

# Profitable **Solutions** *for* **Nonprofits**

Summer 2011

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effective audit committee

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Newsbits



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# Checklist for an effective audit committee

**U**nless you're a small nonprofit with no outside audit, it's likely that your organization has an audit committee. No matter how long it's been up and running, the board of directors should monitor the committee's performance.

The audit committee's main responsibilities are to assist the board in its oversight of the organization's processes for financial reporting, internal controls and the audit and to see that the not-for-profit complies with applicable laws and regulations and a code of conduct. The following checklist will give you a broad reading on how your audit committee is doing — and any "no" answers will help to pinpoint areas for improvement.

## COMMITTEE MEMBERS

- ✓ Are committee members independent of outside interests and objective about their committee decisions?
- ✓ Do they address issues proactively and with integrity and strong interpersonal skills?
- ✓ Are all committee members financially literate? Is at least one member a financial expert — that is, has considerable experience analyzing, preparing or auditing financial statements?
- ✓ If the committee doesn't include a financial expert, has the board considered adding a CPA to the committee — someone not affiliated with the organization's auditing firm?

## COMMITTEE MEETINGS

- ✓ Does the committee meet three to six times a year?
- ✓ Does management forward to the committee all information that's relevant to the agenda (or that should be added to the agenda)?
- ✓ Does it do so in plenty of time for members to review the information before the meeting?
- ✓ Are meetings long enough for the committee to thoroughly discuss all items on the agenda?



## COMMUNICATION WITH MANAGEMENT

- ✓ Does the committee meet regularly with the CFO (and other financial team members as appropriate) to keep abreast of key issues?
- ✓ Does management keep the committee up-to-date on organizational changes, particularly turnover within the financial or management team or the external audit team?
- ✓ Does the committee know how to effectively question, when necessary, management choices related to the organization's finances and financial reporting?

## COMMUNICATION WITH THE FULL BOARD

- ✓ Has the board been clear to the committee in its expectations of the organization's key financial managers, including the CFO?

- ✓ Does the committee provide feedback to the full board concerning key financial management competency?
- ✓ Does the committee report its proceedings and recommendations to the full board after each committee meeting?

#### COMMUNICATION WITH OUTSIDE AUDITORS

- ✓ Does the committee regularly schedule meetings with the independent auditors and communicate with them before, during and after the engagement?

- ✓ Does the committee understand the coordination of work between the independent and internal auditors? Are committee members able to relay that information to both sides and to the board accurately?

#### AND MUCH MORE ...

There are many other components of a strong audit committee, including having effective processes in place to orient new committee members, investigate allegations and recommend the approval or modification of the annual audit to the board. Your CPA can review with your board best practices as well as state and national audit committee requirements. \*

## Does your board “get” your financials?

**F**or nonprofit executives and board members, accurate, relevant and timely financial information is key to making good decisions. But do all of your board members really understand the numbers they receive and what they mean to your organization? And do the numbers provide the right information — for example, when you’re trying to determine how and when to initiate a new program?

If your answers to these questions are “no” — or “I’m not sure” — you may want to reassess the usefulness of the financial information you provide.

#### DETAIL FINANCIAL HEALTH VIA CASH FLOW ANALYSIS

With so many nonprofits finding themselves in a cash crunch, you should add another report to your repertoire: a cash flow analysis. You can present your total cash for the period in a simple spreadsheet, as well as anticipated cash inflows and outflows for the coming month. This can help your board make important short-term decisions, such as applying for, or drawing down on, a line of credit.

#### CONSIDER YOUR AUDIENCE

Your board members probably come from different walks of life and different positions in the community. Some of them may have financial backgrounds, but many of them might not. And it’s this latter point you need to keep in mind as you supply financial data.

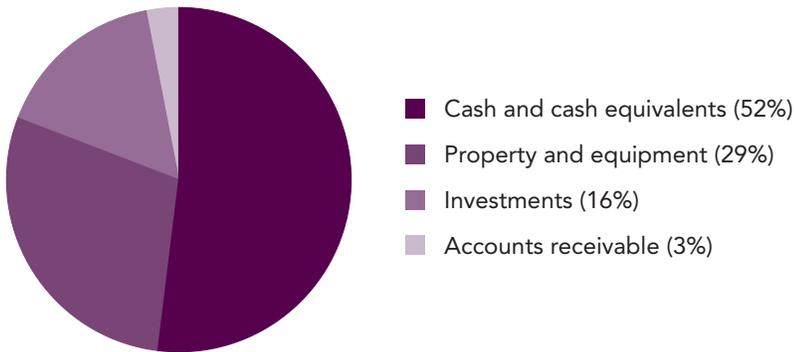
For example, don’t assume that everyone on your board of directors understands financial language. Provide them with some working definitions to help them along. Here are some commonly used financial terms and ways you can describe them in everyday language:

**Liquidity** — the nearness of an asset or liability to cash or cash conversion, or to a requirement to satisfy an obligation in cash.

**Board-designated net assets** — net assets set aside for a particular purpose or period by the board, such as safety reserves or a capital replacement fund, that have no external restriction by donors or by law.

**Net assets released from restrictions** — the transfer of funds from donor-restricted to unrestricted status based on satisfying donor-imposed stipulations with

### Breakdown of total assets



respect to the timing or purpose of the contribution (or, in rare cases, due to permission of a donor of permanently restricted funds).

Also consider providing your board with financial training. Bringing in outside speakers, such as accountants, investment advisors, and bankers, is a good start. Additionally, financially savvy individuals on your board — they may make up a separate finance committee — can be asked to share their financial expertise with the rest of the board.

### SERVE THE MESSAGE WITH A PIE CHART

One of the most common financial documents to circulate is the statement of financial position (the balance sheet). It shows an organization’s assets (cash, accounts receivable, and property and equipment), liabilities (accounts payable and long-term debt) and net assets (unrestricted, temporarily restricted and permanently restricted resources). Long lists of numbers can have a dizzying effect on readers.

But adding a pie chart can quickly show your board the composition of your nonprofit’s assets. See “Breakdown of total assets” above. At a glance, anyone can see that cash and cash equivalents are the largest part of this nonprofit’s total assets and a much smaller percentage is composed of investments and accounts receivable.

Or, you could create a two-slice pie chart that shows what portion of total assets can quickly be converted to cash (cash equivalents, investments and accounts receivable) vs. the portion that cannot (property and equipment).

A different example: You could create a pie chart to show how your annual event was funded last year: money from attendees, sponsors and general contributions. This tool can help a board make quicker and better-informed decisions — in this case, guiding them in setting or readjusting their funding expectations this year.

### USE BAR CHARTS TO SHOW CHANGE

The statement of activities (the income statement) is another commonly circulated financial document. It generally starts with total support and revenue, including

reclassifications from restricted to unrestricted. Then expenses, including program, management and general, and fundraising, are deducted to arrive at the overall change in net assets.

A bar chart is a good way to present this information: It can visually compare current revenues and expenses with those of previous periods. By updating the bar graphs on, say, a monthly basis, you can help nonfinancial board members easily compare revenues and expenses to the budget on a continuing basis.



Your annual budget assumes a particular level of support and revenue. If you don't obtain certain grants — or if you sell less in program services than anticipated — your board will need to revisit anticipated expenses and make adjustments accordingly. An informational graphic is one way to quickly relay a heads-up.

*Members of the community agree to become board members because they want to make a difference. And it's up to you to supply them with information they fully understand.*

#### TRACK EXPECTATIONS BY COMPARING RATIOS

Many entities have experienced cuts in funding and donations in the sluggish economy and, as a result, have reduced costs. If you supply board members with ratios for both the current year and prior year, they can see at a glance if these costs have been cut sufficiently.

Useful ratios include 1) management and general costs to total support and revenue, 2) program services to total support and revenue, 3) fundraising expenses

to total support and revenue, and 4) fundraising expenses to donations (including deferred gifts). These ratios allow your board to see if the nonprofit's costs and revenues are in line with its expectations, as expressed, for example, in the budget.

Let's say that your management and general costs are \$200,000 for the coming year and the total support and revenue for the organization is \$2 million. You'd have a highly impressive ratio of 1:10 — 10% of every dollar earned is spent on administrative costs, with the remaining 90% available to fund programs and supporting activities.

Another useful ratio is the "current ratio." This comparison of current assets to current liabilities is commonly used as a measure of short-term liquidity. For example, a ratio of 1:1 means an organization would have just enough cash to cover current liabilities if it ceased operations and converted current assets to cash.

#### GIVE THEM THE CHANCE

Members of the community agree to become board members because they want to make a difference. And it's up to you to supply them with information they fully understand so that the decisions they make are informed ones. \*

### Creating policies

## Don't reinvent the wheel

Since the revised IRS Form 990 debuted a few years ago, many nonprofits have been reviewing the policies on their books, improving them, and adding new policies to their collections. Form 990 doesn't state that these policies are required, but asking about them implies that they should be in place. Form 990 aside, the public — concerned by stories of nonprofit mismanagement — has put more emphasis on nonprofit governance, including policy adoption and enforcement.





board and board members, chief executive, finance and investments, fundraising, personnel, communications and committees.

**Independent Sector.** This nonpartisan coalition of approximately 600 national organizations, foundations and corporate philanthropy programs posts model policies at [independentsector.org](http://independentsector.org) under “The Principles for Good Governance and Ethical Practice Resource Center.” You can download them for free.

There’s good news about this policy-making uptick: Because so many organizations already have policies on the books, you can learn from their successes.

### TYPES OF POLICIES

What types of policies do nonprofits need? Form 990 asks nonprofits if they have policies on:

- \* Conflicts of interest,
- \* Whistleblower protection,
- \* Document retention and destruction,
- \* Chief executive compensation, and
- \* Activities of chapters, affiliates and branches.

Policies on gift acceptance, investment practices and joint ventures also have become more popular in recent years.

### LEARNING FROM PEERS

Here is a selected listing of organizations and websites that can help you in developing or improving your nonprofit’s policies:

**BoardSource.** At [boardsource.org](http://boardsource.org), you can purchase policy samplers on a variety of topics. An extensive policy sampler contains 241 policies on 48 topics under the categories of ethics and accountability,

**National Council of Nonprofits.** At [councilofnonprofits.org](http://councilofnonprofits.org), members have access to a variety of policy-related information, including a Form 990-related “governance practices” checklist and sample policies on conflict of interest, document retention and destruction, board review of compensation policy, joint venture and partnership, and other topics.

*There’s something to be said about not reinventing the wheel. Just be sure to carefully adjust policies from other sources to fit your operation.*

### CUSTOMIZE, CUSTOMIZE, CUSTOMIZE

Although you should customize your own policies — rather than go with a boilerplate — there’s something to be said about not reinventing the wheel. Just be sure to carefully adjust policies from other sources to fit your operation. Make sure, for example, that the processes are practical for your size and structure, and that the titles and positions listed for policy oversight are correct.

Your CPA can help you customize a policy or review the one you devise. Your lawyer also should review any policy before it’s adopted. \*

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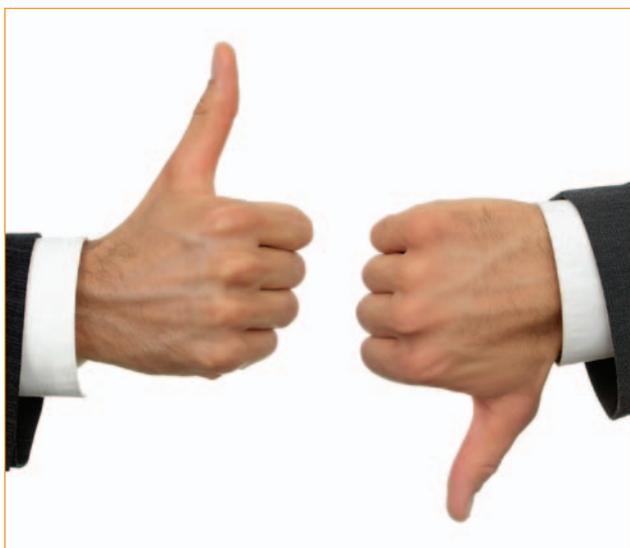
## U.S. NONPROFITS REPORT MIXED SIGNS OF ECONOMIC RESILIENCE

Of U.S. nonprofits responding to a recent survey, 60% reported that they have only three months or less of cash on hand, and 10% said they have no cash reserves.

The 2011 Nonprofit Finance Fund (NFF) survey, sponsored by the Bank of America Charitable Foundation, also showed that 85% of respondents expect an increase in service demand this year. But only 46% of those who expected an increase said they'd be able to meet the growing demand.

While economic uncertainty apparently played a role in the responses, some positive economic signs also surfaced. Of the respondents:

- \* 55% added or expanded programs or services,
- \* 49% increased the number of clients served,
- \* 47% partnered with another organization to improve or increase services,
- \* 44% reported ending 2010 with a surplus compared to only 35% who had a surplus in 2009,



- \* 39% reduced annual expenses,
- \* 36% relied more on volunteers,
- \* 35% said they raised more revenue in 2010 than anticipated, and
- \* 25% added to reserve funds in 2010.

"Years of economic uncertainty have forced nonprofits to adjust to the 'new normal' of scarce resources and increased demand," said NFF vice president of consulting services Rebecca Thomas. \*

## CLARIFYING EMPLOYER HEALTH CARE COVERAGE REPORTING

The Patient Protection and Affordable Care Act requires employers to report the cost of employer-provided health care coverage on Form W-2 starting next year. (That cost is still excluded from an employee's taxable income.)

The good news is that IRS Notice 2010-69, issued last fall, made reporting the cost of health coverage on the 2011 Form W-2 (furnished to employees in 2012) voluntary for *all* employers. And IRS Notice 2011-28, issued this year, makes it optional for small employers (those filing fewer than 250 W-2 forms) for 2012 and until further IRS guidance is issued. \*

## PHILANTHROPIC HAIKUS?

The blog *Tactical Philanthropy* ([tacticalphilanthropy.com](http://tacticalphilanthropy.com)) recently announced a "just for fun" haiku-writing contest and posted this sample entry from a reader:

Donors want data  
Nonprofits measure impact  
Experts watch and smile

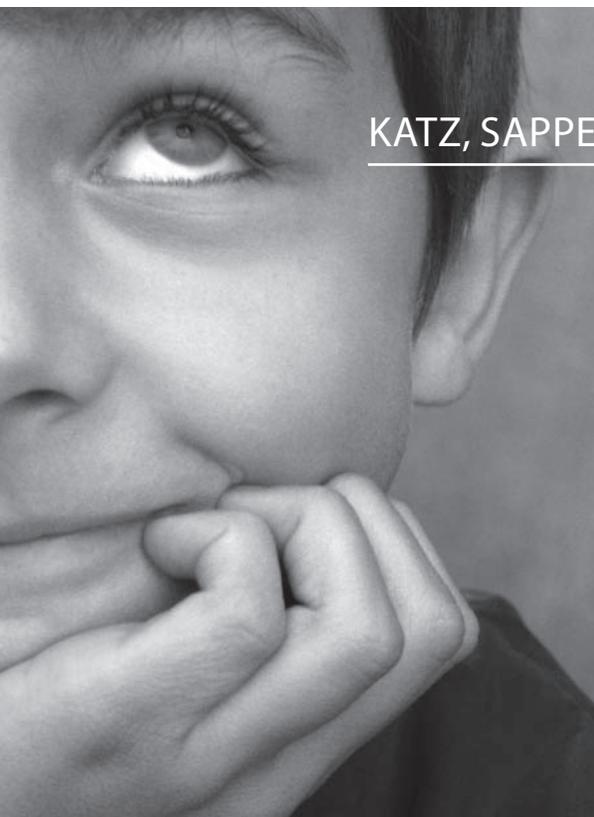
The verse form of Japanese origin may be an unusual way to say it, but the message about the reasons to measure your program results rings true. \*

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