Policy Samples Packet

Information to assist leadership and staff in reviewing and adopting policies identified in the new IRS Form 990 (Dec. 2007.)

The new form will be used in 2009 for the 2008 tax year. According to the IRS website, "Form 990 has not been significantly revised since 1979, and it is universally regarded as needing major revision. It has failed to keep pace with changes in the law and with the increasing size, diversity, and complexity of the exempt sector. As a result, the current form fails to meet the Service's tax compliance interests or the transparency and accountability needs of the states, the general public, and local communities served by the organization."

For a copy of Form 990, visit www.irs.gov/pub/irs-tege/f-990rcore.pdf

Be sure to utilize legal and accounting counsel before adopting policies.

This information supplements the article titled, "Year of the Policy Manual – 2008."

Contents

- Document Destruction – Record Retention
- Conflict of Interest
- Audit – Audit Committee

For educational purposes only. Rely on legal and accounting counsel when reviewing governance, laws, etc.

Resources at Grant Thornton can be found at www.grantthornton.com.

Document Destruction

The Sarbanes-Oxley Act addresses the destruction of business records and documents and turns intentional document destruction into a process that must be carefully monitored.

Nonprofit organizations should have a written, mandatory document retention and periodic destruction policy. Policies such as this will eliminate accidental or innocent destruction. In addition, it is important for administrative personnel to know the length of time records should be retained to be in compliance.

This information is provided as guidance in determining your organization's document retention policy.[1]

Type of Document	Minimum Requirement
Accounts payable ledgers and schedules	7 years
Audit reports	Permanently
Bank Reconciliations	2 years
Bank statements	3 years
Checks (for important payments and purchases)	Permanently
Contracts, mortgages, notes and leases (expired)	7 years
Contracts (still in effect)	Permanently
Correspondence (general)	2 years
Correspondence (legal and important matters)	Permanently
Correspondence (with customers and vendors)	2 years
Deeds, mortgages, and bills of sale	Permanently
Depreciation Schedules	Permanently
Duplicate deposit slips	2 years
Employment applications	3 years
Expense Analyses/expense distribution schedules	7 years
Year End Financial Statements	Permanently
Insurance Policies (expired)	3 years
Insurance records, current accident reports, claims, policies, etc.	Permanently
Internal audit reports	3 years
Inventories of products, materials, and supplies	7 years
Invoices (to customers, from vendors)	7 years
Minute books, bylaws and charter	Permanently
Patents and related Papers	Permanently
Payroll records and summaries	7 years
Personnel files (terminated employees)	7 years
Retirement and pension records	Permanently
Tax returns and worksheets	Permanently
Timesheets	7 years
Trademark registrations and copyrights	Permanently
Withholding tax statements	7 years

[1] Be sure to seek legal and accounting counsel prior to adoption and implementation (RCH.)

_________________________ ASSOCIATION
DOCUMENT RETENTION POLICY

This is the document retention policy of the ________________ Association ("ASSOCIATION").

ASSOCIATION shall retain records for the period of their immediate or current use, unless longer retention is necessary for historical reference or to comply with contractual or legal requirements. Records and documents outlined in this policy include paper, electronic files (including emails) and voice mail records regardless of where the document is stored, including network servers, desktop or laptop computers and handheld computers and other wireless devices with text messaging capabilities. Any employee of ASSOCIATION, or any other person who is in possession of records belonging to ASSOCIATION who is uncertain as to what records to retain or destroy, when to do so, or how to destroy them, may seek assistance from ASSOCIATION's Document Retention Policy (DRP) manager who is ________________.

In accordance with 18 U.S.C. §1519 and the Sarbanes Oxley Act, ASSOCIATION shall not knowingly destroy a document with the intent to obstruct or influence an "investigation or proper administration of any matter within the jurisdiction of any department, agency of the United States…or in relation to or contemplation of such matter or case". If an official investigation is under way or even suspected, document purging must stop in order to avoid criminal obstruction. In order to eliminate accidental or innocent destruction, ASSOCIATION has the following document retention policy:

TYPE OF RECORD	SPECIFIC RECORD	RETENTION PERIOD
Accounting Records		
	Annual financial statements	Permanent
	Monthly financial statements	3 years
	General ledger	20 years
	Annual audit records	10 years
	Journal entries	8 years
	Special reports	8 years
	Canceled checks	8 years
	A/P paid invoices	8 years
	Business expense records	8 years
	Credit card receipts	3 years
	Cash receipts	3 years
	A/R invoices	8 years
	Data for acquired/divested assets	Permanent
	Data for nonacquired/nondivested assets	5 years
	Accounts payable	7 years
	Accounts receivable	7 years
	Audit reports	7 years
	Chart of accounts	Permanent
	Expense records	7 years
	Inventory records	7 years

TYPE OF RECORD	SPECIFIC RECORD	RETENTION PERIOD
	Loan documents	7 years after final payment
	Purchase orders	7 years
	Sales records	7 years
	Stop payment orders	3 years
	Bank reconciliations	3 years
Tax Records		
	Federal tax returns (not payroll)	Permanent
	State & local tax returns	Permanent
	Form 990 & supporting documentation	Permanent
	Form 990-T & supporting documentation	Permanent
	Supporting documentation for taxes	4 years
	City & State excise tax reports & supporting documentation	5 years (or longer if designated by state law)
	Unclaimed property filings & supporting documentation	6 years (or longer if designated by state law)
	1099 forms	8 years
	Magnetic tape & similar records	1 year
	Payroll taxes (W2, W3)	Permanent
	Payroll taxes (Form 941, state withholding forms, state unemployment returns)	8 years (or longer if designated by state law)
Payroll Records		
	Wage rate tables	3 years
	Cost of living tables	3 years
	Wage	6 years
	Salary	6 years
	Payroll deductions	6 years
	Time cards or forms	5 years
	W-2 forms	8 years
	W-4 forms	8 years
	Garnishments	4 years after termination
	Payroll registers	Permanent
	State employment forms	4 years
	State unemployment tax records	Permanent
	Cancelled payroll checks	8 years
	Deductions register	8 years
	Earnings records	8 years
	Changes or adjustments to salary	8 years

TYPE OF RECORD	SPECIFIC RECORD	RETENTION PERIOD
Insurance Records		
	Policies (including expired) Permanent Claims for loss/damage, accident reports, appraisals	5 years
Workplace Records		
	Incorporation records (including Bylaws)	Permanent
	Meeting minutes	Permanent
	Policy statements	Permanent
	Employee directories	5 years
Legal Records		
	General Contracts	3 years after termination
	Real estate contracts & records	Permanent
	Personal injury records	8 years
	Trademark registration	Permanent
	Copyright registration	Permanent
	Patents	Permanent
	Litigation claims	5 years following close of case
	Court documents & records	5 years following close of case
	Deposition transcripts	5 years following close of case
	Discovery materials	3 years following close of case
	Leases	6 years after termination
Personnel Records		
	Employment applications (persons not hired)	1 year
	Employment applications (persons hired)	3 years following termination of employment
	Employee resumes & employment history	3 years following termination employment
	Evaluations	3 years following termination of employment
	Promotions, raises, reclassifications & job descriptions	5 years following termination of employment
	Disciplinary warnings, demotion, lay-off & discharge	5 years following termination of employment
	Employment & termination agreements	Permanent
	Beneficiary information	Permanent
	Medical and safety records	6 years
	Accident reports	6 years
	Education assistance	While employed
	Sick leave benefits	While employed
	Retirement plans	Permanent

TYPE OF RECORD	SPECIFIC RECORD	RETENTION PERIOD
	Incentive plans (after expiration)	6 years
	Pension plans	Permanent
Technical Materials		
	Manuals	Permanent
	Standards	Permanent
	Committee Meeting Minutes	Permanent
	Correspondence	5 years after manual or standard becomes obsolete
	Invoices to customers	7 years

The retention periods described herein are guidelines. There are circumstances under which a record or document may have to be maintained longer than the guidelines. This will be a decision made by the Document Retention Policy Manager.

Code of Ethics
Board of Directors and Officers
Of the

____

Service on the Board of Directors of a national organization is an important honor and responsibility. Much is expected of officers and the governing Board of the ________. The membership of the association relies on its officers and Board to act in its best interests, to be knowledgeable about and proactive on the issues facing the early childhood care and education industry, to study the questions before it and to base decisions on reliable information, to be a good steward of the resources of the association, and to be honest and trustworthy in all actions. To assure the trust and ethical expectations of the members of the ______ Association, I affirm the following:

Duty of Care

In all matters affecting the ______ Association, I will act in good faith and exercise my best efforts in the performance of my duties.

I will faithfully prepare for discussions and decisions that affect the association by reading information sent to me by the association officers and staff and by striving to be knowledgeable on issues of importance to the association and its members.

I will be responsible for disseminating information I receive as a Director to all members, with my primary responsibility to inform my constituency, i.e., state association, national, or regional company, or at-large members. *(See attached examples)*

I will make decisions based on factual data rather than unsubstantiated opinions.

I will make decisions based on what is in the best interest of all members of the association, rather than any one group, individual, or special interest.

I will be honest in doing the work of the association and in speaking on behalf of the association and its leadership in order to foster trust among association members and the public.

I will respect my fellow Directors and the members of the association, acknowledging differences of opinion, providing for open and respectful discussion, and making decisions only after listening to all points of view and all available data.

I will publicly support the majority decisions made by the Board of Directors.

I will refrain from any discussion of tuition, fees, wages, etc. that might be construed as an infraction of anti-trust law or price fixing.

I will support and encourage participation in all association programs including endorsed programs.

I will hold my own business to the highest standards of professionalism, quality, and integrity, because the manner in which I conduct my individual business affairs can affect the public image of the _________ Association,

Confidentiality

I will not disclose, beyond its intended scope, any information which is marked, designated, or treated as confidential by the Board, officers, or staff and which I receive as a Director of the ______________ Association.

I understand that my obligation to maintain confidentiality extends indefinitely beyond my term of office.

Conflict of Interest

I acknowledge that information, programs, research, services, and methods of operation are developed by ___________ for all members and as a Director I am obligated to pass on this information to my constituencies. Therefore I will not expropriate for myself, my business, or another organization any information I receive as a result of my position as a Director of the ______________ Association prior to disseminating this information to my constituents. (*See attached examples*)

I will not create any program that is in direct competition with an ________ program including the __________, the _______ credential, the Annual Conference, or other programs that the association may develop in the future.

I will openly declare any actual or perceived conflict of interest that may result from my taking part in discussion or decision making on an issue before the association while having business, professional, or personal interests that could bias my decisions. I further acknowledge the Board of Directors has the sole responsibility for determining whether my interests constitute a conflict and if so what the remedy will be. *(See attached example)*

Signature of Director or Alternate Director ____

Date ____________________________

Example of Duty of Care:

"I will be responsible for disseminating information I receive as a Director to all members with my primary responsibility to inform my constituency, i.e., state association, national, or regional company, or at-large members."

______ Director, John Doe, receives a notice on the _______ Board of Directors list serve about a grant available to child care centers in all states. John fails to pass this information on to his state association members.

- **As the representative of the membership as a whole, John is obligated to pass on this information to his constituency, and in the spirit of leadership, should make a reasonable effort to do so immediately in order to equalize the opportunity among members, including himself.**

Examples of Conflict of Interest:

"I acknowledge that information, programs, research, services, and methods of operation are developed by ______ for all members and as a Director I am obligated to pass on this information to my constituencies. Therefore I will not expropriate for myself, my business, or another organization any information I receive as a result of my position as a Director of the _________ Association prior to disseminating this information to my constituents."

1. **In the example above, John not only does not pass on the information he receives through the Board-only list serve, he applies for the grant for his own center.**

    - **John is taking advantage of information available to him in his capacity as a member of the Board of Directors of ______ and using this information for his personal gain.**

2. **_______ Board member John Doe conducts a training class for Field Counselors which is not the _________ prescribed training and/or charges a fee for the training.**

    - **John Doe is taking advantage of his position as a Director to profit when he charges a fee which is contrary to _____'s policy and interest. ____ provides this training free of charge.**

    - **John Doe is not using the prescribed training approved by _____ and therefore is negatively impacting the integrity of the ____ program.**

3. **_______ Director Mary Doe uses association-developed programs, data, papers, or other intellectual property (correspondence, procedure manuals, methods of operation, curriculum, presentations) without permission of the association and/or without citing the association as the creator or fails to report unauthorized use by his/her state association or company.**

    - **Even though the association material Mary uses may not be copyrighted, it is unethical to use the association's property for one's own benefit or to misrepresent the origin of the material. If the material is copyrighted, Mary's actions are also illegal.**

“I will openly declare any potential conflict of interest that may result from my taking part in discussion or decision making on an issue before the association while having business, professional, or personal interests that could bias my decisions. I further acknowledge the Board of Directors has the sole responsibility for determining whether my interests constitute a conflict and, if so, what the remedy will be.”

1. **Director John Doe owns a printing company. He lobbies the Membership Committee to have his company print the new membership brochures.**

    - **John must disclose his financial interest in the printing company. The Chair of the Membership Committee should then ask John to excuse himself from debate in committee and not to discuss the printing of the brochure with any Committee member.**

Conflict of Interest Disclosure Statement

This form was approved and adopted in 2003, in accordance with Section # of the Bylaws. It will be distributed to each director, officer, and staff member prior to the October Board meeting each year and must be submitted at that meeting for subsequent review by the Executive Committee of the Board of Directors.

<u>In completing this form, please consider the following guidelines from the bylaws</u>:

1. Any <u>potential</u> conflict of interest that could result in a direct or indirect financial or personal benefit to a Director, officer or staff member must be disclosed in good faith or known to the Board of Directors or committee authorizing a contract or other transaction.
2. All questions as to whether a conflict of interest exists shall be resolved by a vote of the Board of Directors in which the interested individual may not vote.
3. The interested individual may participate in the information-gathering stage of the Board of Directors' or committee's discussion, but shall retire from the room in which the Board of Directors or a committee thereof is meeting and shall not participate in the final deliberation or decision regarding such contract or other transaction. Such interested individual may not vote on such contract or other transaction.
4. In connection with all actions taken by the Board of Directors with respect to any contract or transaction between the Association and one or more of its directors or officers, or between the Association and any other corporation, firm, association, or other entity in which one or more of the directors or officers of the Association is a director or officer or has a substantial financial interest, affiliation, or other significant relationship, each such interested director or officer of the Association shall:
   - disclose to the Board of Directors the material facts as to such director's or officer's interest in such contract or transaction and as to any such common directorships, offices, or significant financial interest, affiliation, or other significant relationship, which disclosure shall be duly recorded in the minutes or resolutions relating to such actions, and
   - abstain from voting on any such contract or transaction.

At present, I am aware of the following potential conflict of interest in regard to my position on the Board of Directors or staff (if none, leave blank):

____

____

____

If I become aware of a potential conflict of interest in the future, I will disclose this potential conflict to the President. I understand that, when in doubt, disclosure is recommended.

NAME (please print) ____

SIGNATURE ______________________________________ DATE ____________

In response to an ASAE Listserv query in February 2008, associations contributed the following examples. Be sure to rely on legal and accounting professionals for development of policies.

IRS References

b If "Yes," how many transactions did the organization review under this policy and related procedures during the year? 3b

4 Does the organization have a written whistleblower policy? 4

5 Does the organization have a written document retention and destruction policy? 5

whistleblower policy A policy to encourage staff and volunteers to come forward with credible information on illegal practices or violations of adopted policies of the organization, specifies that the organization will protect the individual from retaliation, and identifies those staff or board members or outside parties to whom such information can be reported. (See Panel on the Nonprofit Sector June 2005 Final Report.)

General Definitions

One who reveals wrongdoing within an organization to the public or to those in positions of authority: *"The Pentagon's most famous whistleblower is . . . hoping to get another chance to search for government waste"* (Washington Post).

The disclosure by a person, usually an employee, in a government agency or private enterprise; to the public or to those in authority, of mismanagement, corruption, illegality, or some other wrongdoing.

#1 Whistleblower Protection Policy

Association prides itself on its adherence to federal, state, and local laws and/or regulations, including business ethics policies. As such, even though it is not obligated to do so, the Association has decided to voluntarily adopt a whistleblower protection policy. Pursuant to this policy, any employee who becomes aware of any violation of federal, state, or local law or regulation, including any financial wrongdoing, should immediately report the violation to the Executive Vice President to allow the organization to investigate and, if applicable, correct the situation or condition.

If the Executive Vice President is involved or is believed to be involved in the matter being reported, employees may, in the alternative, make a report to the Association's legal counsel. The Association will conduct an investigation and take appropriate action within a reasonable period of time. Such complaints will be held in confidence to the extent the needs of the investigation permit.

"Financial wrongdoing" may include, but is not limited to:

- Questionable accounting practices;
- Fraud or deliberate error in financial statements or recordkeeping;
- Deficiencies of internal accounting controls;
- Misrepresentations to company officers or the accounting department (including deviation from full reporting of financial conditions).

If any employee reports in good faith what the employee believes to be a violation of the law and/or financial wrongdoing to the Association, its legal counsel, or to a federal, state, or local agency or assists in an investigation concerning financial wrongdoing, it is the Association's policy that there will be no retaliation taken against the employee.

Employees are reminded of the importance of keeping financial matters confidential. Employees with questions concerning the confidentiality or appropriateness of disclosure of particular information should contact the Executive Vice President.

# # #

#2 Whistleblower Policy

Purpose

The Association is committed to high standards of ethical, moral and legal business conduct. In line with this commitment and association's commitment to open communication, this policy provides an avenue for employees to raise concerns. It also provides reassurance that employees will be protected from reprisals or victimization for whistleblowing. (For purposes of this policy, an employee is defined as any individual who is paid for providing services to association headquarters and includes both full-time and part-time employees.)

This whistleblowing policy is intended to offer protections if an employees raises concerns regarding association, including concerns regarding:

- incorrect financial reporting;
- unlawful activity;
- activities that are not in line with association policy; or
- any other activities that constitute serious improper conduct.

Safeguards

Harassment or Victimization - Harassment or victimization for reporting concerns under this policy will not be tolerated.

Confidentiality - Every effort will be made to treat the complainant's identity with appropriate regard for confidentiality.

Anonymous Allegations - This policy encourages employees to put their names to allegations because appropriate follow-up questions and investigation may not be possible unless the source of the information is identified. Concerns expressed anonymously will be explored appropriately, but consideration will be given to:
The seriousness of the issue raised;
The credibility of the concern; and
the likelihood of confirming the allegation from attributable sources.

Bad Faith Allegations - Although the employee is not expected to prove the truth of an allegation, the employee should be able to demonstrate to the person contacted that the report is being made in good faith. Allegations made in bad faith may result in disciplinary action.

Procedure: 1. Process for Raising a Concern

Reporting- The whistleblowing procedure is intended to be used for serious and sensitive issues. Such concerns, including those relating to financial reporting, unethical or illegal conduct, may be reported directly to the association General Counsel:

[Insert Contact Information Here]

Employment-related concerns should continue to be reported through your normal channels such as to a supervisor or the CEO.

Timing - The earlier a concern is expressed, the easier it is to take action.

Procedure: 2. How the Report of Concern Will be Handled

The action taken by association in response to a report of concern under this policy will depend on the nature of the concern. The Audit Committee of the association's Executive Committee shall receive information on each report of concern and follow-up information on actions taken.

Initial Inquiries - Initial inquiries will be made to determine whether an investigation is appropriate, and the form that it should take. Some concerns may be resolved without the need for investigation.

Further Information -The amount of contact between the complainant and the person or persons investigating the concern will depend on the nature of the issue and the clarity of information provided. Further information may be sought from or provided to the person reporting the concern.

# # #

 # 3 Reporting and Investigating Wrongdoing Policy

The Association has a responsibility for the stewardship of member and employee contributions and resources. In fulfilling that responsibility, the Association is committed to compliance to all laws and regulations to which it is subject.

In addition to complying with the law, it is the policy of the association to promote ethical practices and ethical treatment of its members and employees. Whether known or suspected, instances of misuse of Association resources or other improper activities should be reported and appropriately investigated. Members and employees have a responsibility to each other and to the organization to maintain an environment in which problems are addressed immediately, and they are therefore protected from retaliation for making such reports.

The association endorses and utilizes internal controls and operating procedures intended to detect and prevent improper activities. If, however, those controls or procedures fail to safeguard against irregularity, or if intentional or unintentional violation of laws or regulations occur, it is the policy of the association that members and employees are encouraged to report those irregularities and violations.

It is also the policy of association not to hide, destroy, alter or falsify documents to prevent their use in litigation or other official proceedings. Toward that end, the Association will have and regularly review a document retention policy. Officers, members, and employees of the association are expected to adhere to this policy.

Last, the association (through its Conflict of Interest Policy) has asked the Board of Directors to disclose any real, perceived, or potential conflicts of interest that relate to board duties or deliberations, and to recuse him/herself when the board makes decisions affected by the conflict. Refusal to abide by the organization’s conflict of interest policy may result in removal from office and a referral to the Association’s Ethics Committee for review. Employees may not engage in any activity, paid or unpaid, that conflicts, or gives the appearance of conflicting with their obligations to association.

The provisions of this policy statement do not negate or minimize the effect or import of the association’s Code of Ethics, Membership Standards and Sanctions, or the Employee Handbook. Individual complaints about the professional conduct of members or of employees will be handled according to those governing documents.

# # #

Whistleblower Policy

PURPOSE OF THIS POLICY: A key defense against fraud occurring in an organization is the availability of a means for employees and other constituents to anonymously report suspected wrongdoing (whistleblowing). Respondents to a 2004 survey by the Association of Certified Fraud Examiners (ACFE) revealed that various forms of fraud are detected 40 percent of the time by tips, the leading method for detecting fraud.

While whistleblower programs are not required of not-for-profit organizations, CRS believes that it is a prudent practice to follow. In addition, some states have adopted whistleblower provisions, and federal law prohibits retaliation against anyone “blowing the whistle” with respect to a violation of a federal law or regulation. These would include:

- Forgery or alteration of documents
- Unauthorized alteration or manipulation of computer files
- Fraudulent financial reporting
- Pursuit of a benefit or advantage in violation with the CRS conflict of interest policy
- Misappropriation or misuse of CRS resources, such as funds, supplies, or other assets
- Authorizing or receiving compensation for goods not received or services not performed
- Authorizing or receiving compensation for hours not worked

CRS Whistleblower Policy

General

The CRS Code of Conduct (hereinafter referred to as the Code) requires directors, other volunteers, and employees to observe high standards of business and personal ethics in the conduct of their duties and responsibilities. Employees and representatives of the organization must practice honesty and integrity in fulfilling their responsibilities and comply with all applicable laws and regulations.

The objectives of the CRS Whistleblower Policy are to establish policies and procedures for:

- The submission of concerns regarding questionable accounting or auditing matters by employees, directors, officers, and other stakeholders of the organization, on a confidential and anonymous basis.

- The receipt, retention, and treatment of complaints received by the organization regarding accounting, internal controls, or auditing matters.

- The protection of directors, volunteers and employees reporting concerns from retaliatory actions.

Reporting Responsibility

Each director, volunteer, and employee of CRS has an obligation to report in accordance with this Whistleblower Policy (a) questionable or improper accounting or auditing matters, and (b) violations and suspected violations of CRS's Code (hereinafter collectively referred to as Concerns).

Authority of Executive Committee

All reported Concerns will be forwarded to the Executive Committee in accordance with the procedures set forth herein. The Executive Committee shall be responsible for investigating, and making appropriate recommendations to the Board of Directors, with respect to all reported Concerns.

No Retaliation

This Whistleblower Policy is intended to encourage and enable directors, volunteers, and employees to raise Concerns within the Organization for investigation and appropriate action. With this goal in mind, no director, volunteer, or employee who, in good faith, reports a Concern shall be subject to retaliation or, in the case of an employee, adverse employment consequences. Moreover, a volunteer or employee who retaliates against someone who has reported a Concern in good faith is subject to discipline up to and including dismissal from the volunteer position or termination of employment.

Reporting Concerns

Employees

Employees should first discuss their Concern with their immediate supervisor. If, after speaking with his or her supervisor, the individual continues to have reasonable grounds to believe the Concern is valid, the individual should report the Concern to the Chief Executive Officer (CEO) or the Vice President of Operations (VPO). In addition, if the individual is uncomfortable speaking with his or her supervisor, or the supervisor is a subject of the Concern, the individual should report his or her Concern directly to the CEO or Vice President of Operations.

If the Concern was reported verbally to the CEO or VPO, the reporting individual, with assistance from the CEO or VPO, shall reduce the Concern to writing. The CEO or VPO is required to promptly report the Concern to the Chair of the Executive Committee, who has specific and exclusive responsibility to investigate all Concerns. If the CEO or VPO, for any reason, does not promptly forward the Concern to the Executive Committee, the reporting individual should directly report the Concern to the Chair of the Executive Committee. Contact information for the Chair of the Executive Committee may be obtained either through the Leadership Manual or by calling the CRS office. Concerns may be also be submitted anonymously. Such anonymous Concerns should be in writing and sent directly to the Chair of the Executive Committee.

Directors and Other Volunteers

Directors and other volunteers should submit Concerns in writing directly to the Chair of the Executive Committee. Contact information for the Chair of the Executive Committee may be obtained from the CEO.

Handling of Reported Violations

The Executive Committee shall address all reported Concerns. The Chair of the Executive Committee shall immediately notify the Executive Committee, the CEO and the VPO of any such report. The Chair of the Executive Committee will notify the sender and acknowledge receipt of the Concern within five business days, if possible. It will not be possible to acknowledge receipt of anonymously submitted Concerns.

All reports will be promptly investigated by the Executive Committee, and appropriate corrective action will be recommended to the Board of Directors, if warranted by the investigation. In addition, action taken must include a conclusion and/or follow-up with the complainant for complete closure of the Concern.

The Executive Committee has the authority to retain outside legal counsel, accountants, private investigators, or any other resource deemed necessary to conduct a full and complete investigation of the allegations.

Acting in Good Faith

Anyone reporting a Concern must act in good faith and have reasonable grounds for believing the information disclosed indicates an improper accounting or auditing practice, or a violation of the Codes. The act of making allegations that prove to be unsubstantiated, and that prove to have been made maliciously, recklessly, or with the foreknowledge that the allegations are false, will be viewed as a serious disciplinary offense and may result in discipline, up to and including dismissal from the volunteer position or termination of employment. Such conduct may also give rise to other actions, including civil lawsuits.

Confidentiality

Reports of Concerns, and investigations pertaining thereto, shall be kept confidential to the extent possible, consistent with the need to conduct an adequate investigation.

Disclosure of reports of Concerns to individuals not involved in the investigation will be viewed as a serious disciplinary offense and may result indiscipline, up to and including termination of employment. Such conduct may also give rise to other actions, including civil lawsuits.

Whistleblower Policy - Sample

Introduction

[ORGANIZATION NAME] Code of Ethics and Conduct requires directors, officers and employees to observe high standards of business and personal ethics in the conduct of their duties and responsibilities. As employees and representatives of the Organization, we must practice honesty and integrity in fulfilling our responsibilities and comply with all applicable laws and regulations.

> Definition: One who reveals wrongdoing within an organization to the public or to those in positions of authority.
>
> *A key element of Sarbanes Oxley.*

Reporting Responsibility

It is the responsibility of all directors, officers and employees to comply with the Code and to report violations or suspected violations in accordance with this Whistleblower Policy.

Retaliation

No director, officer or employee who in good faith reports a violation of the Code shall suffer harassment, retaliation or adverse employment consequence. An employee who retaliates against someone who has reported a violation in good faith is subject to discipline up to and including termination of employment. This Whistleblower Policy is intended to encourage and enable employees and others to raise serious concerns within the Organization prior to seeking resolution outside the Organization.

Reporting Violations

The Code addresses the Organization's open door policy and suggests that employees share their questions, concerns, suggestions or complaints with someone who can address them properly. In most cases, an employee's supervisor is in the best position to address an area of concern. However, if you are not comfortable speaking with your supervisor or you are not satisfied with your supervisor's response, you are encouraged to speak with someone in the Human Resources Department or anyone in management whom you are comfortable in approaching. Supervisors and managers are required to report suspected violations of the Code of Conduct to the Organization's Compliance Officer, who has specific and exclusive responsibility to investigate all reported violations. For suspected fraud, or when you are not satisfied or uncomfortable with following the Organization's open door policy, individuals should contact the Organization's Compliance Officer directly.

Compliance Officer[1]

The Organization's Compliance Officer is responsible for investigating and resolving all reported complaints and allegations concerning violations of the Code and, at his discretion, shall advise the Executive Director and/or the audit committee. The Compliance Officer has direct access to the audit committee of the board of directors and is required to report to the audit committee at least annually on compliance activity. The Organization's Compliance Officer is the chair of the audit committee.

Accounting and Auditing Matters

The audit committee of the board of directors shall address all reported concerns or complaints regarding corporate accounting practices, internal controls or auditing. The Compliance Officer shall immediately notify the audit committee of any such complaint and work with the committee until the matter is resolved.

Acting in Good Faith

Anyone filing a complaint concerning a violation or suspected violation of the Code must be acting in good faith and have reasonable grounds for believing the information disclosed indicates a violation of the Code. Any allegations that prove not to be substantiated and which prove to have been made maliciously or knowingly to be false will be viewed as a serious disciplinary offense.

Confidentiality

Violations or suspected violations may be submitted on a confidential basis by the complainant or may be submitted anonymously. Reports of violations or suspected violations will be kept confidential to the extent possible, consistent with the need to conduct an adequate investigation.

Handling of Reported Violations

The Compliance Officer will notify the sender and acknowledge receipt of the reported violation or suspected violation within five business days. All reports will be promptly investigated and appropriate corrective action will be taken if warranted by the investigation.

[1] Note: Compliance officer could be a committee of the board, a designated director, or a third party such as an HR Specialist or the board attorney (rch.)

Audit Committee

Audit Committee
Members of a board of directors who are responsible for dealing with the external and internal auditors.

Audit
The result of an independent accountant's review of the statements and footnotes to ensure compliance with generally accepted accounting principles (GAAP) and to render an opinion on the fairness of the financial statements.

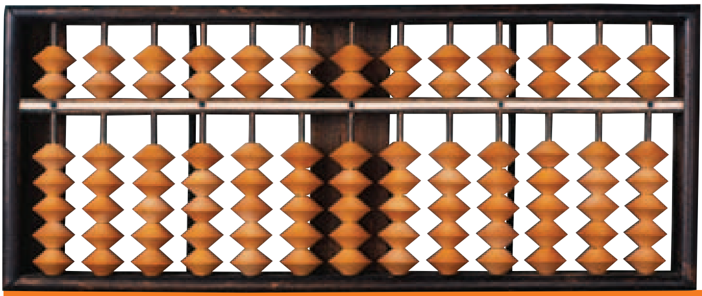
Audit Report
A report issued by an independent CPA that expresses an opinion about whether the financial statements present fairly a company's financial position, operating results, and cash flows in accordance with generally accepted accounting principles (GAAP).

Review
Performing inquiry and analytical procedures that provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles (GAAP)

Compilation
Information resented in the form of financial statement information that is the representation of management without undertaking to express any assurance on the statements. It is a cursory review of an organization's financial operations.

Serving on the **audit committee of a not-for-profit organization** is an important undertaking. Recent scrutiny of financial responsibility in both the not-for-profit and for-profit...

Grant Thornton



Audit committee handbook for not-for-profit organizations

...sectors has brought the role of the audit committee into the public eye. Grant Thornton LLP has created this audit committee handbook to provide an overview of what you can expect in your role and what will, in turn, be expected of you by the various stakeholders of the organization.

Your organization's most valuable asset is its reputation and good name. As an audit committee member, your fundamental task is to help the board of directors assure the integrity and credibility of the organization's financial statements and financial management. That task can be rewarding, yet challenging.

This handbook outlines the organization, functions and duties of an audit committee. It also covers some of the tax concerns affecting not-for-profit organizations, including intermediate sanctions, private inurement and unrelated business income tax.

If you have further questions or require more detailed information than this booklet provides, please contact Grant Thornton LLP's not-for-profit professionals for the answers you're looking for.

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2 Accountability and independence

The guiding principles of the audit committee can be summed up in two words: accountability and independence.

A not-for-profit organization is accountable to its various stakeholders for the use of funds received either as fees, donations, grants, or exchange contracts. These include the donors of the funds and the people who use the resources of the organization.

In addition, the organization's tax-exempt status carries with it a much broader responsibility to society at large. Tax-exempt status is, in part, recognition of the societal value of the services a not-for-profit organization performs. It is also a method by which all taxpayers underwrite these services. In effect, every taxpayer is a stakeholder in your organization.

The primary role of the audit committee is to instill confidence that the funds of the organization are used in a manner consistent with good financial practice. This includes making certain that funds are used only for the purposes for which they were intended and in ways that do not violate the principles that resulted in tax-exempt status.

Independence

The audit committee is charged with protecting not only financial assets, but also the organization's most important asset: its good name and reputation.

To maintain this independence, the audit committee is charged with ensuring that:

- The audit committee itself is independent of the organization's management and its external auditor, focusing solely on representing the board's responsibility to protect the mission and best interests of the organization.

- The organization's internal auditor is independent from management and that the auditor's opinion is based only on its independent professional judgment.

- The organization's board members and management are independent from vendors to the board or, if not independent, that the relationships are fully disclosed.

A not-for-profit organization's audit committee has three main missions.

First, it represents the board of directors in overseeing the establishment and implementation of appropriate accounting policies and internal controls so that financial reporting is accurate and reliable and fraud is avoided. Therefore, the audit committee needs to work diligently to ensure proper stewardship over the organization's assets and to protect the organization's reputation through fiscal transparency.

Second, the audit committee assesses the business risks for the organization and determines whether it is planning adequately for those risks. To do this, the committee should review the organization's overall risk management profile, including investment practices, adherence to tax regulations, disaster recovery plans, compliance with donor/grantor requirements, state charitable registration and unclaimed property reporting, and adequate insurance coverage.

Third, the audit committee monitors the roles of the board, management and internal and external auditors to ensure that the organization follows good financial governance practices.

The exact responsibilities assigned to the audit committee to fulfill these missions will vary from organization to organization, depending on the not-for-profit's size and the nature of its activities.

The tasks most commonly assigned to an audit committee include:

- Recommending to the board, or appointing directly, an independent audit firm.
- Ensuring the appropriateness of financial statement presentation and the adequacy of footnote disclosures.
- Ensuring clear communication of financial information using appropriate communication methodology.
- Reviewing the scope and plan for the independent audit.
- Receiving and acting upon the results of the audit with the external auditors, including reporting the results to the full board.
- Providing oversight of the internal control structure.
- Approving the annual internal audit plan and review the resulting reports prepared by the internal auditor.
- Reviewing or approving the contracting for any non-audit services provided by the external auditors.
- Resolving disagreements between auditors and management.
- Reviewing the Form 990 that is filed with the Internal Revenue Service (IRS).

Audit committee members should meet with the organization's auditors at least twice a year — once to discuss the auditor's workplan and once to review their findings before they are presented to the board. In most cases, however, audit committee members' duties are more involved.

In larger not-for-profit organizations that have an internal audit department, the audit committee approves the department's workplan, receives its reports and oversees the department's staffing and performance. In some cases, the internal audit department reports administratively to the chief financial officer, but its workplan and reports should be approved and received by the audit committee. The internal audit director should have confidential access to the audit committee chair. Additionally, the committee should evaluate the performance of the internal audit director.

The committee should make sure the internal audit and external audit plans a are thorough and complement each other.

As part of its duties, the audit committee should be charged with monitoring specific policies that represent best practices, such as:

- A code of ethics for the organization, including the board;
- A conflict-of-interest policy for the organization, including the board (the code-of-ethics and the conflict-of-interest policy can also be incorporated into one policy);
- A whistle-blower policy through which stakeholders, including employees, can raise concerns without fear of retaliation; and
- A records-retention policy so that critical documents are preserved for a certain period of time.

Some organizations incorporate audit committee functions into their finance committees. The trend, however, is toward the establishment of separate audit committees with standing committee status. The role of an audit committee is quite different than the roles usually assigned to a finance committee.

A finance committee's principal task is the approval and monitoring of the budget, which requires individuals who understand the programmatic structure and mission of the organization. An audit committee, however, puts the focus on understanding the fundamental principles of accountability, financial reporting and internal controls and its members are likely to view the organization more critically.

If your audit committee is new, consider working with the board to draft an audit committee charter that spells out, in writing, the committee's exact responsibilities. (For an example of an audit committee charter, see Appendix I.)

Composition of the audit committee

The audit committee generally should be composed of three to five members drawn from the board of directors. All audit committee members should be independent of organization management: i.e., they should not have accepted, directly or indirectly, any salary or compensatory fees from the organization.

Most or all of the audit committee members should have a solid grounding in business and finance and a good understanding of internal control issues.

They should be financially literate: i.e., be able to read and interpret a financial statement and be conversant in basic financial terminology.

One or more of the members should be a financial expert with a professional knowledge of financial reporting (including generally accepted accounting principles or GAAP), business risk assessment and internal control practices. Ideally, there should also be individuals on the committee with specific knowledge of not-for-profit accounting and business issues.

Of course, the supply of individuals with such backgrounds will vary considerably from one organization to the next. If your organization does not have board members with a financial background, you should actively recruit such individuals, including bankers, accountants and other financial professionals to fill this need.

The number of finance committee members serving on the audit committee should be limited. The audit committee monitors the business operations of the organization creating a conflict-of-interest for finance committee members serving on the audit committee.

It is very important for audit committee members to have a healthy skepticism about what they are told and about how the organization operates. The audit committee should ask management difficult questions about its practices and policies and pursue issues until it is satisfied with the answers.

Individuals who are uncomfortable asking difficult questions or coming to critical conclusions can't serve effectively on an audit committee.

The final characteristic an audit committee member must possess is a willingness to commit the time and effort necessary to do the job.

Depending on your organization's size and structure, this time commitment may be substantial.

Member liability

Board members of not-for-profit organizations face potential personal legal liabilities, so the question of whether serving on an audit committee entails any further legal risk is a legitimate one.

Since many of the events that could result in liability for the board as a whole stem from failures in internal controls, the audit committee is partly responsible for protecting itself — and the rest of the board — from such liability.

Before considering any board position, you may wish to investigate whether your organization carries adequate directors and officers' (D&O) insurance coverage. D&O insurance coverage protects boards against allegations of wrongdoing.

When reviewing the D&O policy, be sure it covers legal costs, which will be incurred regardless of the outcome of a lawsuit. You may also wish to consult with legal counsel regarding the specific laws in your state concerning your exposure.

6 The inside perspective: Working within a not-for-profit organization

An effective audit committee must work with a variety of groups within an organization.

Specifically, the audit committee works with the board as a whole, with the organization's management team, and, if one exists, with the internal audit department. Understanding the audit committee's role in each of these relationships is essential.

The audit committee and the board

The audit committee represents the board of directors in fulfilling some of the board's responsibilities for financial oversight of the organization.

Although a share of the audit committee may be made up of board members, not all audit committee members need be board members. Including board members provides the expertise needed, while non-board members provide an independent perspective.

The committee should report at least twice a year to the board on 1) results of external and internal audits and any issues that arose in those audits that merit the board's attention, 2) issues of financial accountability and business risk that the organization faces, 3) any internal control or procedural issues, 4) new systems and controls evaluated and put in place, and 5) regulatory issues.

The audit committee and management

Management is responsible for creating and maintaining internal controls and the audit committee is responsible for seeing that those controls are adequate and implemented. While the committee will work collaboratively with the external auditors, internal auditors — if any — and management, the committee is independent of each of these groups and must come to its own conclusions.

As part of the audit process, the external auditors will consider the organization's internal controls. Their audit findings should include a list of control issues they believe need addressing and suggestions for improving them. If you have internal auditors, they, too, will test and report on internal control issues.

The audit committee should discuss these control issues with management and review management's plans for fixing them. In some cases, management may recommend against implementing an auditor's suggestions on a cost-benefit basis, or they may recommend an alternative solution.

The audit committee should consider these suggestions, discuss them with the auditors, if necessary, and bring any unresolved material disputes to the board's attention.

The audit committee can also provide management with a valuable, objective sounding board for any issues dealing with internal controls or the public trust. By giving management an opportunity to discuss sensitive matters up front, the audit committee can help head off potential problems before they arise.

Working with internal auditors

Today, audit committees are expecting more from their internal audit functions. If your not-for-profit organization has an internal audit function, the audit committee should work with it in much the same way that it works with your external auditors.

The committee should review and approve the internal audit work plan, including the areas within the organization targeted for detailed examination. The audit committee should receive and review the group's findings and discuss any control issues that have arisen.

Audit committees are also looking to internal auditors to monitor the status of various findings and recommendations to ensure appropriate corrective action plans are implemented.

Some internal auditors are developing more elaborate systems to identify findings as material weaknesses, significant deficiencies or reportable conditions.

Internal auditors may require periodic reports to be issued by the auditee on the status of the corrective action plan, require the auditee to present their responses to the audit committee or require a re-audit after a certain period of time.

8 A vigilant team: Working with your external auditors

The audit committee will spend much of its time dealing with your organization's external auditors, who have been appointed by the committee (or the board itself) to assist in assessing the organization's financial condition and financial oversight.

The pre-audit meeting

One of the audit committee's most important jobs is working with your auditors to ensure an effective audit effort.

Prior to the audit, the audit committee should meet with the external auditors to review their work plans. An auditor's work plan spells out its strategy for conducting the audit. It will identify those areas that the auditor has targeted for the greatest scrutiny, indicate staffing levels and set a schedule for the audit.

The audit committee should review the work plan with the auditors in light of the committee's own concerns regarding business risks, internal controls and other issues. If the audit committee has concerns about a specific financial area, the auditor's work plan should include that area.

If the plan does not include the area, the committee must decide whether to add it, or substitute it, for another area. It must then determine the cost of any additional work it requests, and whether there are steps the organization can take to help control the cost of the audit.

The pre-audit meeting is also the venue for the auditors to solicit input from the committee on areas of financial statement and internal control risk, including the risk of fraud.

The audit committee should also discuss with the auditors any internal control or other issues raised by the prior year's audit. The committee should inform the auditor of the steps, if any, management has taken to resolve those issues, and should seek the auditor's opinion of those solutions.

The post-audit meeting

As its name would imply, the post-audit meeting is held after the auditors complete their fieldwork. At this meeting, the audit committee will discuss many items with the auditors.

The auditors will present audit results, including draft reports, supplemental financial information and related auditor reports for review and discussion by the committee. In addition, the auditors' professional standards require that they communicate certain matters to the committee.

Statement of Auditing Standards (SAS) No. 60, "Communications of Internal Control Structure Matters Noted in an Audit," requires auditors to report to the audit committee matters that "… in the auditors' judgment… represent reportable conditions in the design or operations of the internal control structure, which would adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements."

These are referred to as a "reportable conditions" and are normally included in the management advisory comment letter with the auditors' other recommendations to management.

SAS No. 61, "Communications with Audit Committees," mandates that the auditor discuss the following issues:

- *The auditors' responsibility under GAAP*
  The auditors must communicate their level of responsibility for matters such as review of, and reports related to, the internal control structure and whether the financial statements are free of material misstatement. Auditors also must make sure that the committee understands the fundamental concepts of an audit. Specifically, they should make it clear to the committee that an audit is designed to deliver reasonable, not absolute, assurance that the financial statements are presented fairly and in accordance with GAAP.

- *Significant accounting policies*
  The auditors should inform the audit committee about selection of, changes in or application of significant accounting principles and financial reporting practices and policies. Discussions should include the effect of these practices and policies in controversial or emerging areas and any likely future changes.

- *Judgments of management and accounting estimates*
  Accounting estimates are an integral part of financial statements. They can be particularly sensitive because of the possibility that future amounts may differ significantly from those estimates. The auditors should educate the audit committee on the process that management employed to formulate sensitive accounting estimates and on the basis for the auditors' conclusions regarding the reasonableness of those estimates. The allowance for uncollectible accounts receivable is an example of a significant estimate.

- *Significant audit adjustments*
  The audit committee should be informed of all significant adjustments made as a result of the audit that may not have been otherwise detected by management. Management should also provide the audit committee with a listing of proposed audit adjustments that were not recorded because the amounts involved were not considered material to the financial statements, either on an individual basis or in the aggregate.

- *Responsibility for other information in documents containing audited financial statements*
  The auditors should discuss their responsibility and involvement with information in other documents containing audited financial

statements, such as published annual reports.

- *Disagreements with management*
  The auditors should discuss any disagreements with management about matters related to accounting principles, financial reporting practices and policies, and auditing matters that could be significant to the financial statements or the auditors' report. These disagreements might include application of accounting principles, judgments about accounting estimates, the scope of the audit, or the wording of the auditors' report.

- *Consultation with other accountants*
  If the auditors are aware that management has consulted with other auditors about auditing, accounting or financial reporting matters, the views of those auditors should be discussed with the audit committee.

- *Major issues discussed with management prior to retention*
  The auditors and the audit committee should review any major management issues raised when the auditors were retained, including discussions about accounting principles, financial reporting practices and policies, and auditing standards and procedures.

- *Difficulties encountered in performing the audit*
  The auditors should inform the audit committee of serious difficulties in dealing with management while performing the audit, such as failure to provide necessary information, unreasonable delays, unavailability of client personnel, or failure of client personnel to complete requested schedules on a timely basis.

In addition to these topics, the audit committee may also want to discuss the following areas with the auditors:

- Assessment of the audit compared with anticipated results.

- Any need to expand audit procedures and the reasons for doing so.

- Changes in report format or note disclosures from the previous year and the reasons for these changes.

- Evaluation of personnel involved in preparing and controlling the financial information.

- Non-audit services provided to the organization by the external auditors for the prior year and related fees.

- The report of the audit committee

that the audit committee chairperson will present to the governing board of directors.

Generally, during the post-audit meeting, the audit committee will meet in separate executive sessions with the external auditors, the internal auditors and with financial management.

If an executive session deals with issues including compliance or whistle-blower situations, the audit committee may consider having its own legal counsel present.

Evaluating your external auditors

Part of the audit committee's responsibility is to evaluate the qualities of your external auditors. The audit committee should consider many factors when evaluating the auditors, including:

- *Industry expertise* — The not-for-profit sector has a variety of specific accounting requirements that an auditor should know intimately. Strong experience in the not-for-profit sector is a desirable characteristic in your auditor.

- *Tax capabilities* — You should look for a firm with a strong tax specialty in the not-for-profit area. Not-for-profit organizations have many tax issues and, because an organization's tax-exempt status is critical, it is vital that the firm understand relevant tax issues.

- *Manpower and location*—Does your audit firm have sufficient staff to do the job? Insufficient staff can lead to delays or poor performance. Where is its staff located? If your audit will be staffed from out of town, travel expenses may add to your bill.

- *Depth of expert resources*—The firm should have the depth of expertise to provide its own staff and your organization with information and experience that provides critical business advice to improve your organization's operations.

- *Price*—While price should not be the sole determining factor in your auditor choice, it is certainly a consideration. Be sure to evaluate both what the auditors propose to do for their fee and their ability to serve the special needs of your organization.

- *Use of technology*—Information technology plays an important role in the accounting profession. Your auditors will have to work with electronic data from your systems. An ability to use technology allows the auditor to work more effectively and efficiently with less disruption of your staff.

- *Chemistry* — The audit committee, management and people throughout your organization will all have to work closely with your auditors. The personal chemistry between key personnel in your organization and the partners, managers and staff of your auditors is very important.

A not-for-profit organization may put its audit work out for proposal for a variety of reasons, some having to do with the auditor, some having to do with the organization itself, and some having to do with a policy of periodically re-bidding all procurement arrangements.

If it becomes necessary to solicit proposals, the audit committee, usually with management's assistance, should prepare or approve a list of potential accounting firms and a request for proposal (RFP). The RFP spells out the scope of services your organization requires, as well as specific questions that management would like proposing firms to answer.

The management team, or the audit committee itself, usually reviews the proposals and identifies a short list of candidates for oral presentations. The audit committee, often in conjunction with management, conducts the oral interviews and then presents its selection to the board for approval.

Audit and compliance committee

Many not-for-profit organizations are studying the possibility of enhancing the responsibility of the audit committee by adding compliance oversight responsibilities. To cover the scope of its duties, some organizations have changed the name of the audit committee to audit and compliance committee.

Compliance would entail a review and monitoring of legal and regulatory issues, which are are presently beyond the responsibility of most audit committees.

Special financial, tax and regulatory concerns for not-for-profit organizations

While audit committee members should have a solid grounding in finance before being appointed, they also need a basic understanding of the specific financial management issues that face not-for-profit organizations.

Six issues audit committee members should consider as they address their organization's controls and financial reports are tax-exempt status, private inurement, intermediate sanctions, unrelated business income tax, issues related to donations, and the importance of staff.

Tax-exempt status

The Internal Revenue Code (IRC) provides more than 20 categories of tax-exempt status; however, most not-for-profit organizations derive their tax-exempt status from one of the following five sections of the IRC:

- *Section 501(c)(3)*—Religious, charitable, educational, and scientific organizations;
- *Section 501(c)(4)*—Social welfare organizations and civic clubs;
- *Section 501(c)(5)*—Labor unions and agricultural organizations;
- *Section 501(c)(6)*—Trade and professional associations; and
- *Section 501(c)(7)*—Social clubs.

One of the greatest responsibilities for audit committee members — and, indeed, for all board members — is to ensure that the organization is in compliance with tax laws and does not endanger its tax-exempt status.

Losing tax-exempt status could devastate your organization through resulting large income tax liabilities, excise taxes (some of which may be imposed on officers and directors personally), denied tax deductions for your contributors, loss of government grants, ineligibility for reduced postage rates, and loss of various state tax exemptions.

The category of your tax-exempt status generally determines the primary thrust of your activities. For example, organizations exempt under 501(c)(3) and 501(c)(4) usually have an outward focus and provide some type of public good.

Organizations exempt under 501(c)(5) or 501(c)(7) are generally inwardly focused and act for the benefit of their members, while 501(c)(6) organizations must maintain or improve business conditions for an industry as a whole, as opposed to providing specific services for members.

The category of your tax-exempt status also determines, in part, what activities would threaten its tax-exempt status.

Intervention in political campaign activities can cause problems for most not-for-profit organizations. Specifically, Section 501(c)(3) organizations are strictly prohibited from intervening in partisan political campaigns to elect, defeat or appoint persons to public office.

Violation of the rules may result in loss of tax-exempt status, and the imposition of income taxes and excise taxes on the organization and those persons (in their personal capacity) who violated the rules. Other not-for-profit organizations may incur a substantial tax on any money spent for political purposes.

The category of your tax-exempt status also determines the extent to which your organization is allowed to lobby. While lobbying may be a key activity for a trade association or social welfare organization, no substantial part of a charitable organization's activities may constitute lobbying.

Not-for-profit organizations that lobby may be subject to lobbying taxes. You should ensure that management has adequately addressed the applicable lobbying rules.

Tax-exempt status normally requires the filing of IRS Form 990, which is a public document. That means you must provide a copy in a timely manner to anyone who requests it. Consequently, the audit committee should realize that any interested party (e.g., your competitors, the news media, your employees, your members, or your donors) may review the organization's financial activities.

Public disclosure demands that you focus on the information contained in Form 990 and anticipate questions from the public. You should carefully consider how you will address the questions that may result when the public at large views your organization's Form 990.

Private inurement

Some transactions may result in the loss of tax-exempt status for any not-for-profit organization. One of the greatest dangers, both to your organization's tax-exempt status and to its public image, is private inurement.

Private inurement may result when the organization's assets or earnings are used for the benefit of an insider rather than for the good of the organization itself or its stakeholders.

Insiders are generally directors, officers and certain key employees, as well as their families or businesses. Embezzlement or theft are obvious cases, but there are other more common examples.

For instance, compensation paid to employees that is disproportionately high compared with their duties could be considered private inurement. Excessive travel or entertainment expenses could also constitute private inurement. Procuring merchandise or services from vendors who are relatives or friends of insiders at higher than market rates or for other inappropriate reasons can also constitute private inurement.

You should closely scrutinize all transactions with insiders because of the inherent conflict of interest that exists. Not-for-profit organizations are also prohibited from distributing their earnings to their members.

Another major consequence of private inurement is severe damage to the organization's reputation. Therefore, the audit committee and your organization as a whole should set and follow very strict standards concerning compensation and benefits; travel, entertainment and other expenses; and any financial dealings between the organization and any parties related to staff, management or the board.

In addition, under the excess benefit rules, called "intermediate sanctions," improper dealing with insiders can also result in severe financial penalties in the form of excise taxes imposed directly on those insiders in their personal capacity who took unfair advantage of a 501(c)(3) or 501(c)(4) organization and on those managers who knowingly approved the transactions. These provisions are discussed in more detail in the next section.

Intermediate sanctions

The intermediate sanctions apply to organizations exempt from tax under 501(c)(3) and 501(c)(4) and provide another strong reason to guard against private inurement.

Where the IRS previously only had the option of revoking a not-for-profit organization's tax-exempt status as a penalty for private inurement, it can now force "disqualified persons" (generally directors, officers, key employees, or others with substantial influence over the organization's affairs) benefiting from inappropriate transactions to pay an excise tax of 25 percent of the excess benefit received.

Those persons must also undo the inappropriate transaction by returning the excess benefit, including interest, to the organization or face an additional excise tax of 200 percent of the improper benefit.

In short, they have to at least pay a 25 percent excise tax on the improper benefit and then return the money they are taxed on — a stiff penalty, indeed.

Any officer, director, trustee, or similarly empowered person within the organization who knowingly and willfully approves the transaction also faces an excise tax of 10 percent of the excess benefit — up to a limit of $10,000 per transaction.

A transaction is covered if the benefit provided to the insider exceeds the value of the consideration the organization receives. This consideration can consist of services provided in exchange for compensation.

Typical transactions covered include unreasonable salaries and benefits; selling goods, property, or services to the organization for more than they are worth, or paying less than fair market value for the organization's assets.

Persons who have a substantial influence over the organization's affairs are covered by the law. This determination is based on facts and circumstances and generally will include members of the governing body (the board), the chief executive officer, chief operating officer, and chief financial officer.

Audit committee members are disqualified persons if they are members of the board.

Once someone is covered by this definition, that person, his or her family members and any business in which they own a 35 percent interest is also included. Even when persons resign from the organization, they retain classification as a disqualified person for five years.

As an audit committee member, you should ensure the organization has procedures in place to prevent conflicts of interest and excessive payments to disqualified persons.

All transactions involving insiders should be approved by the board of directors or a committee that has no conflicts of interest with the person whose transaction is under consideration. You should also make sure that all compensation and benefits, including those provided to you as a board member or officer, are properly disclosed on Form 990 and, if taxable, reported on Form 1099 or Form W-2 as appropriate.

Failure to properly document and report compensation and benefits is likely to result in violations of these rules.

The intermediate sanctions violations also carry a heavy public relations cost. Not-for-profit organizations must disclose the full details of any excess benefit transactions and the names of the individuals involved on the annual information return, Form 990.

Because these forms are public documents and are often reviewed by potential funders, these disclosures could be very damaging.

Finally, many state attorneys general have broad powers to impose additional penalties on persons who misuse charitable assets. Guarding against intermediate sanctions is a vital audit committee duty.

Unrelated business income tax

Not-for-profit organizations often conduct activities that generate income that is unrelated to their tax-exempt purposes.

The IRS imposes an unrelated business income tax (UBIT) on income generated from these activities. While unrelated business income can arise from many activities, the sale of advertising space in an organization's newsletter is a good example of income that is almost always considered unrelated business income.

The Internal Revenue Code imposes income taxes on the net income generated from your unrelated business activities even though the net proceeds are used for tax-exempt purposes.

There are three items to keep in mind concerning UBIT. First, the audit committee needs to ensure that the organization's unrelated business activities do not become the primary focus of the organization. Excessive involvement in unrelated business activities can threaten the organization's tax-exempt status.

Second, the audit committee should realize that such activities, even after paying UBIT, can be a valuable source of income for the organization.

Third, the audit committee must ensure that the UBIT is properly reported o to the IRS on Form 990-T.

Issues related to donations

One key difference between not-for-profit organizations and for-profit businesses is the source of revenue. For-profit businesses are paid in exchange for goods or services. Customers that do not receive goods or services will complain, providing a built-in financial control.

Not-for-profit organizations, on the other hand, often rely heavily on donations or dues, for which the donor may not receive goods or services in return. These one-way, or non-reciprocal, transactions present internal control issues that the audit committee should ensure the organization addresses.

Fund-raising activities may differ, but you must address the question of developing controls that protect contributions. Your external auditor should be able to recommend any necessary improvements in your system of internal control over donations.

Not-for-profit organizations or related charitable foundations that intend to solicit donations may have to register with the state attorney general before these solicitations occur. Organizations that solicit donations nationwide may be required to register in approximately 40 states.

In addition, federal and state regulations normally require solicitations for dues and contributions to contain certain specified language.

Finally, charities are required to follow the quid pro quo rules when they provide certain goods or services to donors in exchange for contributions. The failure to register with the state attorneys general, if required, or include the required notices could subject you to additional taxes or financial penalties.

The importance of staff

The best single control that your organization can use to mitigate risks is an effective management team.

Your chief financial officer (CFO), controller and other financial personnel should be professional, well-trained and fairly compensated. Your job, and the job of your auditors, will be much easier — and the risk of internal control and other problems significantly lessened — if your staff has the appropriate experience and training to do their jobs.

To mitigate potential risks, it is also important to do an up-front background check on senior financial and executive staff.

You can take a number of steps to ensure a strong financial staff.

Ask your auditors for their impression of your CFO, controller and other financial staff during the post-audit meeting. Your auditors are often in the best position to evaluate not only your internal controls, but also the people you rely on to enforce them.

They also can knowledgeably compare your people and your compensation and benefits packages with those at similar organizations.

How high is the turnover rate among your financial staff? High turnover makes it difficult to maintain a consistent control environment. If you believe that turnover may be threatening your organization's controls, you may need to bring it to the attention of the board or explore possible solutions with management.

Be sure that your organization maintains a strong core of skilled professionals, and that the rest of your financial team receives adequate training and supervision.

When your primary focus is on the balance sheet, it can often be easy to overlook the human factor. Make sure you don't.

As this brief overview demonstrates, an audit committee's job is varied and challenging. However, while an audit committee's duties will differ at each organization, there is one overriding responsibility — maintaining vigilance.

Consider the various scandals that have befallen not-for-profit organizations. Some could have been averted had a vigilant audit committee — with the support of the full board — raised questions about internal controls, salaries and policies.

As an audit committee member, asking those questions — and ensuring satisfactory answers —is your responsibility. Your board, your organization, the clients or members that your organization serves, and the taxpaying public depend on your diligence.

In an environment in which confidence in many institutions is eroding, all not-for-profit organizations are under closer scrutiny than ever before.

If your organization, your board, and your audit committee do not ask the tough questions, someone else very likely will.

APPENDIX I: SAMPLE AUDIT COMMITTEE CHARTER

Membership

The audit committee will consist of five board members who are appointed by the board of directors to staggered terms. These individuals, or their immediate relatives, shall not hold a salaried position with the organization nor be employed by any entity that provides services for a fee to the organization.

The Chair of the audit committee shall be selected by the board of directors according to the board's usual procedures for making such appointments.

At least one of the members of the committee shall be knowledgeable, by training and experience, in generally accepted accounting principles (GAAP), the preparation of financial statements and the principles of internal control.

Functions and responsibilities

The board has full authority and ultimate responsibility for the stewardship and management of all resources entrusted to the organization. The board has established the audit committee to oversee the annual audit of the organization's financial statements by a public accounting firm and to monitor the review, establishment and implementation of accounting policies and internal controls.

The audit committee shall assume the following responsibilities to accomplish its charge:

- Review and update the audit committee's charter annually or as deemed necessary.
- Recommend the selection and retention of the independent public accountants for the organization to the board.
- Recommend to the board, when the audit committee deems it advisable, that the independent public accountants engages in specific studies and reports regarding auditing matters, accounting procedures and other matters.
- Review annual financial statements, including any adjustments to those statements recommended by the independent public accountants, and any significant issues that arose in connection with the preparation of those financial statements.
- In consultation with the independent public accountants, recommend to management inclusion of financial disclosures in audited financial statements.
- Review, as appropriate and in consultation with the independent public accountants, accounting policies, internal controls and procedures of the organization as well as any management responses to comments relating to those policies and procedures.

- Evaluate the business risks of the organization and plans to mitigate risk, including requiring management to communicate its risk assessments to the committee.
- Investigate, when the audit committee deems it necessary, potential or actual improprieties in the organization's operations.
- Meet at least annually with the senior management and the independent public accountants to discuss any issues arising from the audit committee's responsibilities.
- Meet at least twice annually with the independent public accountants, or more frequently as circumstances require, to discuss any issues arising from the audit committee's responsibilities. Two such meetings will be an audit planning meeting to adopt the scope of the upcoming audit and a post-audit meeting to receive the results of the audit.
- The audit committee may request the presence of members of management or others to attend meetings and provide pertinent information as necessary, including review of advisory services and related fees provided by the independent public accountants.
- Meeting at least annually with management (outside the presence of the independent public accountants) to discuss management's evaluation of the work performed by the independent public accountants.
- Obtaining from management and external advisors reports relating to accounting, tax, regulatory, governance, investment, and other business matters.
- Obtaining from management its assessment of the business risks facing the organization and its plans to mitigate those risks.
- Recommending to the board a conflict-of-interest policy, recommending changes as needed, and ensuring the organization's compliance with its policy on at least an annual basis.
- Recommending to the board a code of ethical conduct, recommending changes as needed, and ensuring that a system has been established to enforce this code for all staff and volunteers.
- Obtaining the advice of outside consultants and professionals (including, but not limited to, retention of special legal counsel) to advise the audit committee on matters within the scope of its charge.
- Submitting the minutes of all meetings of the audit committee to the board in a timely manner.
- Reporting to the board, either in writing or in person, at least once a year.
- Reviewing Form 990, 990-T and related state filings to ensure compliance with tax laws.

APPENDIX II: SAMPLE AUDIT COMMITTEE MEETING PLAN

The audit planning meeting will include these items:

1. Review and discuss with external auditors the scope and plan for the current year's audit.
2. Examine areas of significant audit emphasis (e.g., this year's fund-raising campaign, compliance with Office of Management and Budget Circular A-133, etc.).
3. Discuss significant new and pending accounting principles, financial reporting practices or auditing matters with external auditors.
4. Review management response to the external auditor's management advisory letter resulting from the prior year audit, including plan of action, if necessary.
5. Review the internal audit plan and scope for the year with internal audit manager (if there is such a function). Receive and review reports from internal auditors.

The post-audit meeting will include these items:

1. Review the status of the current year's audit with the external auditors and discuss matters under consideration, including new disclosures and anticipated major variances or changes in year-end financial statements.
2. Review the results of the investigation of items requested by the committee.
3. Review the draft financial statements and the applicable auditors' report.
4. Receive the report to the audit committee from the external auditors regarding required communications.
5. Receive recommendations from the external auditors to management resulting from the audit, including "reportable conditions."
6. Meet separately and privately, in executive session, with external auditors.
7. Meet separately and privately, in executive session, with internal auditors.
8. Meet separately and privately, in executive session, with financial management.

The audit committee may request the presence of members of management or others to attend meetings and provide pertinent information as necessary.

Other matters which should receive consideration for discussion include:

1. Significant findings during the year, including the status of prior year management recommendations.
2. Any difficulties encountered in the course of performing audit work, including any restrictions on the scope of activities or access to required information.

3. Significant revisions or adjustments to the auditors' work plan as initially approved by the audit committee.
4. The auditors' independent qualitative judgments about the appropriateness, not just the acceptability, of the accounting principles and the clarity of the financial disclosure practices used or proposed to be adopted by the organization.
5. Confirm and assure the independence of the independent public accountants, including review of advisory services and related fees provided by the independent public accountants.

APPENDIX III: SAMPLE RECORDS-RETENTION PLAN

RECORD CATEGORY	DESCRIPTION OF RECORDS	MANNER OF RECORD KEEPING	RETENTION PERIOD	DISPOSITION
General	Correspondence	Compile and store current correspondence in appropriate subject files or in accordance with general corporate filing guidelines.	Seven years	Archive only correspondence important to business activities. Useless documents should be recycled or shredded.
	Accounts payable, ledgers and schedules	Compile and file records on an annual basis.	Seven years. Store with financial records.	Archive with financial records and shred after three years of storage.
	Accounts receivable, ledgers and schedules	Compile and file on an annual basis.	Seven years. store with financial records.	Archive with financial records and shred after three years of storage.
	Annual information returns (IRS Forms 990)	Federal law requires that copies of the three most recent years' returns be kept in the organization's headquarters and be made available for public inspection.	Permanent. Store with financial records.	Not applicable
	Audit reports	Compile and file records on an annual basis.	Permanent. Store with financial records.	Not applicable
	Bank statements and reconciliations	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Cash books	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Chart of accounts	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Cancelled checks	For important payments, i.e., taxes, purchases of property, special contracts, etc., checks should be filed with the papers pertaining to the underlying transaction. Otherwise, compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Depreciation schedules	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Duplicate deposit slips	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.

RECORD CATEGORY	DESCRIPTION OF RECORDS	MANNER OF RECORD KEEPING	RETENTION PERIOD	DISPOSITION
General	Duplicate deposit slips	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Expense analyses and distribution schedules	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Year-end financial statements (others are optional)	Compile and file on an annual basis.	Permanent. Store with financial records.	Not applicable
	General/private ledgers, year-end trial balances	Compile and file on an annual basis.	Seven years. Store with financial records	Shred at the end of the retention period.
	Journal entries	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Notes receivable, ledgers and schedules	Compile and file records on an annual basis.	Permanent. Store with financial records.	Not applicable
	Payroll records and summaries	Compile and file records on an annual basis.	Permanent. Store with financial records.	Shred at the end of the retention period.
	Petty cash vouchers	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Property records, including costs, depreciation reserves, year-end trial balances, depreciation schedules, blueprints and plans.	Compile and file records on an annual basis.	Permanent. Store with financial records.	Not applicable
	Tax returns, worksheets and revenue agents' reports	Compile and file records on an annual basis.	Permanent. Store with financial records.	Not applicable
	Time cards	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Vouchers (invoices) for payments to vendors and employees, including allowances and reimbursements of employees, officers and consultants for travel and entertainment expenses	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.

RECORD CATEGORY	DESCRIPTION OF RECORDS	MANNER OF RECORD KEEPING	RETENTION PERIOD	DISPOSITION
General	Withholding tax statements	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
Governance	Board of directors' minutes, notes and reports from all years	Compile and file records on an annual basis.	Permanent. Store with financial records.	Not applicable
	Governing documents, including articles of incorporation, bylaws, amendments and other related documents	File documents with other corporate records.	Permanent. Store with financial records.	Not applicable
Grants	Proposals, original contract agreements, supporting data, accounting documents, financials, subrecipient policy reports, time cards, invoices for payments to subawardees, subaward agreements, procurement documents, A-133 audits and related correspondence	Compile and file records on an annual basis.	Seven years. Store with financial records.	Archive with grant records for three years at the end of the retention period following the filing of the closing report and acceptance by the funding agency.
Human resources	Employment applications	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.
	Personnel files (current)	Compile and file records on an annual basis.	Permanent. Store with other human resources records.	Not applicable
	Personnel files (from date of termination)	Compile and file records on an annual basis.	Permanent. Store with other human resources records.	Not applicable
	Retirement and pension records	Compile and file records on an annual basis.	Permanent. Store with other human resources records.	Not applicable
	Records of pension paid to employees or beneficiaries (after final payment)	Compile and file records on an annual basis.	Permanent. Store with other human resources records.	Not applicable
	Insurance policies (expired)	Compile and file records on an annual basis.	Permanent. Store with other human resources records.	Not applicable
	Insurance records, current accident reports, claims	Compile and file records on an annual basis.	Permanent. Store with other human resources records.	Not applicable
	Garnishments	Compile and file records on an annual basis.	Seven years. Store with financial records.	Shred at the end of the retention period.

RECORD CATEGORY	DESCRIPTION OF RECORDS	MANNER OF RECORD KEEPING	RETENTION PERIOD	DISPOSITION
Whistle-blower	Records relating to employee complaints or concerns pursuant to the organization's whistle-blower policy	Compile and file records on an annual basis.	Seven years; notwithstanding any shorter period provided above for the particular category of document. Store with other whistle-blower records.	Unless otherwise provided above for the particular category of document, shred at the end of the retention period.

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OTHER RESOURCES AVAILABLE

In addition to our not-for-profit audit committee handbook, Grant Thornton also offers industry publications, including:

- *Serving on the board of a not-for-profit organization*
- *Planned giving: A board member's perspective*
- *Investments policy for not-for-profits*
- *NFPerspectives* quarterly newsletter

To receive any of these publications or for more information about Grant Thornton's not-for-profit practice, contact:

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