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ON THE NOT-FOR-PROFIT FRONT

What's Included?

- New Auditing Standards Impact Upcoming Audits
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NEW AUDITING STANDARDS IMPACT UPCOMING AUDITS

As CPAs, when we audit financial statements, we are required to follow certain standards. A large portion of those standards are issued by the American Institute of CPAs (AICPA). Certain new auditing standards must be implemented for audits of periods *beginning* after December 15, 2006 (years ending December 31, 2007 and after). The new standards will require additional work on the part of both auditors and auditees.

Internal Control Documentation and Testing (new!)
Audits for periods *beginning* after December 15, 2006 will now include a substantial element of documenting, evaluating, and in some cases, testing of internal controls.

In order for auditors to be able to fully understand, evaluate and test internal controls, clients will need to have documented their internal controls. In most cases, the auditor will not be able to help develop the internal control documentation as that could impair the auditor's independence.

Which internal controls are relevant will vary, depending on the organization's size and complexity. The accounting policies and procedures manual can be a good place to start the documentation process. A flow

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WASHINGTON CHARITIES BILL

On May 15, 2007, Gov. Gregoire signed SHB 1777, the "Charities Bill," into law. The Charities Bill is intended to improve accountability by increasing reporting requirements and creating educational programs for both the organizations' leaders and the public.

Not-for-profit organizations help make a vibrant and growing community, both socially and economically. Yet some have created a bad name for the rest by misusing donations or using only a small fraction of donated money for charitable purposes. It can be difficult for donors and regulators to discover which organizations will use funds to improve the community and which will misappropriate funds.

The most significant aspect of the legislation is intended to make charities' finances more transparent. Organizations which solicit funds for charitable purposes with more than $1,000,000 in gross revenue (averaged over three years) must have Form 990 completed or reviewed by a third party who normally prepares or reviews these forms. Audited financial statements prepared by an independent CPA will be required for organizations which solicit contributions and have more than $3,000,000 in gross revenue (averaged over three years). These items will be submitted with the charitable solicitations renewal form.

Take note that these requirements apply to any organization which solicits contributions and therefore applies to any type of organization - i.e., not just Sec. 501(c)(3) organizations. This means that even if an organization is a Sec. 501(c)(4) or 501(c)(6) these Form 990 and/or audit requirements could apply.

State leaders also wanted to make sure financial reports made available to the public are accurate and reliable. Therefore, the Board of Directors now must review and accept the state filings before they are submitted. The organization can be fined if the reports are materially misstated.

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ONLINE WORKSHOP FOR TAX COMPLIANCE ISSUES

As an educational outreach to increase compliance with tax laws, a web-based workshop, called Stay Exempt – Tax Basics for 501(c)(3)s, is available through the Internal Revenue Service at http://www.stayexempt.org/. The workshop covers tax compliance issues for small and mid-sized tax-exempt organizations, including charities and churches.

Because the IRS can only offer its live workshops in a few major cities, this virtual workshop is a convenient tool that can be accessed by anyone anywhere. Registration is not required, visitors remain anonymous, and the modules can be completed in any order as many times as desired.

The five interactive modules are:

- Tax-Exempt Status — How can you keep your 501(c)(3) exempt?
- Unrelated Business Income — Does your organization generate taxable income?
- Employment Issues — How should you treat your workers for tax purposes?
- Form 990 — Would you like to file an error-free return?
- Required Disclosures — To whom do you have to show your records?

Additional available resources include summaries of course content, a glossary and copies of forms and publications. ♦

CHARITIES CAN CLAIM TELEPHONE EXCISE TAX REFUND ON FORM 990-T

The IRS has formalized the details on a one-time tax refund available to long-distance telephone customers for 2006, for individuals, businesses and tax-exempt organizations. Federal excise taxes on local telephone services remain in effect. Federal long-distance excise taxes paid on land-line, cell phone, and fax service all qualify for the refund.

Tax-exempt organizations should attach Form 8913, Credit for Federal Telephone Excise Tax Paid to the 2006 Form 990-T. If you omitted this, you can still file an amended return. All filers, including tax-exempt organizations, have the option of using a formula which estimates federal long-distance excise taxes paid using phone bills for April 2006 (when the tax was collected) and Sept. 2006 (after the tax was no longer collected) rather than all months included in the refund period. ♦

INTERNAL CONTROL – ROLES AND RESPONSIBILITIES

Everyone in the organization has some role to play in the organization's internal control system.

Chief executive officer (CEO). The CEO has ultimate responsibility for the internal control system. The individual in this role sets the tone at the top that affects the integrity and ethics and other factors that create the positive control environment needed for the internal control system to thrive. Aside from setting the tone at the top, much of the day-to-day operation of the control system is delegated to other senior managers in the organization, under the leadership of the CEO.

Chief financial officer (CFO). Much of the internal control structure flows through the accounting and finance area of the organization under the leadership of the CFO. In particular, controls over financial reporting fall within the domain of the CFO. The audit committee should consider interacting with the CFO, and others, as a basis for their comfort level with the internal controls over financial reporting.

Controller/director of accounting or finance. Much of the basics of the control system come under the domain of this position. The controller must understand the need for the internal control system, be committed to the system, and must communicate the importance of the system to all people in the accounting function. Further, the controller must demonstrate respect for the system through his or her actions.

Board of directors/audit committee. A strong, active board is necessary. This is particularly important when the organization is controlled by an executive or management team with tight reins over the organization and the people within the organization. The board should recognize that its scope of oversight of the internal control system applies to three major areas of control: operations, compliance with laws and regulations, and financial reporting. The audit committee is the board's first line of defense with respect to the system of internal controls over financial reporting.

All other personnel. The internal control system is only as effective as the employees throughout the organization who comply with it. Employees throughout the organization should understand their role in internal control and the importance of supporting the system through their own actions and encouraging respect for the system by their colleagues throughout the organization. ♦

CHARITIES BILL

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The Charities Bill makes changes to initial registration requirements as well. Now, when organizations register with the Secretary of State:

- Each organization must register separately. Parent organizations can no longer include subsidiaries as part of a consolidated filing.
- Organizations must file copies of contracts with commercial fundraisers before the fundraisers begin their work.
- Organizations no longer have to register with the Secretary of State in order to solicit contributions for a specific person.
- Commercial fundraisers no longer have to include a list of all states where they solicited funds as part of the registration requirement.

The Secretary of State is also authorized to develop educational programs for charitable organizations, the members of their Board of Directors, and the general public. These programs should help the organizations understand the more strict reporting requirements. The programs should also help the public use the information now available to them to make informed and wise giving choices.

These changes will not be effective until the Secretary of State's office goes through its rule-making process, which means implementation will likely be in 2008 or later. ♦

NEW AUDITING STANDARDS

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Internal Control Documentation and Testing (new!)

chart also might help document the flow of source documents, internal procedures and output documents. Flowcharts are not required if you have other ways of organizing the internal control documentation. Focus on those controls that are most important and/or most effective for your organization. If you have documented some of the processes already, full documentation may be a smaller task than you think.

After the internal controls are documented and understood, auditors will need to assess the risks of material misstatement and perform audit procedures in response to the assessed risks. This will also require additional time for both auditors and clients. All of the emphasis on internal controls will likely make the first audit that is subject to the new standards more time consuming.

There may be a silver lining for the organization in incurring the extra time to assess and document internal controls. If all of the processes are clearly identified and documented, redundancies or inefficiencies may be more clearly seen. The documentation may be able to ease the transition when turnover occurs within the organization. Rather than starting from scratch each time personnel changes occur, reviewing (and possibly updating) the internal control documents may help the organization continually improve its processes.

Audit Evidence (new!)

Another major change is that auditors will no longer be allowed to rely on inquiries for audit evidence. Now when the auditor asks the organization questions about the audited information, the auditor will be required to follow up further and objectively test the answers provided. For example, if an inquiry is made about why a particular expense increased and the client's response is to indicate that a new project was started, the auditor will need to observe some additional evidence of the program.

Internal Control Deficiencies (on-going)

Many audits completed in the past year were subject to a requirement that was new for audits of periods *ending* after December 15, 2006 related to the disclosure of any significant internal control deficiencies identified by auditors.

As part of the audit work performed, including audit journal entries posted, the auditor is required to determine whether those entries indicate that there are deficiencies in the organization's internal controls. If the auditor does conclude that deficiencies exist, the auditor must disclose them in a written communication with those responsible for governance.

This requirement has already resulted in a noticeable increase in the number of internal control problems required to be reported. Auditors expect that number to grow even more with the implementation of the new auditing standards.

New Statements on Auditing Standards

SAS 104 – *Due Professional Care in the Performance of Work*
SAS 105 – *Generally Accepted Auditing Standards*
SAS 106 – *Audit Evidence*
SAS 107 – *Audit Risk & Materiality in Conducting an Audit*
SAS 108 – *Planning and Supervision*
SAS 109 – *Understanding the Entity and Its Environment & Assessing the Risks of Material Misstatement,*
SAS 110 – *Performing Audit Procedures in Response to Assessed Risks & Evaluating the Audit Evidence Obtained*
SAS 111 – *Audit Sampling*

Recently Implemented Statement on Auditing Standards

SAS 112 – *Communicating Internal Control Related Matters Identified in an Audit* ♦

IRS RELEASES SUBSTANTIAL REVISIONS TO 2008 FORM 990

The IRS is updating Form 990 and will dramatically change the information needed to be gathered and presented on Form 990. A core 10-page Form 990 will be required for all tax-exempt organizations, as well as up to 15 additional schedules, depending on the nature and operations of the organization. In redesigning the new Form 990, the IRS focused on three principles: "enhancing transparency," "promoting compliance and assessing the risk of non-compliance," and "minimizing the burden of filing." Considerably more detailed information is required as a result, especially in the areas of governance, related parties and organizations, compensation, revenue sources, and functional expense allocation.

For example, the proposed schedules will require key employee compensation to be split into base pay, bonus and incentive pay, severance, other pay, nonqualified deferred compensation, nontaxable benefits, nontaxable expense reimbursements and supplemental nonqualified retirement plan contributions. Many of the other changes will organize similar types of questions on similar schedules, rather than spreading them throughout the return, as is currently the case.

PRACTICE POINTER: We recommend that all nonprofits that file Form 990 review the requirements of the new format. Changes to your general ledger may be needed in order to facilitate the data retrieval that will be necessary in order to comply with the new reporting requirements. The new Form 990 will be required for years including December 31, 2008. Therefore, organizations that report on a calendar year basis may need to consider general ledger changes right away.

To review the proposed changes to the Form 990 series, you can go to the IRS website:
http://www.irs.gov/charities/article/0,,id=176613,00.html ♦

FORM 990-N: THE "E-POSTCARD" FOR SMALL NONPROFITS

Form 990-N is a new filing requirement for small tax-exempt organizations, nick-named the "e-Postcard" because it must be filed electronically. Until recently, small nonprofits were not required to file returns, but that will change for periods beginning after December 31, 2006 as a result of the Pension Protection Act of 2006.

In July 2007, the IRS began notifying organizations that they may now need to file Form 990-N. This annual filing requirement will apply to nonprofits with gross receipts of $25,000 or less who are not required to file Form 990 or Form 990-EZ. There are exceptions for organizations included in group returns and private foundations who file Form 990-PF.

The penalty for failing to file the e-Postcard or another informational return for three consecutive years is **revocation of the organization's tax-exempt status**.♦

PUBLIC DISCLOSURE OF FORM 990-T

Form 990-T is now subject to the same disclosure requirements and penalty rules applicable to Form 990 for tax-exempt section 501(c)(3) organizations. Section 501(c)(3) organizations are entities organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes, or to foster national or international sports competition or for the prevention of cruelty to children or animals. ♦

ALWAYS FEEL FREE TO CONTACT US!
Call or e-mail us with your ideas for future articles on topics of interest or with names of others who may want to receive *On The Not-For-Profit Front*. Also note that previous issues of all our newsletters, which include *TMA Report* and *Small Business Outlook*, are included in the newsletter section on our website.

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Following is a listing of our e-mail addresses and telephone extensions. To reach us, dial (206) 623-6116, wait for the greeting and press the extension of the person you would like to reach.

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