several years, 60%-75% of total expenses related to mission)



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Measurements and Metrics


Key metrics (cont'd)

- **Metric:** cash-flow return ratio
- **How it's calculated:** operating cash flows + total assets
- **What it measures:** efficiency; all assets are focused on generating cash-flow
- **What trend do you want to see:** increasing ratio; higher the ratio the more successful the organization in generating returns on investment


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USING 990s AS A FINANCIAL PLANNING TOOL



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990s

Overview of Form 990

- There are different types of tax exempt entities
- Reporting requirements vary by type
- Contribution deductibility varies for both individuals and businesses
- Tax exempt entities include:
 - **501(c)(3)**—Religious, educational, charitable organizations (ChildFund International)
 - **501(c)(7)**—Social and recreational clubs (Dunwoody Country Club)
 - **501(c)(4)**—Civic leagues, social welfare organizations, and local associations of employees (American Association of Retired Persons)
 - **501(c)(10)**—Domestic fraternal societies and association (Free & Accepted Masons of Pennsylvania)
 - **501(c)(5)**—Labor, agricultural, and horticultural organizations (National Football League Players Association)
 - **501(c)(11)**—Teachers' retirement fund associations (St. Paul Teacher's Retirement Fund Association)
 - **501(c)(6)**—Business leagues, chambers of commerce, real estate boards (Corn Refiners Association)
 - **527**—Political Organizations (Republican Governors Association)



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990s

Overview of Form 990 (cont'd)

- Not technically a tax form, it's for informational purposes only
- Provides a snapshot in time of organization
 - Most useful when compared to other years' info
 - Orgs are required to make available three (3) most recent 990s
- Used to show that the organization is operating according to its mission or program service
- Form 990s are available free to the public on Guidestar.org or Charitynavigator.org.



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990s

What do third parties look for in 990s?

- Mission statement, significant activities, accomplishments
- Funding sources
 - Public donations
 - Government
 - Program/service fees
- Expenses
 - Compensation
 - Program
 - Fundraising
 - Is money being used for the organization's exempt purpose?


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990s

How do 990s differ from financial statements?

- Unrealized gains/losses are not included as revenue
- Donation of services or use of facilities are not included as revenues or expenses
- Form 990 requires reporting investment income and investment management fees separately

Form 990, Part I:

		Beginning of Current Year	End of Year
19	Revenue less expenses. Subtract line 16 from line 12	2,695,000.	75,000.
20	Total assets (Part X, line 16)	80,720,000.	81,410,000.
21	Total liabilities (Part X, line 20)	14,025,000.	14,305,000.
22	Net assets or fund balances. Subtract line 21 from line 20	66,695,000.	67,105,000.


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Form 990, Schedule D, Parts XI and XII (previously XII and XIII):

Schedule D (Form 990) **THE SCHOOL OF EXCELLENCE** 12-3456789 Page 4

Part XI Reconciliation of Revenue per Audited Financial Statements With Revenue per Return

1	Total revenue, gains, and other support per audited financial statements		1	25,895,000.
2	Amounts included on line 1 but not on Form 990, Part VII, line 12:			
a	Net unrealized gains on investments	2a	335,000.	
b	Donated services and use of facilities	2b	120,000.	
c	Recoveries of prior year grants	2c		
d	Other (Describe in Part XIII.)	2d	291,000.	
e	Add lines 2a through 2d	2e	746,000.	
3	Subtract line 2e from line 1	3	25,149,000.	
4	Amounts included on Form 990, Part VII, line 12, but not on line 1:			
a	Investment expenses not included on Form 990, Part VII, line 7b	4a	15,000.	
b	Other (Describe in Part XIII.)	4b	2,000,000.	
c	Add lines 4a and 4b	4c	2,015,000.	
5	Total revenue. Add lines 3 and 4c. (This must equal Form 990, Part I, line 12.)	5	27,164,000.	

Part XII Reconciliation of Expenses per Audited Financial Statements With Expenses per Return

1	Total expenses and losses per audited financial statements		1	25,485,000.
2	Amounts included on line 1 but not on Form 990, Part IX, line 25:			
a	Donated services and use of facilities	2a	120,000.	
b	Prior year adjustments	2b		
c	Other losses	2c		
d	Other (Describe in Part XIII.)	2d	291,000.	
e	Add lines 2a through 2d	2e	411,000.	
3	Subtract line 2e from line 1	3	25,074,000.	
4	Amounts included on Form 990, Part IX, line 25, but not on line 1:			
a	Investment expenses not included on Form 990, Part VII, line 7b	4a	15,000.	
b	Other (Describe in Part XIII.)	4b	2,000,000.	
c	Add lines 4a and 4b	4c	2,015,000.	
5	Total expenses. Add lines 3 and 4c. (This must equal Form 990, Part I, line 18.)	5	27,089,000.	

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How do 990s differ from financial statements? (cont'd)

990s

Activities reported as net on Statement of Revenue:

	(B) Real	(C) Personal		
6 a	Gross rents			
b	Less: rental expenses			
c	Rental income or (loss)			
d	Net rental income or (loss)			
7 a	Gross amount from sales of assets other than inventory	(B) Securities	(C) Other	
b	Less: cost or other basis and sales expenses			
c	Gain or (loss)			
d	Net gain or (loss)			
8 a	Gross income from fundraising events (not including \$ of contributions reported on line 1c). See Part IV, line 15			
b	Less: direct expenses			
c	Net income or (loss) from fundraising events			
9 a	Gross income from gaming activities. See Part IV, line 15			
b	Less: direct expenses			
c	Net income or (loss) from gaming activities			
10 a	Gross sales of inventory, less returns and allowances			
b	Less: cost of goods sold			
c	Net income or (loss) from sales of inventory			

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How are 990s similar to financial statements?

990s

- The balance sheet of Form 990 typically ties to that of the financial statements
- Allocation of functional expenses are usually the same in both
- Endowments reported on Schedule D usually reflect the information in the footnotes of the financial statements

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What should Board members review?

990s

- Part I: Compare current year and prior year revenue/expenses
- Part VI: Governance, Management and Disclosure
 - Organization's process used to review Form 990
 - Any significant changes to governing documents
 - Processes for determining compensation
- Appropriate policies in place for excess benefit transactions
- Compensation of officers, key and highest compensated employees
- Public support percentage (Schedule A)
- Lobbying activities (Schedule C) and Unrelated Business Income (Form 990-T)
- Schedule O - Supplemental information
- Transactions between interest persons (Schedule L) and related organizations (Schedule R)

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What are the most recent changes to Form 990?

990s

- Part VII, Section A - Report average hours per week worked for related organizations in addition to hours worked for filing organization
- Part VII, Section B - Insurance providers should not be reported as independent contractors
- Part VII, Statement of Revenue - All 501(c)(3) organization that are shareholders in an S-corporation must treat all allocations of income as unrelated business income
- Part IX, Statement of Functional Expense - Detail of "other expenses" must be provided on Schedule O when the amount on line 11g exceeds 10% of functional expenses

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What are the most recent changes to Form 990? (cont'd)

990s

- Part XI, Reconciliation of Net Assets - includes new lines for net unrealized gains or losses on investments, donated services, use of facilities, investment expenses, and prior period adjustments. This was previously reflected on Schedule D, Part XI
- Revised definition of "disqualified person"
- Disregarded entities and joint ventures - filing organizations are no longer required to report their share of revenue or assets using Schedule K-1; rather, they can report according to their books and records

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990s

What hasn't changed?

- No change to filing threshold of Form 990
 - At least \$200,000 of gross receipts for the tax year or
 - \$500,000 of total assets at the end of the year
- Form 990-N (e-postcard) can be filed for organizations with less than \$50,000 in gross receipts

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990s

Tax exempt orgs may still be subject to tax

- Unrelated business income (UBI)
 - A trade or business
 - Performed regularly
 - Not substantially related to an organization's exempt purpose
 - A tax-exempt university runs a pizza parlor. Income from this venture is not tax-exempt.
- Exceptions
 - A charitable organization holds annual cookie sales that are tax exempt because the activity is substantially related to their mission
 - A social service nonprofit holds an occasional bake sale but is not taxed because they are not recurring

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990s

Tax exempt orgs may still be subject to tax (cont'd)

- Exceptions to UBI
 - Sale of donated merchandise
 - Income from convention or trade show participation
 - Activities conducted for the convenience of members
 - Laundry operated by college to launder dormitory linens and students' clothing is not an unrelated trade or business
 - Traditional bingo
- Exclusions from UBI
 - Interest and dividends
 - Royalties
 - Certain rental income from real properties
 - Certain gains and losses

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990s

Tax exempt orgs may still be subject to tax (cont'd)

- Advertising vs. sponsorship
 - Advertising promotes products or services
 - Sponsorship: no substantial benefit other than the use of the business name, logo, or product lines in connection with the organization's activities

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Why would the IRS want to audit a tax exempt organization?

- Ensure organization is truly operated for public (not private) interests
- Determine whether nonprofits pay any excessive compensation, fees, or benefits
- Determine whether nonprofits are engaged in UBI
- Determine whether nonprofits engage in lobbying or participate in political campaigns

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How to avoid an IRS audit

- Meet your basic tax obligations
- Maintain transparency
- File on time



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What are potential red flags that could trigger an IRS Audit?

- Organizations that conduct gambling fundraisers
- Organizations engaged in joint ventures with for-profit companies (this information should be disclosed on Schedule R)
- Organizations engaging in political activities
- Failure to file required tax returns
- Form 13909 - Tax Exempt Organization Complaint (Referral) Form

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Consequences of failure to file

- Monetary penalties against the organization
 - \$20 a day, not to exceed \$10,000, can be charged when a return is filed late
 - \$100 for each day failure continues, with a maximum penalty of \$50,000 (organizations with annual gross receipts exceeding \$1 million), applies on each day after the due date that the return is not filed
 - Possible relief if late filing was due to reasonable cause

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Consequences of failure to file

- Automatic revocation for not filing for three consecutive years
 - The law requires tax-exempt organizations, other than churches, to file an annual return with the IRS
 - No longer eligible to receive tax-deductible contributions
 - May need to file income tax returns and pay income tax on any income (either Form 1120 or Form 1041)
 - May reapply and pay necessary user fee
 - Recommend contacting state to determine how revocation affect any state filing requirements
- Added to a list on irs.gov/charities
 - Currently 65,536 organizations are listed

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BREAK!

15 minutes: synchronize watches, please.

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AUDITS

What to expect and benefits to gain

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Audits

Overview of an audit

- Provides assurance on the validity of financial information
- Required by
 - Financial institutions
 - Grantors
 - Federal funds (OMB A-133)
- Can be requested by
 - Board
 - Management

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Audits

What to expect during an audit

- **Process**
 - Planning
 - Risk assessment
 - Field work
 - Review with management and board
 - Approval and issuance of final opinion
- **Timing**
 - Performed annually
 - Ideally, occurs shortly after year-end
 - Usually takes between 2 weeks to two months (based on size of org)



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Audits

Benefits

- **Confirmation of accuracy of financial reporting**
 - Donors and financial institutions have confidence your organization is run well and worth their investment
- **Evaluation of processes and controls**
 - Annual feedback on potential risks/weaknesses in management letter
 - Opportunities to learn about and leverage best practices
- **Value beyond audit**
 - Provide specific guidance to improve operations and finance

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RISKS AND INTERNAL CONTROLS

Protecting your organization

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Risk & Internal Controls

Protecting your mission against internal threats

- **Fraud or mismanagement can jeopardize your organization**
 - Damage to image (PR) affects donations/pledges/membership
 - Inability to meet financial obligations
 - Inability to meet regulatory requirements
 - Inability to provide services
- **Monthly review of financial data helps to identify risk as early as possible**
- **Processes and policies create internal controls to prevent/address risk**

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Risk & Internal Controls

Internal controls provide defense and protection

- **Maintain accuracy and reliability of financial reports**
- **Comply with laws, regulations, obligations and agreements (i.e., grants, conditional pledges, etc.)**
- **Operate organization efficiently and effectively**
- **Protect organization's assets**
- **Protect "brand" (reputation)**



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Risk & Internal Controls

Audit identifies control risks

- **Internal cycles are reviewed to identify weaknesses**
 - Cash receipts
 - Cash disbursements
 - Payroll
 - Treasury
 - Financial reporting
- **Weaknesses could include:**
 - Lack of segregation of duties
 - Lack of oversight by management
 - Lack of training
- **Audit includes communication that outlines weaknesses and recommendations to address**

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Risk & Internal Controls

Types of weaknesses identified in audit

- **Material weakness**
 - Deficiency in internal controls that could lead to a material misstatement in an organization's financial statements
- **Significant deficiency**
 - Less severe than material, but important enough that it should keep management up at night
- **Internal control deficiency**
 - Operational deficiency that may prevent the identification of errors in the financial statements



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Risk & Internal Controls

A word about Sarbanes-Oxley

- Sarbanes-Oxley was enacted after ENRON to protect shareholders; applies to public companies
- Only two provisions apply to non-profits:
 - Whistleblower policy
 - Document retention policy
- Nonprofits are not **REQUIRED** to change auditors/audit partners periodically



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Risk & Internal Controls

Examples of fraud

- Cash receipts
- Cash disbursements
- Payroll
- Treasury
- Financial reporting





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Risk & Internal Controls

How controls address weaknesses

- **Cash receipt controls**
 - Segregate responsibilities for receiving, recording and depositing funds
 - Monthly review of bank statements and reconciliations
- **Cash disbursements**
 - Segregate responsibilities for initiation, approval and disbursement of funds
 - Require secondary review and approval of checks
 - Management review of vendor lists
 - Control of credit card possession and review of monthly credit card statements
 - Periodically review AP aging detail



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Risk & Internal Controls

How controls address weaknesses (cont'd)

- **Payroll**
 - Management review of payroll report and approval of all payroll changes
 - Board approval of management salaries and bonuses
- **Treasury**
 - Management review debt covenant compliance and investment statements
 - Board approval of all new debt and investments
 - Management review of roll-forward net assets
 - Proper maintenance of donor restricted documentation


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Risk & Internal Controls

How controls address weaknesses (cont'd)


- **Financial reporting**
 - Board and management review of financial statements
 - Management review and approval of journal entries
 - Proper training of staff preparing financial statements
- **Entity-level controls**
 - Code of conduct
 - Whistleblower policy
 - Strong ethical leadership




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QUESTIONS?



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Thank you



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