

AICPA's New Audit Standard Addresses Fraud Risks

If your next annual audit seems more rigorous than in the past, it's not just your imagination. The American Institute of Certified Public Accountants (AICPA) has issued a new audit standard known as SAS No. 99, *Consideration of Fraud in a Financial Statement Audit*.

The new standard requires auditors to interact more with management, employees and boards of directors in performing audits and expands the level of inquiry. SAS No. 99 is effective for audits of financial statements for fiscal years beginning on or

after Dec. 15, 2002. (See the sidebar "*SAS No. 99: What It Requires*" on page 2) Depending on when a not-for-profit's fiscal year ends, some may already have been exposed to the new standard.

The heightened focus on fraud detection makes it essential that each party involved in the audit do its part to enable the free exchange of ideas and information. The following guidelines provide some insight about what to expect at audit time and how you can work more effectively with your external auditor.

Questions for management

SAS No. 99 requires auditors to approach audits with professional skepticism. It directs them to ask management more in-depth questions about fraud risks than in the past. Topics that management should be prepared to discuss include:

- Fraud risks,
- Known or suspected fraud or fraud allegations,
- Programs or controls used to minimize risks and deter and detect fraud,
- How fraud risks are monitored at various locations and whether certain locations or operations may be more susceptible to fraud, and
- How management communicates ethical business practices and behaviors to employees.

Employee interviews

Auditors also are required to interview others, such as non-management and non-financial employees who may not have been involved in, or are even aware of, past audits. These include employees with varying levels of authority, program staff, those involved in complex transactions, and in-house legal counsel.

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These interviews are intended to provide auditors with a broader understanding of an organization's risk profile. They're also designed to capitalize on the fact that employee tips are one of the most effective means of uncovering fraud.

Audit committee role

Audit committees can play a critical role in the audit. They can provide objective direction to auditors and help them identify areas of greatest interest or concern. If a not-for-profit doesn't have an audit committee, the tasks associated with that committee usually are performed by the finance committee, executive committee, or the entire board.

An audit committee should meet with an organization's auditors at least

twice a year — before and after the audit. These meetings are important from both a control and an educational standpoint. As outside advisors, external auditors play a key role in educating committee members about the risks facing their organizations.

Many audit committees will need to meet more frequently. What's important is not how often the committee meets but that the sessions are comprehensive enough to satisfy the fiduciary demands placed on the board.

Coordinated efforts

SAS No. 99 emphasizes the need for a coordinated effort between auditors and the not-for-profits they serve. Management, employees and audit committees all are vital components in ensuring the integrity of a not-for-profit's financial statements and minimizing the risks of fraud. For help understanding SAS No. 99, please call us. ■

SAS No. 99: What It Requires

Not-for-profits should be aware of a new audit standard aimed at fighting corporate fraud. Issued by the American Institute of Certified Public Accountants (AICPA), the strengthened standards will require more intensive and time-consuming audits, and fees are expected to rise as a result.

The standard, known as Statement on Auditing Standards (SAS) No. 99, requires auditors to:

- Approach audits with greater skepticism and not assume honesty on the part of management. Audit teams are even required to brainstorm about how and where fraud might occur in an organization.
- Discuss fraud risks with management, the audit committee, and non-management employees.
- Design tests for fraud aimed at areas, locations, and accounts that the client wouldn't expect to be scrutinized and that aren't predetermined with company management.
- Use procedures to test for management override of controls that could lead to financial statement fraud. ■

10 Tips for Better Board Meetings

Not-for-profit board members face many demands—both as volunteers and as individuals with careers and personal lives to manage. That's why not-for-profits must use their board's meeting time as effectively as possible. The following pointers can help your board make the most of its time together:

1. Be selective about agenda items. Use e-mail or handouts to share items that may be worthy of the board's attention, but not the agenda.

2. Distribute the agenda well before meetings. Put the most important items first, and distinguish between those that require action and those that are simply informational. Handing them out a week ahead of time is ideal.

3. Allocate time to each item. This helps move meetings along. Allow some flexibility by building in extra time for unplanned discussions.

4. Designate an assertive chairperson or facilitator. A meeting is only as good as its leader; having one person who steps in when the proceedings bog down is critical.

5. Involve everyone. Encourage quieter members to present their views; conversely, more extroverted members should be careful not to dominate the meeting.

6. Follow rules of order. Publish ground rules with the agenda or in the board manual, along with reminders about common courtesies, such as the need to arrive prepared and on time.

7. Use consent agendas to consolidate routine items and resolutions. This allows the board to vote on items at once without discussion or additional explanation.

8. Keep it interesting. A well-timed presentation by an outside speaker can break up the monotony of committee reports and agenda items.

9. Evaluate meeting effectiveness. Survey board members occasionally for feedback and suggestions to improve meetings.

10. Wrap it up. Show board members courtesy by ending meetings on schedule. Postpone matters on which you can't reach conclusions. ■

Unemployment Insurance

Look at the Way You Pay for Potential Cost Savings

“Cost cutting.” “Streamlining expenses.” These are buzzwords you hear on a daily basis. Prudent fiscal managers of many not-for-profit organizations look for every possible way to reduce expenses, while strategizing to increase revenues and improve program services. One of the many ways to reduce expenses is to seek potential cost savings by the way you pay for unemployment insurance.

Options Available to New York State Not-For-Profit Organizations

One option available is to pay unemployment insurance tax on the first \$8,500 of remuneration paid to each employee in a calendar year. However, rather than paying the quarterly unemployment insurance tax on their payrolls, not-for-profits organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes (those exempt under section 501(c)(3) of the Internal Revenue Code), and governmental entities have the option of reimbursing the state for the actual unemployment benefits paid to their former employees. In other words, not-for-profits can be “self-insured” and incur the actual unemployment expense directly.

A request to elect the benefit reimbursement option must be submitted in writing to the Department of Labor before the beginning of the calendar year in which it is to apply or within 30 days after the calendar quarter in which the not-for-profit organization or governmental entity became liable under the NYS Unemployment Insurance Law. The request must be sent to the Department of Labor, Liability and Determination Section.



Following the end of each calendar quarter, a not-for-profit organization or governmental entity that has elected this benefit reimbursement option is billed for the total benefits charged. They also are required to complete Form NYS-45, *Quarterly Combined Withholding, Wage Reporting and Unemployment Insurance Return*, to include the number of employees; the total remuneration (Part A line 1); Parts B and C; and signature.

Employers electing the benefit reimbursement option are not required to contribute to the Re-Employment Service Fund, which normally is a 0.075% re-employment tax on payroll in addition to the regular unemployment insurance taxes.

Have You Done Your Homework?

Prior to electing the benefit reimbursement option, not-for-profit organizations should perform certain analyses in evaluating whether or not there would be a cost savings from electing this option.

Review your historical trend (three to five years). A comparison between NYS Unemployment Insurance taxes paid and actual unemployment benefits claimed by the former employees. Does it make sense to be self-insured? Did the unemployment benefits claimed by former employees exceed the unemployment insurance taxes paid in those years?

Take a look at your future plans. Project your organization’s trend relating to the future stability of your workforce. Are you expecting minimum layoffs in the next few years? On the other hand, is your organization planning for significant downsizing, which might result in

higher future unemployment claims? It is important to consider future changes in your workforce because the year that you opt out of the NYS Unemployment Insurance program, you are required to remain with the benefit reimbursement option until the end of that same year.

In addition, consider administrative costs. Are the cost savings from electing the benefit reimbursement option more than the administrative costs incurred internally or paid to a service organization?

There are various options relating to the administration of the benefit reimbursement option, such as:

- Administering the plan internally, though if your organization chooses this option, someone in the organization will have to be trained in how to administer the program.
- Engaging an insurance claims processing company to manage and process the unemployment benefit claims.
- Participating in a "Group Self-Insurance Plan." The Group Self-Insurance Plan works as a trust where the participating member not-for-profit organizations make monthly or quarterly contributions to their individual accounts within the trust. The contributions generally are less than what you would pay the state.

The contributions are deposited into your individual accounts within the trust and direct payments of unemployment benefit claims are drawn against the accounts.

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On the Verge of a Merge?

What You Need to Consider Before Proceeding

When for-profit corporations announce a merger, the people at the top usually are heady with excitement and anticipation. They envision new markets, more product lines, and healthier balance sheets.

In the not-for-profit sector, mergers are not always viewed so charitably. They even may be seen as an unfortunate, but inevitable, turn of events. This isn't always the case, of course. Many not-for-profits find that mergers allow them to further their mission and improve their service.

Knowing the benefits

Regardless of how your organization may feel about the subject, not-for-profit organizations that merge frequently cite these benefits:

- Increased effect and reach,
- Fewer service area redundancies,
- Less competition for funding,
- Greater efficiencies,
- Stronger organizations, and
- Continued ability to fulfill one's mission, albeit in a different form.

But beware of potential downsides. Most notably: the possibility that the mission will become diluted and service will suffer, or that the culture and passion that defined your organization will be lost.

Evaluating the issues

Still, as the severe funding crisis drags on, more not-for-profits are exploring the possibility of merging their operations in some way. If your organization is among them, here are some issues to contemplate before and during the exploration process:

Identify and rank the reasons a merger might be advisable. This exercise is best done before identifying a possible partner. Then, develop a "wish list" of the characteristics you would want in a merger partner — as well as a list of those that would be

deal breakers. Use these lists to guide the exploration and negotiation process.

Examine the synergistic value of merging. Would each not-for-profit bring funding sources that would strengthen the unified organization? Do your causes or constituencies overlap? Are your operating and administrative practices compatible? Could you significantly reduce operating costs? Attempt to quantify the benefits and likely outcomes of merging.

Establish ground rules for the exploratory process.

You'll want to proceed carefully in the initial discussion stage. Neither organization should be forced to commit at this point — in fact, ground rules should allow for a period during which either entity can back out without fault. Also important to decide is how much information about the negotiation — if any — the two entities will share, who will be responsible for releasing it and how it will be disseminated.

Follow a work plan led by a strategy team or an objective facilitator. Merger discussions ideally are structured with equal representation from both organizations so that neither is at a disadvantage. The team or facilitator leading the process should develop a work plan that outlines key tasks, dates, and roles and responsibilities. The goal of this process is to identify potentially contentious issues early on so they can be worked through or the talks can be scuttled if necessary.

Examine the mission and core values of both entities to gauge compatibility. You might even try integrating these key areas in the preliminary discussion stage. Some missions and core values will dovetail

perfectly; others may seem dissonant. In the latter case, the courtship probably should come to an end.

Tally the human toll. Many mergers fall apart when not-for-profits start trying to mesh their organizational charts, so address this issue in the early stages. Develop a new organizational chart listing every position and person that would likely continue with the new entity. This is an excellent test of the merger's viability for both participants.

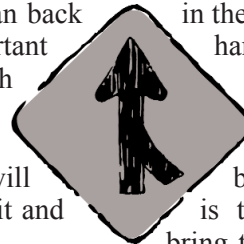
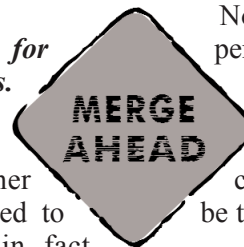
Not-for-profits also should perform this exercise for their constituencies and causes. If either entity would have to abandon or severely limit certain pet programs, it might be time to apply the brakes.

Merge cultures equally. Especially in the not-for-profit world, a heavy-handed approach in which one organization simply consumes the other probably won't succeed. To preserve the best of both — which, after all, is the reason for the union — bring the entities together to engage in strategic planning exercises.

These planning exercises allow them to forge a new identity and common vision. This won't occur overnight; cultures evolve over time, but you'll give both organizations a chance to unite and start anew.

Putting it all together

Although many not-for-profits have been severely hobbled in recent years, most observers agree that survival alone is not the best reason for a merger. Like an arranged marriage, the entities involved in forced unions may feel resentful and never fully engage in the partnership. On the other hand, if both parties see value in coming together, the new entity should emerge as better than its individual parts. ■



How Conflict-Free is Your Board of Directors?

Like public companies, board members of not-for-profit organizations have legal and ethical obligations to their organizations and the public that supports them. So guarding against conflicts of interest is essential. The legal system has even held that boards can be liable for these conflicts if they represent a breach of fiduciary responsibility.

Conflicts of interest can arise when a board member's personal or professional relationships or concerns potentially affect his or her ability to put the organization's interests first. And conflicts don't have to be real to be problematic—even the appearance of a conflict can be damaging.

Avoid real or perceived conflicts. To help boards avoid allegations of conflict of interest, actual or perceived, consider taking these steps:

Develop a written policy that outlines conflict-of-interest situations. These policies, which should be presented and signed annually, generally require that board members offer full disclosure about their personal or professional connections with groups or individuals seeking to do business with the not-for-profit. They also should disclose other relationships or situations that might influence their ability to govern. In addition, these policies usually require board members to abstain from debating and voting on matters in which a potential conflict may arise.

The most effective policies are tailored to a specific organization. Boards also can sharpen their awareness of conflicts by discussing hypothetical situations, listening to periodic presentations on the subject or reading material about ethical issues.

Maintain an objective relationship with the executive director. The board must avoid becoming a “rubber stamp” for the executive director. After all, a key role

of the board is to oversee and moderate the director's power and review his or her performance. Board members would be wise, therefore, to avoid overly close relationships with the director that might hinder their ability to objectively appraise performance.

If something untoward occurs with a not-for-profit, a board of directors with a web of personal ties to the director could face particularly harsh criticism. For this reason, the governance committee or board chairman should lead the board member selection process, rather than allowing the director to handpick new members.

Ensure the independence/qualifications of audit/finance committee members. Although independence in leadership and judgment is an important attribute for all board members, the accounting scandals of recent years have underscored the need for this quality in audit committee members.

Ensuring that your audit committees are free from accusations of conflicts of interest has become increasingly important. For example, an audit committee member who is a paid consultant or an employee of your organization wouldn't be considered independent. In addition, audit committee members need a reasonable level of financial expertise to competently review financial statements and assess auditor performance.



Proceed carefully when overseeing sensitive areas. Especially when dealing with highly charged issues, such as hiring fund-raisers or authorizing telemarketing campaigns, boards must be careful to follow the highest standards of conduct to protect themselves against potential charges of not upholding their fiduciary duties.

For instance, in hiring fund-raisers, a reasonable safeguard is to obtain more than one bid before signing a contract. Boards also need to exercise control over

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Unemployment Insurance

On an annual basis, your accounts will be credited with return on investments as the service organization invests the assets from the trust. When a claim is filed, the service organization reports the claim and other necessary information to the state on your behalf. The service organization should evaluate all claims and protest all inaccuracies and improper claim determinations.

Other Cost Savings Tips

Organizations also can control rising unemployment costs by observing sound hiring and disciplinary practices, and by documenting all warnings, reprimands, and separations. Unemployment benefits are not available to former employees who are discharged for misconduct or who voluntarily left the organization. Therefore, accurately documenting the particular circumstances of each employee separation is extremely important to prevent unnecessary unemployment claims.

For more information about these unemployment insurance cost savings opportunities, contact Senior Audit Manager Patrick Yu at 631-752-7400 x-219 or PatrickYu@hrcpa.com. ■

telemarketing campaigns to gain assurance that the organization is not misrepresenting itself to the public.

Take action today. Not-for-profits aren't required to adopt governance standards now mandated in the public sector. But many believe that the reasonable application of certain standards is also beneficial to the not-for-profit world—which lacks the layers of protection that exist in the for-profit world.

Whether or not not-for-profit board practices change significantly—and many small organizations face practical challenges in improving governance—what's important is that boards improve their ability to understand and recognize conflicts and address them head-on. ■

Streamlined registration system on the way

The process of registering your not-for-profit at the state level should become much easier, thanks to an online information system under development by GuideStar and the National Association of State Charities Officials (NASCO). Initial launch of the system, known as NASCONet, is expected to occur sometime in 2004.

GuideStar recently was awarded a federal grant to help fund the creation of the information repository that will enable the easy exchange of data among nonprofits, regulators, donors and fund raisers. NASCONet aims to significantly streamline the registration and reporting process for nonprofits. The current oversight system is costly and repetitive for entities that must comply with registration laws in multiple states.

Look for more information about the network from GuideStar or from the website of your state attorney general. You can also send questions or comments to nasconet@guidestar.org.

IRS releases publications on tax-exempt status

The IRS has released several new brochures aimed at helping charities better understand the laws conferring tax-exempt status:

Publication 4220, *Applying for 501(c)(3) Tax-Exempt Status*, and Publication 4221, *Compliance Guide for 501(c)(3) Tax-Exempt Organizations*, are concise, easy-to-use brochures that contain the information most organizations need to receive and maintain their exempt status.

Other newly released publications include Publication 1828 (English and Spanish versions), a quick reference guide for churches and religious organizations. It explains their benefits and responsibilities under the federal tax system and discusses tax-exempt status, unrelated business income tax, employment tax, special rules for compensating ministers, and record keeping and filing requirements.

Publication 3608 discusses the IRS' Tax Exempt and Government Entities (TE/GE) Division and its business units: Employee Plans (EP), Exempt Organizations and Government Entities. Publication 3636 focuses on the EP unit, which helps retirement plan sponsors, participants and benefits practitioners understand and comply with pension laws.

Publication 3835 is a guide to the office of Customer Account Services, the unit that helps TE/GE customers prepare returns, fill out determination applications and obtain exempt status verification. It provides a list of common tax topics and forms.

You can download all of these publications from the IRS Web site (www.irs.gov) or order a free copy by calling 1-800-TAX-FORM.

Cyberspace can boost your auctions

If your organization has ever hosted an auction fund-raiser, you know these events can be time intensive and costly to plan and host. If you're interested in getting more reach for your efforts, you may want to explore cMarket (www.cmarket.com) to learn more about extending your event beyond the physical auction.

The service, which has been likened to eBay for nonprofits, allows organizations to put their full auction catalog online and send e-mail communications to their entire database. According to cMarket, which charges an average of 8% of gross proceeds for its service, customers have been able to lower their costs and raise more money by conducting auctions at least partially online.

Contact Us

For more information on any issues within these articles, please contact the Partners in our Not-For-Profit department:

Beatrix G. McKane

(631) 752-7400 x-350
BMcKane@hrcpa.com

Gordon M. Siess

(631) 752-7400 x-315
GSiess@hrcpa.com

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NFPAdviser@hrcpa.com.