January 2012

A happy and prosperous 2012 to you and yours! Welcome to the Jones & Associates LLC, CPAs quarterly newsletter.

Audit or Review – What's the Difference?

Organizations need or want to have a financial statement audit or review performed by a CPA for various reasons. Typically, an audit or review is performed if:

- By-Laws state that one will be performed
- Funder insistence
- Bank insistence
- Concerns over possible fraud or errors exist
- Change in senior and/or financial management occurs

With or without the above reasons, in general, you should consider an audit or review when your revenues are over $100,000, or your assets are over $500,000.

Audits and reviews by CPAs can be expensive, so it is best to understand what the organization receives from these services. The higher the level of service required of the CPA, the more time the CPA needs to complete the engagement and therefore the more costly the engagement.

Audited financial statements provide the user with the auditor's opinion that the financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles (GAAP). In an audit, the auditor is required to obtain an understanding of the organization's internal controls and assess fraud and error risk.

Reviewed financial statements provide the user with limited comfort that the CPA is not aware of any material modifications that should be made to the financial statements in order for them to conform to GAAP. In a review, the CPA does not obtain an understanding of internal control nor does s/he assess fraud and error risk.

Whether the organization has an audit or review performed, the cost is high – especially for small organizations. It can be 1% to 10% of the organization's entire budget. Therefore, if an audit or review is NOT required, many small organizations will perform their own "internal review" of the organization's finances. This review is performed by board members or other designated volunteers who are independent of the finances of the organization.

For an example of a typical internal review procedures for a small nonprofit organization or for more details of the differences between a review and an audit, please contact Debbie (Debbie@judyjonescpa.com or (206) 525-5170).

Operating Reserves – Are You Kidding?!?

Research indicates that many nonprofit organizations neglect to put aside funds that will help them preserve their capacity to deliver on their missions in the event of unforeseen financial shortages. In fact, numerous nonprofit organizations have negative reserves. The current economic crisis has caused many organizations to focus solely on survival – making the thought of building reserves a distant priority. However, organizations that review their reserve policies closely and devise plans to replenish them will certainly emerge from this economic crisis in a stronger financial position, ready to withstand the next challenge.

United Way of King County's volunteer Audit Review Committee uses various indicators to analyze whether or not an agency has adequate operating reserves. These indicators show an organizations sustainable infrastructure as well as good stewardship policies.

To learn more about developing operating reserves in this economic climate, the National Center for Charitable Statistics, Center on Nonprofits and Philanthropy at the Urban Institute, and United Way Worldwide sponsored a publication, *Operating Reserve Policy Toolkit for Nonprofit Organization* in 2010. The toolkit is available at: http://www.nccs2.org/wiki/images/b/b4/Operating_Reserves_Policy_Toolkit_1st_Ed_2010-09-16.pdf.

Securing Remote Devices

We are all learning to become more efficient in this convenient day of cloud computing and remote-access technologies. However, this convenience creates more opportunities for fraud, theft and, in some cases, loss of data that might not be fully secured.

In December, 2011, the AICPA Journal of Accountancy carried an interesting article on securing remote devices. It recommended taking several steps to mitigate risk. For a copy of the full article, see http://www.journalofaccountancy.com/Issues/2011/Dec/20114597.

In addition to these steps, consider developing a backup and data testing routine to ensure all systems are working as designed and are adequately safeguarded from viruses and hackers. Lastly, create a Disaster Recovery Plan that will outline the protocol when a system is compromised.

Spending time to plan for possible problems may be one of the best New Year's resolutions you can make.

IRS "Red Flags" That Could Trigger an Audit

In the past few years, the IRS has increased audits of exempt organizations.

The IRS says that its audits of public charities are meant to accomplish the following objectives.

- Ensure that nonprofits are truly operated for public (not private) interests.
- Determine whether nonprofits are engaged in any substantial nonexempt (that is, taxable) activity, such as running unrelated businesses.
- Ensure that nonprofits protect and preserve their assets exclusively for tax-exempt purposes.
- Evaluate procedures for accounting for money paid to individuals or noncharitable organizations.
- Determine whether nonprofits pay any excessive compensation, fees, or benefits.
- Determine whether nonprofits engage in lobbying or participate in political campaigns.
- Determine whether nonprofits should be classified as public charities or foundations.

In general, your organization is more at risk of being audited if it has or is the following:

- Unrelated business income and not filing an annual Form 990-T
- Wages expense but not filing a quarterly Form 941
- Whistle-blower complaints to the IRS
- Gambling fundraisers
- Joint ventures with for-profit companies
- Sponsors travel tours
- Credit counseling agencies
- Donor advised funds
- Hospitals
- Colleges and universities
- Community foundations
- Political activities
- Student loan organizations
- Failure to file required IRS returns

Of course, even if your organization has none of these “red flag” indicators, it can still be selected for an IRS audit. The best defense is to be constantly vigilant in maintaining transparency and accountability in all your operations – just in case you become one of the “lucky” ones.

Should you have any questions about the content of anything in this newsletter, please contact us.

Your dedicated nonprofit team at Jones & Associates LLC, CPAs,

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