

Who's Watching the Watchers' Backs? Protecting Not-For-Profit Whistleblowers

For the most part, the Sarbanes-Oxley Act of 2002 affects only publicly traded companies. But not-for-profits need to take note of a key provision that applies to all corporate entities, including them.

Section 301 of the law requires organizations to establish a confidential mechanism for employees to report suspected financial misconduct. It also imposes criminal penalties for any form of retaliation against whistleblowers and requires organizations to implement policies to protect them.

The whistleblower provision is important to not-for-profits because they have an obligation to the public and other stakeholders to uphold the highest governance standards. And in a time of increasing scrutiny, not-for-profits need to raise awareness within their organizations about the potential for fraud and provide a mechanism that employees can use to confidentially report suspected wrongdoing.

Comply in spirit

To meet their responsibilities in this area and comply with the spirit of Sarbanes-Oxley, not-for-profit executives

and their boards would be wise to take the following steps:

Develop a formal process to deal with complaints. Boards can start by consulting with the chief executive and other staff members about any existing procedures for handling anonymous complaints. The board can then evaluate whether the established process is sufficient for handling issues related to possible fraud.

Design a process appropriate to the organization. The whistleblower provision doesn't specify how complaints should be received,

only that the method used should allow for the "confidential, anonymous submission" of complaints.

Some options for complaint reporting include: toll-free employee hotlines, Internet-based reporting offered by external providers or use of a designated outside contact, such as someone with an outside accounting or law firm. Internal phone numbers that receive voice-recorded complaints from employees are another option. What's important is that employees feel comfortable using whichever method you select.

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Fraud – How Well-Protected is Your Organization?

Fraud. Irregularities. Theft. In the post-Enron era, the headlines seem to contain these words every day. And the not-for-profit world certainly has not been immune. Most recently, major embezzlement at a Long Island school district came to light. While no internal control system is foolproof, especially where collusion occurs, there are some “best practices” your organization should employ to protect against loss and negative publicity from fraud.

How does the purchasing process function in your organization? If one individual can initiate a request, place an order, receive the goods or services, and authorize payment – or even perform several of these functions – your organization is ripe for fraud.

Requests for goods or services should be made by the operating department, with approval of the department head, and documented on a requisition form. A separate purchasing function should exist to negotiate prices and place orders with vendors, using written purchase orders. Purchases should only be made from vendors on an approved list and if the expense fits within the department’s budget. Merchandise should be received and counted by someone independent of both the requisition and the purchase order. Receipt of services also should be documented. Invoices should be received and logged centrally, and then sent to the requesting department head for approval. However, payment only should be made when the accounting department can verify that goods or services were authorized, received, and initialed for payment to an approved vendor.

Using an approved vendor list is an often overlooked control. A formal process should exist to add a vendor to the list, including documentation of the type and amount of business to be authorized, verification that the proposed vendor really exists, credit and reference checks, and approval by several members of executive management. From a

fraud perspective, maintaining and actually checking the approved vendor list before payment will help prevent disbursements to fictitious companies.

Monitoring expenses against budget also is key. Careful measuring against budget and performing budget-to-actual analysis could detect a fraudulent expenditure. Of course, the original budget needs close scrutiny before approval. If your budgeting process is to simply increase last year’s actual by, say, 5%, then this year’s budget could simply increase last year’s fraudulent expenditures by 5% also. However, if the budget process includes careful scrutiny of all proposed expenses, it would enhance the organization’s ability to prevent and detect fraud.

What controls exist over your cash disbursements? There should be clear dollar limits for each authorized check signer. Dual signatures should be required for expenditures above a set amount. For large disbursements, a board member’s signature should be required. Note that a signature stamp, rather than a manual signature, negates the purpose of obtaining the signature. Once the checks are signed, someone independent of the entire cash disbursement function should mail them, or the risk of alterations may occur.

Who receives and reviews your bank statements? Depending on the size of the organization, the bank statement should be opened by the top executive and reviewed for unusual items. Someone independent of the cash disbursement function should perform a very detailed review of cancelled checks, focusing on alterations, unauthorized signatures, unusual vendors, and irregular endorsements.

What about hiring and payroll? Hiring practices should include background checks for all employees, including volunteers, especially those who will have access to cash or other assets. Since payroll is the largest expenditure for most not-for-profits, segregation of duties in the payroll function is key. The person processing payroll should not have ability

Input Wanted!

Enclosed with this newsletter is a letter asking for your impressions of the *HR Not-for-Profit Adviser*.

Your comments will shape the future content of this newsletter, so it is imperative that you get back to us.

Also, if you prefer e-mail, rather than snail mail – tell us that, too!

Let us know what you think, at NFPAdviser@hrcpa.com.

to add employees to or change pay rates in the payroll system. For hourly workers, use technology (such as time clocks) to track hours worked. Sophisticated time-keeping systems (such as those using hand scanners) also are available. Even with technology, department supervisors should approve hours charged before payroll is processed. Paychecks should be distributed by someone independent of payroll processing and employees should be required to sign for their checks.

Who approves the expenses of your executives? This topic is a touchy one at any organization, but after the scandal at a local school district, it requires some additional focus. A subordinate should not approve the expenses of the executive director or equivalent. Instead, a board member, such as the treasurer, must carefully review these expenses and understand the business purpose of each before approval is given. If corporate credit cards are used, these expenditures also must be reviewed and understood by a board member.

Clearly, the key to prevention and quick detection of irregularities is segregation of duties. While many not-for-profits have limited staff and cannot employ all these “best practices,” most organizations can, with some creativity and shifting of responsibilities, at least improve their level of protection against fraud. ■

What Your Not-For-Profit Needs to Know about Lobbying and Advocacy

Misconceptions abound about what not-for-profits can do in the way of lobbying and advocacy. One of the biggest fallacies is that not-for-profits aren't allowed to engage in lobbying.

Within guidelines, lobbying and advocacy activities are permissible by charitable not-for-profits that are tax-exempt under Section 501(c)(3) of the Internal Revenue Code (except private foundations, in most cases).

Know what “lobbying” means

According to Charity Lobbying in the Public Interest, “Lobbying is a form of advocacy that focuses on changing laws that affect individuals’ lives and issues communities care about.”

Many in the not-for-profit sector contend that charities have an obligation to participate in policy making as a means of furthering their mission and educating and influencing lawmakers to formulate supportive policies. But exactly how much lobbying can a so-called “public charity” conduct? According to IRS guidelines, two sets of rules govern activity: the substantial part test and the expenditure test.

Substantial part test. Under the first rule, lobbying can't be “a substantial part” of a not-for-profit's activities. Few definitions exist under this standard about what constitutes lobbying, and there is no clearly specified limitation as to what organizations can spend.

For these reasons, even the IRS acknowledges that organizations wanting more definite rules may want to follow the expenditure test, also known as the 501(h) election or the 1976 lobby law.

The 501(h) election is widely considered the preferred option because it offers clear guidance on lobbying and expenditure limits. Not-for-profits must affirmatively “elect” to be covered under this rule, which provides a sliding scale for lobbying expenditures of up to \$1 million on direct lobbying and up to \$250,000 on grass-roots lobbying.

Direct lobbying refers to an organization's attempts to influence specific legislation by

stating its position or urging a legislator to take specific action. Grass-roots lobbying occurs when an organization urges the public to take action on specific legislation.

Expenditure test. To elect the expenditure test rule, not-for-profits must file Form 5768 with the IRS and report lobbying expenditures annually on Form 990, Schedule A. Those that don't make this election fall under the substantial part test by default.

Some charities have been reluctant to make the election, fearing that it would cause them to lose their 501(c)(3) status or prompt an IRS audit. In fact, the IRS has publicly stated that it encourages charities to make the election and that experience has shown that those that do so are “usually in compliance with the restrictions on lobbying activities.”

Charities that want to extensively engage in lobbying and advocacy activities should

consult with legal counsel about how they should proceed. They also will want to gain an understanding of the nuances of what qualifies as lobbying and what doesn't and which activities can take place without limit. Also, charities should be aware of any state filings and state registration requirements that apply if the charity engages in lobbying.

In general, encouraging action on specific legislation constitutes lobbying, whereas general advocacy or any legislation favorable to, for example, individuals with disabilities wouldn't be lobbying.

Proceed with caution

Although not-for-profits face some restrictions relating to lobbying and its costs, the law offers considerable latitude to influence public policy. To not take advantage of this right is to stand on the sidelines while others determine your fate. ■



Playing by the Rules in an Election Year

Organizations with 501(c)(3) status can't support or oppose political candidates or parties, but that's not to say they can't participate in the political process. As long as they adhere to IRS guidelines, they can engage in activities such as distribution of candidate questionnaires, voter registration drives, and candidate forums and debates – but only in a strictly nonpartisan manner.

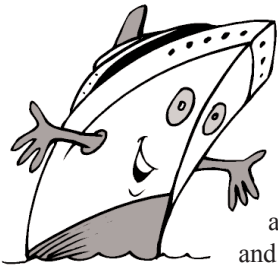
It's critical that not-for-profits understand what's acceptable and what's not when it comes to political activity, because their exempt status could be revoked for even a single violation. You'll want to consult with legal counsel to ensure your activities are properly structured, but here's a brief checklist of some acceptable and unacceptable practices:

Acceptable:

- Inviting political candidates to an event, as long as all candidates are included on equal terms.
- Educating candidates about the not-for-profit's mission and urging them to take supportive positions.
- Continuing normal lobbying activities.

Unacceptable:

- Donating cash or in-kind contributions, such as use of office space, to candidates or campaigns.
- Endorsing or otherwise implying support for a candidate or party. (Staff members and volunteers can support candidates as long as they don't do so in the organization's name or with its resources.)
- Allowing candidates to campaign or raise funds on your premises.
- Using your organization's funds to pay for a candidate's fund-raising event. ■



Running a Tight Ship

Improved Program Management Can Make for Smooth Sailing

Not-for-profits face pressure from all directions to administer programs and services effectively.

Watchdog groups and funders expect not-for-profits to achieve certain benchmarks. And organizations have their own performance demands. In today's environment, after all, they must either operate efficiently or risk extinction.

To control costs and improve delivery of programs and services, not-for-profits need to focus their time, money, and human resources on what's truly important: achieving their mission. Here are a few ideas to help you better assess and improve your effectiveness in this area.

Calculate key ratios

Charities must keep track of program expenditures as opposed to administrative and fund-raising costs. The following are some key ratios that not-for-profits will need to calculate and monitor if they're to evaluate and improve program efficiency:

Percentage spent on program activities. This number offers insight into how much of your total budget is used to provide direct service. To calculate this measure, divide your total program service expenses by total expenses.

Many watchdog groups, such as the BBB Wise Giving Alliance (www.give.org), are satisfied with 65%. But organizations must spend at least 75% of their total expenses on programs each year to be part of the United Way's Combined Federal Campaign.

Percentage spent on fund raising. Another important measure is the amount an organization spends on fund raising. To calculate this measure, divide total fund-raising expenses by contributions (donations, legacies and other gifts). The standard benchmark is 35%, although many organizations aim to do better than that.

Current ratio. This number is an indicator of an organization's ability to pay its

bills. It's worth monitoring closely, as it provides a snapshot of financial conditions at any given time. To calculate, divide current assets by current liabilities. Generally, this ratio should not be less than 1:1.

Reserve ratio. This is an indicator of an organization's ability to sustain programs and services during temporary fluctuations in support, revenue and expenses by having sufficient expendable net assets and related cash and cash equivalents or short-term investments. Some advisors suggest targets of 30 to 90 days or more. The target should be based on the nature of a not-for-profit's operations, its program commitments and the predictability of its funding sources.

To calculate, divide expendable net assets (unrestricted and temporarily restricted net assets less net investment in property and equipment and less any nonexpendable components such as charitable remainder trust interests) by one day's expenses (total annual expenses divided by 365).

Measure and monitor outcomes

Unlike output measures, which quantify the number of products or services delivered, outcome measures focus on true results that relate directly to an organization's mission. Examples of outcome measures might include changes experienced by program participants, such as increased knowledge, improved skills, or the number of clients who successfully kicked a drug addiction.

But what, exactly, should you measure? Start by examining your mission statement and considering the goals you have for your programs and services.

For instance, if your mission is to help low-income families obtain decent housing, how does your organization aim to accomplish that? Maybe it does so by providing educational programs on home ownership or helping clients obtain mortgages. Therefore, your measures might be the number of people who attended programs, applied for mortgages, and received them.

Set benchmarks for each measure. Track your results over time and study

your outcomes to determine why some are increasing while others are decreasing.

It's a good idea to incorporate a mix of quantitative and qualitative measures, since the latter will provide more insight into how satisfied your clients are with your services.

Seek out expert advice

As you know, we can act as your outside advisers to help improve your program delivery. Another option is through social entrepreneurship programs – form an alliance with a business that would offer you executive services on a short-term basis.

These “loaned” professionals can bring innovative business ideas, sought-after skills and a fresh perspective to not-for-profits. In many cases, they've helped organizations streamline processes and systems. The result: less time and money spent on inefficient or redundant practices and more on delivering services.

Other ways to acquire this type of expertise are to look for retired executives who may want to contribute their time and talents, or try to bring in professionals on an advisory or project basis.

Although an executive may not have time to serve on your board, you may be able to get him or her to serve on an ad hoc board for a special project or initiative. Not only is this another way of tapping into outside expertise, but it also helps not-for-profits forge bonds with individuals who can make valuable contributions.

Achieve your goals

All not-for-profits must pay careful attention to how efficiently they're delivering their programs and the results they're achieving. Undoubtedly, each one feels pressure to achieve certain standards.

But hitting the most competitive benchmarks isn't the only sign of success. Those organizations with the broadest bases of support or the constituencies with the greatest need may still be delivering the goods, if not always the numbers. ■

Solidify Expectations with Board Member Contracts

The attention to governance issues in the for-profit world has underscored the need for all organizations with responsibilities to the public to have active, accountable boards. Not-for-profits, in particular, need boards that provide real leadership and oversight, especially during difficult times.

That's why many not-for-profits have adopted board member agreements or contracts that they ask new board members to sign at the start of their tenures and perhaps renew annually. The contract itself can be an abbreviated document that summarizes key expectations associated with board service, both on the part of the board member and the organization.

Along with the contract, not-for-profits may want to include supporting documents that outline board member responsibilities or job descriptions in greater detail.

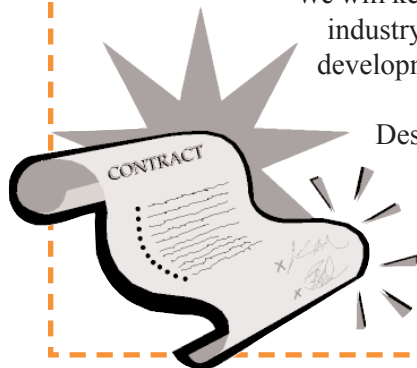
Contracts are intended to be flexible; therefore, organizations will want to tailor them to suit their needs. According to CompassPoint, a not-for-profit training organization, the following are examples of statements that might be included in a **board member** contract:

- I will attend at least 75% of board meetings, committee meetings and special events.
- I will make a personal financial contribution each year.
- I will act in the best interests of the organization. I will disclose any conflicts of interest and excuse myself from discussions and votes where I have a conflict.

A list of the responsibilities of the **organization** might include:

- We will provide quarterly financial reports and updates on organizational activities that allow board members to meet the "prudent person" standards of the law.
- We will offer board members opportunities to discuss with the executive director, the board president and others the organization's programs, goals, activities and status.
- We will keep board members informed about issues in our industry by offering opportunities for professional development as a board member.

Despite the name, board member contracts aren't legally binding. Nonetheless, they have the potential to increase accountability by offering a tangible reminder of the commitment board members and their organizations make to each other. ■



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Who's Watching the Watchers' Backs?

Inform employees of the complaint-reporting process. Not-for-profits will want to educate employees and volunteers about how to report possible wrongdoing and the importance of doing so. Although the complaint-reporting process should be designed to shield a whistleblower's identity, it may be necessary to assure employees that whistleblowers have legal protections.

Convey information about the complaint-reporting process as part of an overall program designed to educate employees about the organization's ethical standards and policies relating to fraud and misconduct. Put these policies in writing so that employees can refer to them as needed.

Establish procedures for handling complaints. Not-for-profits need to determine how they'll document, evaluate, investigate, circulate and act on complaints. To avoid the possibility of complaints being subverted by management, consider having them screened initially by an independent individual or group, such as the audit committee, audit chair or another independent board member; general counsel; an ethics or risk management officer; or a team composed of independent individuals.

Some complaints, because of their nature or seriousness, may need to be immediately forwarded to the board or outside advisors who can offer guidance. Be sure to clarify internal procedures for handling complaints. For instance, will a record of all complaints be sent to the board chair, or only ones that warrant a certain level of investigation?

Respond accordingly

It's essential that not-for-profit leaders take all complaints seriously and address problems as necessary or explain why corrective action isn't needed.

Actions in response to complaints might include: consulting with legal counsel; internal audits or risk assessments; engaging external or forensic auditors; establishing an investigative team with independent external advisors; implementing appropriate process changes; strengthening of internal controls; and additional training, fraud prevention efforts and terminations. ■

Not-for-profits project upturn in donations

Not-for-profits are optimistic that giving is on the upswing. According to an early 2004 survey of the sector, 69% of respondents said they expected charitable gifts to increase in 2004, while 15% anticipated donations to remain the same, and 16% expected a decrease this year.

The survey — conducted by *The NonProfit Times* and Kintera Inc., a software provider to not-for-profits — polled 30,000 not-for-profits. Its other major finding was that online fund raising is becoming a major boon to charities, both in terms of dollars raised and the number of organizations using the Web to raise money.

The projected upturn in donations was attributed to a strengthening economy and the increased availability and ease of online giving. Online fund raising was estimated at nearly \$2 billion in 2003, up more than 60% from the previous year. This estimate was described as “conservative,” since the sample group didn’t include some of the larger not-for-profits, which are major users of online donation technology.

Research explores executive director experience

Is it really lonely at the top? Executive directors who want to see how their peers’ experiences compare may want to download new research on the subject by CompassPoint at www.compasspoint.org/research. These studies include:

- *Daring to Lead*, which is a national study of 1,000-plus executives and their work experiences,
- *On the Rise*, which is a study of women executive directors of color, and
- *Securing the Safety Net*, which examines the career paths and tenure of community clinic executives.

Ethical conduct model established

Not-for-profits that want to establish an ethics code or revise an existing one may want to refer to the model recently developed by Independent Sector (IS), the nonprofit advocacy organization. The group makes its model available at www.IndependentSector.org.

“Donors, members of the public and lawmakers are all taking a closer look at how the sector does its work,” says Diana Aviv, the group’s president and CEO. “We want to be sure that what they see meets the highest possible standards of ethical practice. Toward that end, we strongly urge all not-for-profits and foundations to adopt a code of ethics to guide their governance and operations.

“The process of developing such a code by the board and staff helps to infuse into the culture of the organization a recognition of how important it is to address issues of values and ethics on an ongoing basis.”

The statement identifies a set of values to which organizations may subscribe, including commitment to the public good, accountability to the public and commitment beyond the law. It also outlines broad ethical principles in the areas of personal and professional integrity, mission, governance, legal compliance, responsible stewardship, openness and disclosure, program evaluation, inclusiveness and diversity, and fund raising.

One-stop federal grant information

A single, comprehensive website containing information about finding and applying for federal grant programs is now available. The site, www.grants.gov, contains information about more than 800 available grant programs involving all 26 federal agencies that award grant funds. It also offers a feature that simplifies the process of searching and applying for grants.

Not-For-Profit Services at Holtz Rubenstein

As pioneers in this rapidly-growing financial service area, our comprehensive approach to the Not-For-Profit sector is virtually unmatched. In addition to the traditional CPA services of accounting, auditing and taxation, we provide data processing, rate reimbursement consulting, management consulting, and strategic planning.

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