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Lindley & Associates LLC newsletter is written by Martha Lindley CPA, providing timely articles for nonprofits. As a national speaker on nonprofit issues and Single Audit compliance, she personally writes and provides the quarterly newsletter to over 400 nonprofits as a contribution to our nonprofit community.

We specialize in not for profit organizations and government funded entities providing audit, reviews and tax preparation services. We are committed to those agencies that provide services to our community.

**THIS ISSUE**

Receive More Federal Funding Based on Statistical Research  
Improve Being Awarded More Federal Funds  
SOX Policies: Conflict of Interest, Record Retention and Whistleblower



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The information in this newsletter is necessarily brief. No final conclusions on these topics should be drawn without further review and consultation. For additional information, PLEASE CONTACT US.

**INCREASE FEDERAL FUNDING—STATISTICALLY BASED**

By Martha A Lindley CPA

The statistically based research study has been translated below. In research, “significant” means statistically significant, a change that is too large to be chance, the difference was discernible. Hypothesis: What specific criteria do government funders look at when granting awards to a nonprofit? As a funding source, 11% of NFPs revenue is received from the government (donations comprise 17% of revenue). Five hypotheses tested were:

1) **Inefficiency** – Defined as “total expenses divided by program expenses” (total expenses/program expenses). Many studies have confirmed that that this ratio has a significant **negative** effect on funding if deemed to “high”. To many, this ratio translates to: for every dollar donated, how many cents go to the program? The funder uses this infor-

mation to determine “efficiency” of the programs, all other factors being equal. Since government funders stress “performance” and outcome measures, this ratio is also important. This ratio is used to determine efficiency and a poor ratio effects government funding. The study showed a 1% decrease in government funding for each 1.1% increase in the percentage.

Auditors’ recommendation: Use the statement of functional expenses to tell the story. Program items that can skew the results – such as large in-kind donations or bad debt – can be subtotaled at the bottom of the statement. Also, the percentages can be listed at the bottom of the schedule, a mnemonic device, to pay close attention to these percentages.

Continued page 2, column 2

**CLOUD STORAGE AND HIPAA: ROUND 2**

By Ryan Kauzlarich, Audit Manager

Only 5 years ago it was difficult to find HIPAA compliant cloud storage or processing. In fact, your friendly auditors usually advocated against the use of cloud storage for HIPAA compliant organizations due to cost, security, compliance and complexity. That really isn’t the case anymore. Compliant cloud servers and storage are now readily at your fingertips and are often times well in advance of current HIPAA requirements for encryption and security.

If your organization utilizes case managers or employees

who use the same laptop or should be treated as such. Most organizations will want to have direct control/access to server back-ups, while others are 100% cloud based and prefer not to have any “brick and mortar”. Speak to your IT team about what path works best for your organization.

**Ryan Kauzlarich, Audit Manager**, has over fourteen years of compliance audit experience, including five years as contract internal auditor at Microsoft Legal and Corporate Affairs Division and nine years at Lindley & Associates LLC.

Cloud based server back-up and cloud based storage are very different functions and

## How to Choose a Single Audit Auditor

All CPA firms performing audit and attest (compilations and reviews) in this state are required to have a peer review. The WA Board of Accountancy appoints the WA Society of CPAs to conduct reviews. The peer reviewer conducts the review at the CPA office, reviewing a sample of files for quality. For auditors performing Single Audits (SA), there is additional testing requirements. The results are now posted to a national data base that are shared with the federal government.

Three factors determined by the AICPA to have a statistically significant correlation to quality performance:

- 1) **Size of the single audit practice** – the more the firm performs, the better. Lindley & Associates has performed Single Audits since 2000.
- 2) **GAQC membership** – Lindley & Assoc is a member
- 3) **Qualifications of the engagement partner** (number of single audits reviewed, years of experience, hours of single audit specific training taken) – Martha Lindley has performed/reviewed hundreds of Single Audits, has performed SA since 1992, has taught Single Audit standards for the AICPA or Surgents since 2000. She worked in the State Auditors Office for four years, which performs virtually all Single Audits in WA State.

### GOT FILES?

#### RECORD RETENTION POLICY

SOX Section 1102, which makes it a crime for non-profits to alter or destroy documents that should be maintained for use in official proceedings. It also makes it a crime to impede or obstruct such official proceedings. The destruction-of-documents language in SOX has led many nonprofits to adopt specific policies detailing which documents must be kept and for how long.

**How the NFP can comply:** Review grant contracts – federal state and local contracts frequently have a record retention policy. If there are varying time frames – say five and seven years – adopt the longest. Filing documents by year (both electronically and physically) will facilitate the record destruction cycle. Adopt an electronic file storing plan will assist in record retention. If files are electronic, the hardware and software must also be retained to access the information during the retention period - floppy disks!

## Federal funding Continued from page 1

2) **Amount of advertising (or fundraising)** – Many studies have confirmed that that this ratio has a significant **positive** effect on government funding. As these expenses are often not disaggregated by the client, the reader cannot determine the purpose of the expenses – for donations or grant solicitation or mailers, or dinners, for example. For Federal grants which include a substantial match requirement, this may reinforce that the NFP has mechanisms in place to increase non-governmental funding. The study showed a 1% increase in fundraising expenses results in .4% (that is point four, not four) in government funding.

**Auditor recommendation:** Many NFOs fail to break out the fundraising costs; using “fundraising” with no detail at all. Classifications could be donor cultivation, direct mail or videos. Additional detail can be included the footnotes.

3) **Age of Organization** - Studies have indicated that there is a significant **positive** factor in government funding related to the age of the NFPs, though some studies suggest that younger NFPs may have a more “fashionable” mission and draw more donations. This may be that newer NFP may have perceived missions that are more attractive and innovative. **Auditor recommendation:** There age cannot be changed, however, there are two important places to describe the NFP mission: Note 1 of the financial statements and page 2 for Form 990 – program description. Read and refresh annually – has the description been the same for the last ten years? If you read these program descriptions, would you be compelled to write a check?

4) **Size** – There was **no** significant correlation between the size of the organization and the effect of federal funding, however, larger organizations have more non-governmental funding, which indicates additional funding for a match requirement.

**Auditor recommendation:** The financial statements and Form 990 can break out the revenue sources in additional detail to tell the story, or this detail can be in the footnotes. Again, a chance to tell your story effects the amount of funding.

5) **Wealth** - There is a significant **negative** correlation between “reserves” of the organization and receiving government funding. A 1% increase in the years-of-available funding (total available liquid assets/expenses) – leads to a .33 % decreases in government funding.

**Auditor recommendation:** NFPs need to have an operating cushion, but there is a perceived tipping point of giving money to an organization with money does not make sense.

Nicholas Marudas, Auburn Montgomery, Fred Jacobs, Journal of Management and Marketing Research, data base National Center for Charitable Statistics

## CONFLICT OF INTEREST

“A conflict of interest occurs where individuals’ obligation to further the organization’s charitable purposes is at odds with their own financial interests. For example, a conflict of interest would occur where an officer, director or trustee votes on a contract between the organization and a business that is owned by the officer, director or trustee. Conflicts of interest frequently arise when setting compensation or benefits for officers, directors or trustees. A conflict of interest policy is intended to help ensure that when actual or potential conflicts of interest arise, the organization has a process in place under which the affected individual will advise the governing body about all the relevant facts concerning the situation. A conflict of interest policy is also intended to establish procedures under which individuals who have a conflict of interest will be excused from voting on such matters.

Apart from any appearance of impropriety, organizations will lose their tax-exempt status unless they op-

erate in a manner consistent with their charitable purposes. Serving private interests more than insubstantially is inconsistent with accomplishing charitable purposes. IRS website, updated 1.27.2017

**How the NFP can comply:** We cannot emphasize strongly enough the important of written conflict of interest for NFP, and even greater compliance when federal funding is involved. The document should be included in the board introduction packet, distributed and signed annually, and then retained in accordance with the record retention policy.



## IMPROVE BEING AWARDED FED FUNDS

1) The federal grant approval process identifies a “need” and funds the “need”, not the organization.

2) Federal Agencies request grant proposals, selecting those NFPs that can clearly identify how the need can be met. Money is always an issue. To address these areas in your proposal, outline your unit cost and quantifying the delivery system. Unit cost information moves your proposal to the top of the list.

3) Argue both sides of the argument – this is the cost to provide the service, BUT this the cost to NOT provide the service.

4) Federal awards are awarded on a competitive basis, usually a point system. Arrange your proposal in the same format as the proposal to facilitate comparison of apples to apples.

5) The budget should match the format provided. Do not make logic errors, such as forgetting to include payroll taxes in the benefit line. When com-

pared with other proposals, your error costs to make the budget well-rounded, it awarded and an important line item was missed, it will take time to correct later.

6) Grantors give higher credence to audited financial statements, per my discussions with Federal program personnel. While they may accept other CPA prepared information, remember that in the evaluation process, the lack of an audit report is not ranked the same and those NFPs with an audit.

7) The Feds are taught to read monitoring reports for inconsistencies and errors. It is their job to identify weaknesses and look for problems, as these issues compromise meeting the “need”. If there are many issues, they will schedule a site visit.

8) The Feds take site visits very seriously and very few are random, i.e. there is an agenda. Be prepared.

9) The Feds have seen the worse of the worse in financial management.

They will terminate the funding if your organization is not meeting the need in a cost effective manner.

10) The wheels of government turn slowly but finely – the Feds do not move quickly. They genuinely want to work with the NFP to address and correct issues, but will not hesitate to terminate funding when prudent.

#### WHAT IS A WHISTLEBLOWER POLICY

SOX Section 1107 of the statute makes it a crime for a nonprofit to retaliate against an employee who provides a federal law enforcement officer with truthful information about a nonprofit’s having committed or planned to commit a federal offense.

**How the NFP can comply:** Include the whistleblower policy in the employee handbook with a non-management contact person (usually a board member), post policy in an area shared by employees (over the copier), and adopt a board policy of how reports will be handled (who, documentation requirements, and resolution).