

NONPROFIT AGENDAS MAY 2010

OUTSOURCING BOOKKEEPING

The economic downturn has many nonprofits strapped for cash and outsourcing routine functions to cut costs. Bookkeeping is one of them. And while outsourcing this task has many benefits — such as saving time, labor and resources — it also has a few drawbacks. Here's a look at both the pros and cons of “farming out” this important function.

The plus side

At smaller organizations, employees are more likely to perform several job functions. For someone without a financial background, acting as bookkeeper can be difficult and take much more time than it should. Outsourcing this function can help your organization save man-hours, allowing your staff to focus on the organization's mission and other aspects of the operation.

Another benefit of outsourcing involves the accuracy of your financial records. A small nonprofit — with staff members assuming multiple roles — might not have appropriate internal controls in place, and inaccuracies can result. With outsourcing, on the other hand, you'll have more confidence that the accounting or bookkeeping work will be accurate and completed on time. A well-constructed outsourced arrangement can be the key to better internal controls and continuity in maintaining your accounting records. This arrangement may provide management with better financial information for making important decisions.

Outsourcing the bookkeeper position also eliminates the expense of payroll taxes, workers' compensation insurance, liability insurance, vacation and sick time, health insurance, and other employee benefits. Even though you'll pay the outside firm for their work, you'll still be saving money by not employing someone full-time. And you'll likely save money on office space and furnishings, a computer and software, and recruiting and training costs.

If you decide to outsource bookkeeping, your chief financial officer (CFO) or a manager should continue to review and analyze financial information, including monthly reconciliations and financial statements. This will be a higher level of review than performed in the past, thus saving him or her time by not having to check individual journal entries. Also, keep in mind that professional staffing firms can provide interim CFOs on a short- or long-term basis.

Special considerations

There are many benefits to outsourcing bookkeeping, but you'll need to guard against a few possible drawbacks. With the executive director or CFO not immersed in financial record details, some expenses (missing receipts, for example) might not get recorded.

Also, it can take time to find — or groom — an experienced bookkeeper for outsourcing who understands the expectations and needs of the nonprofit world as well as those of your organization. But setting clear expectations and strong lines of communication from the start can usually ward off potential problems.

When to “farm out”

Outsourcing bookkeeping should be considered if your organization wants to cut costs and keep everyone focused on its mission. The value of your time, accuracy, labor and resources should all be taken into consideration. If you're looking for a bookkeeper, check with colleagues at other organizations for a referral.

GET IN SHAPE

How to form — or improve — an audit committee

If your not-for-profit is like thousands of others, you likely already have — or are considering — setting up an audit committee. Some states *require* not-for-profits with a certain level of annual revenue to have an audit committee in place. Others *strongly encourage* it.

Committee advantages

Beyond those reasons for having an audit committee, your nonprofit wants to be sure it's getting a quality audit product — and having a committee focused solely on the audit helps ensure that. Because joining an audit committee generally represents less of a time commitment than a finance committee or board membership, it's an opportunity to get financial experts with knowledge of the audit process involved in your organization.

Generally, smaller nonprofits that don't require outside audits probably don't need an audit committee. They may have a finance committee instead, which oversees the organization's financial matters. Not-for-profits that *do* have an audit committee should separate it from the finance or investment committee to achieve greater independence.

Committee as overseer

As the name suggests, the primary responsibility of the audit committee is to oversee the annual audit. This involves hiring an outside auditor, meeting with the auditor to plan and review the audit, renewing the contract, and monitoring performance. Throughout the year, the committee should meet with the auditor to discuss suggested improvements or areas of concern. The audit committee also needs to review the organization's tax compliance, in particular its IRS Form 990 filing.

Other typical committee responsibilities are to recommend the approval or modification of the annual audit to the board and to monitor the adequacy and integrity of accounting, internal controls and risk management procedures. The committee also needs to ensure the organization's compliance with all financial reporting requirements.

In addition to reaffirming the important role of the audit committee, many not-for-profits have adopted governance standards from the for-profit sector. These include avoiding conflicts of interest, requiring financial expertise, overseeing positive change and maintaining an active relationship with auditors throughout the year.

Independent — and conflict-free

Audit committee members, who are typically on the board, need to be independent of outside interests and objective about their committee decisions. They shouldn't be paid consultants or employees of the nonprofit. However, staff members can provide support to the committee. Also, members shouldn't have a financial stake — or other conflict of interest — with any organizations that conduct business with your not-for-profit.

In certain instances, such as when a nonprofit has the need for specific expertise as discussed below, a non-board member might be permitted to serve in an advisory role.

Financial backgrounds

All audit committee members will ideally possess financial savvy, but at least one committee member should have a background in analyzing nonprofits and be a "financial expert." This is generally defined as someone with considerable experience analyzing, preparing or auditing financial statements.

Large not-for-profits typically have an easier time attracting board members with financial expertise than do smaller organizations. One way your nonprofit may be able to acquire expertise in this area is to contract with a Certified Public Accountant to act as an advisory member, assuming this practice is permitted by state law. To uphold independence standards, this individual shouldn't be associated with your audit firm or provide other accounting services to your nonprofit.

Audit committees also act as positive agents of change. As part of the annual audit, most not-for-profits receive a management letter outlining suggestions for improvements relating to financial management, accounting and internal control practices. An effective audit committee will make sure its organization understands and acts on their auditor recommendations.

Better with age

Whether you're just now forming an audit committee — or reviewing the one you already have — always keep sight of the committee's primary responsibilities. As your committee matures, works

with auditors and the annual budget, and recommends policy change, the committee's expertise and value are likely to follow.

A heightened regulatory environment

It also needs to be mentioned that the role of the board of directors of nonprofit organizations in the oversight of compliance programs is increasingly gaining in importance and visibility. The experienced professionals at Marks Paneth & Shron can help board members and their organizations comply with the heightened regulatory environment today and going forward.

GOODBYE SAS 112, HELLO SAS 115

There's a new rule in town: Applying AICPA Statement on Auditing Standards No. 115, *Communicating Internal Control Related Matters Identified in an Audit* (SAS 115), will be required during your next fiscal year audit (for periods ending on or after Dec. 15, 2009). This new standard supersedes SAS 112 of the same title. As with SAS 112, understanding what constitutes "control deficiencies," "significant deficiencies" and "material weaknesses" is key to applying the standard.

Spotting control deficiencies

Let's say it's your organization's policy to reconcile bank accounts only at the end of each year with no monthly analysis performed. This is an example of a *control deficiency* because your organization should reconcile bank accounts each month. Reconciling accounts monthly provides you an opportunity to find mistakes quickly and correct them immediately. Other control deficiencies include not having adequate segregation of duties over accounts receivable and not having someone on staff with adequate knowledge and experience to properly record and analyze accounting transactions.

Determining severity

Previously, under SAS 112, auditors were required to take a close look at control deficiencies and classify them as either a *significant deficiency* or a *material weakness*. This still holds true for SAS 115.

But under the former standard, your auditors followed general guidelines to determine whether or not the practice was a significant deficiency. They used a fair amount of judgment by taking into account the likelihood an error wouldn't be found and the dollar amount of any potential error. Under SAS 115, however, less judgment is involved; a significant deficiency is defined as *anything* that should be brought to the attention of those charged with governance. In this case, your auditors would need to evaluate the absence of monthly bank reconciliations and determine if, in conjunction with other controls in place, it's a significant deficiency, or if it's severe enough to be labeled a material weakness.

Under SAS 115, a material weakness (which is worse than a significant deficiency) means that there's a "reasonable possibility" ("more than a remote possibility" in the former standard) that your financial statements are materially misstated — or, plainly speaking, considerably inaccurate. A significant deficiency is less severe than that, but still warrants attention. In this case, not performing monthly bank reconciliations would be considered a material weakness.

While the differences between SAS 115 and SAS 112 are subtle, it's important to note that auditors must now look at your internal controls and determine not only if they can prevent and detect errors, but also if there's a process in place to correct those errors. For example, if you perform bank reconciliation procedures monthly, but no one reviews and approves them, the process still may fail.

Booking adjustments

Perhaps you tend to rely on the auditors to book specific adjustments during the audit. There may be certain instances in which you feel it's easier to have your auditors do that task, rather than book the entries yourself. For example, some nonprofits are concerned solely with cash flows and keep their books on the cash basis of accounting. At year end, their auditors likely book adjustments for noncash transactions such as accounts receivable or accounts payable.

The question becomes: Do you have anyone on staff who has a full understanding of these entries and can record them — or are you relying on your auditors to do this? This isn't a

requirement under either the new or the former standard, but if you don't have someone on staff with these capabilities, your auditors will note this. Your auditor can't be considered part of your internal control system; if you're relying on your auditors to book these adjustments, that would be considered a deficiency.

If you're a small organization, you may not have the funds to hire someone with enough accounting education and experience to ensure that your auditors won't find material misstatements. If you can't afford to have someone permanently on staff, consider outsourcing the bookkeeping function. Or perhaps you can find someone to donate their time for bookkeeping services at year end, such as a board member or other volunteer. In any case, make sure that every financial statement account is reconciled thoroughly at year end.

Keeping your independence

Try to make all your adjustments before your auditors begin their fieldwork. This will save time and energy for all parties and may help you avoid negative SAS 115 comments. If you do this, it would be almost impossible for you to be accused of relying on your auditors too much. But if you later discover a necessary adjustment to your year end trial balance, let your auditors know. This is preferable to them finding any errors.

Remember: You shouldn't think of your auditor as a component of your nonprofit's internal controls. Doing so could tarnish the "independence" that is so key to the auditing process.

What is a material adjustment?

"Material" is certainly hard to define as it relates to an audit or your financial statements. In its simplest terms, a material adjustment is the amount that, if not booked, would mislead financial statement users.

Suppose the largest asset on your financial statements is investments and you failed to record investment activity properly during the year. The error was later discovered by your auditors during audit fieldwork. Although the year end balance may have been correct, what if unrealized investment income was booked to the program service revenue account instead? Or if it offset the overhead expenses account in error? This would definitely mislead the financial statement users, as your program service revenue would be overstated or your overhead expenses would be understated.

NEWS FOR NONPROFITS

The Pension Protection Act of 2006 Could Result in the Loss of Charitable Status for Some Nonprofits

Under the Pension Protection Act of 2006, organizations who have not filed three consecutive annual returns (Form 990-N, 990-EZ, 990 or 990-PF) may have their federal tax exemption revoked by the IRS.

The IRS is giving delinquent nonprofits a six-month grace period in which to file their annual returns. If you have questions about this or think you may be in danger of losing your exemption, contact the Nonprofit and Government Services Group at Marks Paneth & Shron for guidance.

How Can You Find New Staff?

As the nation continues its climb out of the recession, your organization may be looking for new employees. Many nonprofits also need to replace higher-level employees — such as executive directors — nearing retirement.

The search process will require hard work and diligence, but using the Internet can help immensely. A number of sites offer assistance, and while some require a fee, most (see below) charge only a nominal amount to post job openings. Membership in the organization sponsoring the site may be required.

For a general search, check out www.idealists.org. This site can be used to post nonprofit job openings of any type.

Sites for posting fundraising openings include The Association of Fundraising Professionals (www.afpnet.org), an organization that works to advance philanthropy. CareerBuilder.com (www.careerbuilder.com, keyword “nonprofit,” category “nonprofit”) is a less specialized site that includes fundraising positions. Deep Sweep (www.deepsweep.com) provides two portals: one for job seekers and one for employers.

Some useful sites for nonprofit executive searches are execSearches.com (www.execsearches.com); CEO Update (www.associationjobs.com) and ASAE & The Center for Association Leadership (www.asaecenter.org).

Economic Impact

GuideStar has released the results of its eighth annual economic survey, and it confirms patterns that many nonprofits have already experienced firsthand. The survey, conducted in October 2009, shows that contributions decreased in 2009, while demand for services rose. Of the 2,565 public charities and private foundations surveyed, 51% responded that contributions to their organization had decreased in 2009 (compared to 35% in 2008). Surprisingly, 23% experienced an increase in contributions. No explanation was provided for the increase.

The most significant reasons for the decrease in contributions were fewer individuals giving (69%) and gifts from individuals being smaller (69%). Smaller corporate gifts and private foundation grants also played a role. Of the organizations surveyed, 62% stated that demand for services had increased.

Grants made by organizations also changed — 35% decreased the amounts of their awards, while 27% increased. Compare that to 2007, when 12% of organizations decreased their grants and 52% increased.

IRS Lowers Mileage Rates

Make sure your nonprofit is applying the new IRS standard mileage rate for employees who use their vehicles for work this year, and note that it's *lower* than in 2009. As of Jan. 1, 2010, the standard mileage rate for the use of a car (or van, pickup or panel truck) is 50 cents per mile for business miles driven — 5 cents less than last year's 55 cents per mile.

The 2010 rate for driving in service of charitable organizations (volunteers using their vehicles for your nonprofit) is 14 cents per mile, unchanged from 2009. For medical use and moving purposes, the rates dropped more dramatically from 24 cents per mile in 2009 to 16.5 cents per mile in 2010. According to the IRS, the 2010 rates reflect generally lower transportation costs compared to 2009.

TEST YOUR NONPROFIT KNOWLEDGE

What was the first year a Form 990 was required to be filed?

- (a) 1932
- (b) 1942
- (c) 1952
- (d) 1962

The answer will be provided in the next issue of *Nonprofit Agendas*. If you would like to receive a copy of the first Form 990, please send an email to contacts@markspaneth.com.

SPOTLIGHT ON MP&S

International Accounting Training

Working with the new organization Acumen Global Training LLC, MP&S specialists provide US and international accounting training. Instruction is offered on a wide variety of topics including International Financial Reporting Standards (IFRS) and International Public Sector Accounting

Standards (IPSAS) as well as fraud and forensic accounting. Courses are customized to meet the specific needs of each business.

Business Solutions for Privately Held Companies and Their High-Net-Worth Owners

Marks Paneth & Shron has assembled a team of specialists to advise high-net-worth owners of privately held companies. Our professionals are fully conversant in the unique needs of companies in this space and can help identify problems, particularly in the current economic climate, and assist in making the appropriate business decisions when principals face turnaround scenarios.

Thought Leadership

IFRS Roundtable

The globalization of financial markets has intensified the need for a unified set of accounting principles. As the US braces for the roll-out of International Financial Reporting Standards (IFRS), companies face the benefits and challenges of implementing a single standard. Along with panelists from around the US and abroad, Steven Henning, Partner-in-Charge, Litigation and Corporate Financial Advisory Services, discusses the key arguments that support a global convergence of accounting principles.

Audit Might Be Best Choice for US Taxpayers in Voluntary Disclosure Program

In a recent *Tax Analysts* article, David Gannaway, Director, Litigation and Corporate Financial Advisory Services, discusses why US taxpayers who enrolled in the IRS voluntary disclosure program may find it in their best interests to challenge the IRS penalty through an audit.

People in the News

Nonprofit and Government Services Director Receives AICPA 2010 Outstanding Discussion Leader Award

Managing Tax Director Rob Lyons has received the American Institute of Certified Public Accountants (AICPA) 2010 Outstanding Discussion Leader Award. This award recognizes the discussion leaders who achieve the highest overall instructor knowledge and presentation scores in leading AICPA seminars. Recipients are eligible for the award after teaching four different courses at least two or more times during the CPE year (May-April). Minimum overall instructor knowledge/presentation skills scores are 4.80 on a 5.0 scale.

Leading Tax Specialist Joins the Firm

Jeanne Goulet has joined Marks Paneth & Shron as a Senior Consultant in the Tax Practice. With more than 25 years of experience in both industry and public accounting, she possesses a deep understanding of the tax issues related to e-commerce and the internet. She is also very knowledgeable about international tax matters including worldwide tax planning and transfer pricing and served as an advisor to the Organisation for Economic Co-operation and Development.

MP&S FAST FACTS

- One of the 10 fastest-growing accounting firms in the United States (*INSIDE Public Accounting*)
- The 32nd largest accounting firm in the nation and a leader in accounting and auditing (*Accounting Today*)
- The 13th largest accounting firm in the New York Area (*Crain's New York Business*)

FOR FURTHER INFORMATION

If you have any questions, please contact **Michael L. McNee, Partner-in-Charge**, Nonprofit and Government Services Group and the Westchester Office, at 212.503.8954 or mmcnee@markspaneth.com. You may also contact one of the following members of the group:

Partners**Hope Goldstein**

hgoldstein@markspaneth.com

Joseph J. Kanjamala

jkanjamala@markspaneth.com

Steven P. Monteferante

smonteferante@markspaneth.com

Warren Ruppel

wruppel@markspaneth.com

Directors**Howard Becker**

hbecker@markspaneth.com

Robert Lyons

rlyons@markspaneth.com

In addition, more information on the MP&S Nonprofit and Government Services Group can be found at www.markspaneth.com.

IRS CIRCULAR 230 DISCLOSURE

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