

July 2012

Happy summer, everyone! Here is this quarter's newsletter from Jones & Associates LLC, CPAs.

Top 11 Red Flags on the IRS Form 990

Now that we have had a couple years' experience with the changed IRS Form 990, the IRS has acknowledged that some of the responses to questions they are asking on the form may cause a higher risk of audit. The top ten areas of the most concern are:

1. Compensation policies—part VI and Schedule J
2. Foreign activities—Schedule F
3. Conflict of interest-policy in part VI
4. Independence of board members
 - a. Identifying and reporting transactions with interested persons
 - b. Compensation payments by related organizations
 - c. Ratio of independent to non-independent members
5. Joint ventures – policy in part VI, Schedule R
6. Unrelated business income – Form 990-T
7. Hospitals & orgs with hospital units – Schedule H
8. Political activity – Schedule C
9. Tax exempt bonds – Schedule K
10. Public support test fluctuations – Schedule A
11. Significant diversion of assets – box checked as “yes”

The IRS also recently performed a study on governance practices and tax compliance. They found that when a Board of Directors reviewed the 990 before it was filed with the IRS, the organization was more likely to be compliant. They also found that organizations with a small number of Board members are more likely to be non-compliant.

The “Cloud” and Your Organization

What an exciting time for technology these days! Virtually all of your financial information, authorizations, governance documents, discussions, and collaborative events can be managed in an off-site space known as “the cloud.”

For smaller organizations, this can be a tremendous benefit to internal controls: bills can be properly authorized before payment; timesheets can be reviewed and approved in a timely manner; and donor contributions can be shared with appropriate parties as soon as they are received.

Organizations are increasingly using technology to streamline the authorization process. If your organization is interested in “catching the wave” of better technology controls, you can see all the options by doing a Google search to find cloud service providers just right for you. But we thought we would tell you about one that we tested at the recent AICPA Not-For-Profit Industry Conference in Washington DC a few weeks ago.

Bill.com helps you manage cash flow, as well as document approvals. It also has an added benefit of letting you automatically sync the information with QuickBooks. It costs about \$50 per month for up to 5 users. For more information, check out their website at www.bill.com.

Internal Control Seminar Recap

In June we presented a seminar on Internal Control for the Small Nonprofit. We discussed why we need internal controls, walked through the top 5 internal control risk concerns, outlined good controls regarding cash receipts and disbursements and gave the participants time to work through a control they have in their offices to ask questions of each other and our team.

Some of the highlights of the seminar included:

- Internal controls are critical to help prevent and detect fraud. This matters to the nonprofit community since 46% of fraud happens at small companies and on average results in a loss of \$190,000 once discovered.

- The top five areas to focus on are: Control Environment; Who is Responsible for What; Physical Controls; Cash Controls; and Bank Statements.
- In general, all financial transactions should have two sets of eyes (a preparer and reviewer) and be adequately supported (documented).
- Each major process should have written controls around the processing, the review and the monitoring of the control.

Thank you to everyone that participated! While this seminar answered some generic questions, should you wish a more personalized look at your systems, please see the next article on the Financial System Review.

In response to the feedback we received from the seminar, we are planning on hosting another seminar in early November on **Using QuickBooks to Account for Restricted Funds**. Please be on the lookout for more information on this upcoming seminar.

Financial System Review

Because we serve so many smaller nonprofit organizations, we are frequently asked if there is an alternative to having an expensive audit that would provide similar feedback on the organization's internal controls and financial practices.

Financial Systems Review (FSR) is a unique consulting service designed as an operational review of a nonprofit organization's financial operations and internal controls. FSR also addresses process efficiencies and cost controls comparing your organization's practices with those of others in the nonprofit industry.

We meet with the organization's finance or accounting staff to "walk-through" how transactions and information are managed through your system. We look at how the organization's internal controls are designed and functioning; how receipts, disbursements and payroll transactions are managed; how restricted donations are tracked; how cost allocations are applied; and review various other critical areas.

After the review, we prepare a report highlighting areas of concern so that the organization's management can set priorities on any necessary correction.

This service usually takes 6 to 8 hours to complete. Compared to a typical audit for a small organization that may take 50 hours to complete, FSR is a much less expensive alternative. However, this service is not an attest function (i.e. an audit), as defined by the American Institute of Certified Public Accountants and the final report cannot be given to others outside of the organization. If you have a grantor or bank requirement for an audit, FSR is not a substitute for a full audit. But if your organization does not have such a requirement, FSR may be a less expensive alternative.

For more information about a Financial Systems Review, please contact Judy C. Jones, CPA. Her direct phone is (206) 525-5186.

Washington State Excise Tax Responsibilities

We sometimes get questions regarding nonprofit responsibilities with the Washington State Department of Revenue. Occasionally this will come in the form of "*we're a nonprofit, so we don't have to pay any tax, right?*" The answer to that is probably no. There are no broad exemptions for nonprofits in Washington. Whether or not a nonprofit is subject to business and occupation (B&O) tax or sales tax is based purely on the sources of income. If the activity is classified as the sale of tangible personal property or retailing service, both B&O and sales tax could be owed. However, if the activity is classified as Services & Other, it will be subject to only B&O tax. To further complicate things, the list of exemptions and deductions can be daunting.

We strongly encourage all organizations to take a look at their income sources and be sure that it is in compliance with income reporting, paying B&O and collecting and remitting sales tax. Even if no B&O or sales tax is due, the organization is still obligated to ensure that sales tax is being paid properly to vendors as needed or being paid directly to the State as use tax. In particular, watch out for out-of-state vendors and online purchases.

Some useful references include: Nonprofit Organizations pamphlet:

<http://dor.wa.gov/docs/pubs/industspecific/nonprofit.pdf>

Nonprofit Organizations link: <http://dor.wa.gov/content/doingbusiness/businessypes/industry/nonprofit/default.aspx>

Use tax information: <http://dor.wa.gov/content/findtaxesandrates/usetax/>

Also, for our friends in the City of Seattle, there are additional taxes that may apply including the annual business license and gross receipts tax, the square footage tax, and admissions tax.

Please see the following link for the City of Seattle: <http://www.seattle.gov/rca/taxes/taxmain.htm>

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

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