

Profitable Solutions for Nonprofits

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Not all audits are the same

A rundown of what your nonprofit might need

Nonprofit leaders and staff often regard the word “audit” with dread. After all, audits can be disruptive and cumbersome processes that eat up time and resources. But different types of audits come with other obligations and benefits. Here’s what you need to know before you engage a financial professional to conduct an audit.

Independent financial engagements

An *independent* — or external — financial audit is probably what comes to mind when most people think of audits. In this type, an independent auditor reviews financial statements, transactions, accounts, records, internal controls, and accounting and financial processes and procedures.

Following such examinations, auditors issue an opinion on whether financial statements:

- › Fairly present the organization’s financial position as of the year-end date,
- › Fairly present the organization’s changes in net assets and its cash flows for the year under audit, and
- › Comply with U.S. generally accepted accounting principles.

Auditors may also provide recommendations and a letter to the nonprofit’s audit committee, discussing the audit process and results. (See sidebar, “The case for audit committees.”)

Internal reviews

Internal audits, on the other hand, are performed by members of the nonprofit’s staff. At a minimum, your team should scrutinize the adequacy of your internal controls and the accuracy of your records and reports, and their findings should be reported to your board of directors. They may go further by verifying proper authorization of activities and expenditures and confirming the physical existence of assets.

An internal audit can help you prepare for an independent audit. If you unearth and remedy shortcomings before the independent auditors arrive, you can streamline the overall process and potentially reduce audit-related costs. Even if you don’t find any issues during an internal audit, you’ll have much of the information auditors require already collected and readily available.

Forensic examinations

A *forensic* audit of an organization’s financial operations is typically triggered by some type of lapse (for example, a data breach) or suspicion of employee wrongdoing. These audits can focus on specific transactions or areas where concerns about fraud have arisen.

Forensic audits should be conducted by an independent forensic auditor or certified fraud examiner



The case for audit committees

Among other things, your nonprofit's board of directors is charged with fiduciary oversight. One of the most effective ways of fulfilling this duty is to delegate it to an audit committee. A proactive audit committee can both enhance the benefits of an independent financial audit and reduce fraud.

Audit committees are separate from finance committees (which primarily monitor budgets, investments and financial statements). Your audit committee should oversee the conduct and integrity of your organization's financial practices and reporting, including risk management, internal controls and, of course, the audit function.

The committee must work closely with external auditors, meeting with them before the audit to discuss the work plan. The committee should also review the auditors' findings before they're presented to the board and ensure the board responds appropriately to any recommendations. Finally, this committee plays a critical role in combating fraud. It's responsible for reviewing whistleblower and antifraud policies, overseeing procedures for uncovering errors or illegal acts, and conducting fraud risk assessments.

who's capable of thoroughly investigating red flags. The auditor you engage will approach the process with an eye toward collecting evidence that could be used in court (if necessary) and by quantifying any losses.

Focus on operations

As for *operational* audits, they can help your organization improve its processes and controls. This type of review evaluates systems, productivity, and efficiency (or lack thereof), and auditors may decide to observe and interview staff members to gather information. An operational audit report provides a comprehensive overview of how your organization operates on a daily basis.

The audit's focus can be narrow — for example, homing in on HR or IT — or it can be broad. Either way, such audits can help your organization refine or significantly improve its practices. Although it may seem like a drain on limited resources during a time of financial uncertainty, an operational audit can help you achieve more with what you have.

Cybersecurity assessments

Increasingly, nonprofits keep vast amounts of data about donors, clients, staffers and others. Your

organization may also be subject to data privacy laws, such as the European Union's General Data Protection Requirements or various state statutes. It's essential to determine whether your safeguards are sufficient in protecting such data.

A *cybersecurity* audit can help determine the risks confronting your organization. These could range from employees using weak passwords or falling

victim to phishing schemes to outsiders gaining unauthorized access to personally identifiable information. In addition to determining the effectiveness of your safeguards, these audits propose solutions to address any weaknesses.

Keep in mind that cyber risks are constantly evolving. So cybersecurity audits must be conducted periodically — ideally, at least once a year.

Doing your part

Regardless of the type of audit conducted, you and your staff can ease the process for audit professionals. For example, if you maintain accurate records and everyone in your organization closely adheres to internal controls, you can reduce the time and burden of audits. ■

If you unearth and remedy shortcomings before the independent auditors arrive, you can streamline the overall process.

Add “tax reporting” to your special event’s to-do list

Special events, such as galas, conventions and sports tournaments, require an enormous amount of planning. So you’d be forgiven if you pushed “tax compliance” to the bottom of your to-do list. However, tax reporting for nonprofit events may differ from and be more complex than what you’re accustomed to with other activities. So the sooner you start thinking about it, the better.

Reporting requirements

If your organization adheres to Generally Accepted Accounting Principles (GAAP), you typically report revenue and expenses related to special events on your financial statements as net special event revenue. For tax purposes, though, your organization may need to report some of the event ticket revenue as contributions on your IRS Form 990. For example, if attendees pay more for a ticket to a dinner than the dinner’s fair market value (FMV), the excess would be a contribution.

You also must report other special event data on Form 990 if you have more than \$15,000 in fundraising event gross income and contributions. Complete Schedule G, “Supplemental Information Regarding Fundraising or Gaming Activities.” It requires your organization to report amounts for individual events that grossed over \$5,000. Besides revenue amounts, you’ll need to report these expenses:

- › Cash prizes,
- › Noncash prizes,
- › Facilities rental,
- › Food and beverages,
- › Entertainment, and
- › All other direct costs.

If your event includes gaming, you’ll need to answer a series of multipart questions. You’ll also need to allocate income and expenses between the gaming and fundraising events.



Goods and in-kind donations

Nonprofits often rely on donated services or facilities, as well as the work of volunteers. Although GAAP generally requires nonprofits to record these types of in-kind contributions and, in some cases, the value of volunteer time, the IRS doesn’t include them in contributions or expenses.

Say a local hayride vendor donates \$2,000 of his time and use of his truck to your autumn harvest festival. You must report a donation of \$2,000 in services on your financial statement, with a corresponding in-kind expense. But you won’t report the amount in contributions or expenditures for tax purposes.

Goods donated for an event, on the other hand, receive similar treatment on financial statements and tax returns. They’re reported as contribution revenue and, when the donations are used, as expenses. For example, if a vendor donates balls and gloves for a softball tournament, the donation is a contribution. When the items are used at the event, they’re an expense.

Role of FMV

Donors may not be aware of tax rules for participating in a special event, particularly if they're accustomed to deducting the full amount of cash donations. Help them understand that deductible contributions are reduced by the FMV of the benefit they receive (for example, the meal, entertainment, round of golf or souvenir t-shirt).

You should provide donors with a written statement listing their payment amount and the FMV of goods and services received. If their payments are more than \$75, tell them to deduct only the excess of their payment over the FMV. Note that it's the initial payment amount that triggers the obligation, not the amount of the deductible portion. Also recognize

that failure to make this disclosure can result in a penalty of \$10 per contribution, up to a maximum of \$5,000 per fundraising event.

Careful recordkeeping

As with other kinds of financial reporting, good recordkeeping is essential to accurately reporting special events. Track revenues, expenses and related documentation throughout the planning stage, and ensure that data is easily accessible in one place after your big event. Contact us about special circumstances, such as the additional reporting implications of gaming activities or if you think your event has potentially produced taxable unrelated business income. ■

Succession planning

How would your nonprofit handle a leader's departure?

Even in an egalitarian organization where each staffer's contributions are valued, the departure of an executive director (ED) or other senior leader can be devastating. If your nonprofit doesn't have a succession plan, such an event can be even more traumatic. The services, relationships, finances and the very existence of an organization may be threatened. If you haven't already done so, plan now for a smooth and orderly transition.

Significant consequences

Succession planning shouldn't be limited to your ED position. Include every employee who's considered indispensable and difficult to replace due to experience, institutional knowledge, donor relationships and other characteristics. Ask whose departure would have the most significant consequences for your organization and its ambitions. When you look

at it that way, you can see why succession planning should be broader than you might first consider. In addition to the ED, you may need to develop plans for high-level staff (for example, the development director) and even board members.

Also, keep in mind the various departure scenarios. Some leaders may announce their retirement a year in advance, giving you plenty of time to plan.

However, in other circumstances, a leader could unexpectedly die or become disabled, rendering them unable to perform their job. Consider how you'd handle a sudden leadership emergency. You might, for example, want to nurture relationships with nonprofit headhunting agencies, should you need their services at some point.



Focus on the future

Successors must have specific qualifications to carry out your organization's short- and long-term strategic plans and goals, which their job descriptions might not reflect. Review and refresh job descriptions to account for any changes to your size, offerings and needs — and keep these descriptions updated.

Remember that succession planning is future-focused, and you should consider the current jobholder's experience and qualifications only as a starting point. What worked for the last 10 or 20 years might not cut it for the next 10 or 20, so build some flexibility into your nonprofit's roles.

Groom potential successors

Although you shouldn't publicize jobs until they're available, you might want to start grooming potential internal candidates before the need arises. Identify "high potential" employees with the ambition, motivation and ability to move up substantially in your organization. You can assess your staff using performance evaluations, discussions about career plans and other tools to determine who might be qualified a year or several years from now.

Some leaders may announce their retirement a year in advance, giving you plenty of time to plan.

Once you've identified potential internal candidates, make individual plans for each. Action plans might include job shadowing, which can provide you with insight into how a person would perform in the position under consideration. Also offer mentoring and coaching. For example, if you assign someone a special project, follow the staffer's progress closely and provide constructive feedback throughout the assignment.

Important: Avoid leaving potential leaders in holding patterns. If they don't receive timely promotions or

other growth opportunities, they may pack up their skills and qualifications and go elsewhere.

Formal document

Although succession plans usually aren't legal documents, your plan should be a formal, written document that you can easily share with board members and others who may be privy to the details. You should also share the plan's *existence* with key stakeholders, including employees, grantmakers, and donors. This will assure them that your nonprofit is prepared and likely won't be knocked off course if a leader suddenly leaves. ■

Effective onboarding for your nonprofit's board members

Welcoming new members onto your nonprofit organization's board is more than a formality. It's a critical process that determines how effective and engaged they'll be over the long term. Here are some practical steps to help ensure your onboarding strategy empowers new board members and prepares them to make meaningful contributions.

Clarify roles and provide resources

Start by articulating the board's responsibilities and individual directors' roles. Most board members will probably bring professional experience, but they may not be familiar with the nuances of nonprofit governance. Share board member job descriptions that outline fiduciary duties, meeting conventions, committee service and fundraising expectations. New members should also receive an onboarding packet that includes:

- › Descriptions of your organization's mission, vision and strategic plan,
- › Recent financial statements and budgets,
- › Bylaws and governance policies,
- › Meeting schedules and past minutes, and
- › Key staff and board member bios.

Such documentation enables new directors to understand your organization's current position and long-term objectives.

If you conduct performance reviews of board members, make sure they understand that the job's responsibilities also involve accountability. You don't want to spring performance reviews on these unsuspecting volunteers!



Introductory meetings

Onboarding isn't only about sharing information. It's also about building relationships. Schedule a welcome meeting with your board's chair and your nonprofit's executive director to provide a personalized introduction. Arrange for a board mentor or peer liaison to serve as a go-to resource for questions. And consider hosting informal gatherings or lunches to help integrate new members socially and foster a sense of community.

To ensure that new board members understand the nuts and bolts of the position, host a formal orientation session. Provide new members, particularly those from outside the nonprofit sector, with training on the basics of nonprofit accounting and fundraising. Attendees should be encouraged to ask questions, provide feedback and share their motivations for joining your board.

This is also a good opportunity for new members to learn about the various standing committees and decide where they'd like to serve. It's essential to let them choose where they want to direct their energy, but you may want to steer them toward a committee that aligns with their skill sets and experiences.

Following up

The onboarding process doesn't end after one board orientation or introductory meeting. Be sure to follow up with members at regular intervals to assess how they're acclimating to the role and to provide additional resources and support as needed. ■



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Understanding and Preventing Occupational Fraud

Occupational fraud—the use of one’s position to intentionally misappropriate resources for personal gain—remains a serious threat to businesses across all industries. These schemes can lead to substantial financial losses, reputational harm, and legal consequences if left unchecked.

Types of Occupational Fraud

Occupational fraud typically falls into three categories:

- **Asset Misappropriation** is the most frequent and includes theft of cash, misuse of donations, or falsified expense reports.

Ex. A program coordinator at a youth services nonprofit used a corporate credit card to make personal online purchases, hiding them under vague budget codes.

- **Corruption** includes bribery, kickbacks, and conflicts of interest.

Ex. One arts nonprofit discovered that a staff member was directing contracts to a friend’s event planning company in exchange for cash payments.

- **Financial Statement Fraud** is less common but highly damaging.

Ex. A small community health nonprofit inflated its revenue in financial reports to maintain eligibility for a federal grant.

Red Flags and Warning Signs

Employees committing fraud may exhibit warning signs, including:

- Living beyond their means
- Unusual resistance to oversight or audits
- Missing or incomplete records
- Unexplained changes in behavior or lifestyle
- Control issues or unwillingness to share duties

While these signs don’t confirm fraud, patterns of such behavior may warrant further investigation.

Who Commits Occupational Fraud?

Often, perpetrators are long-term, trusted employees with access to financial systems and limited supervision. Personal pressures like debt, addiction, or perceived unfair treatment can be motivating factors. Many rationalize their actions as temporary or deserved.

Ex. A former development officer caught embezzling from a capital campaign fund admitted feeling entitled to the money after years of unpaid overtime and minimal recognition.

Strategies for Prevention

Organizations can significantly reduce fraud risk by adopting proactive measures:

1. Establish a Strong Ethical Culture

Leadership should set a clear tone at the top, reinforcing integrity and accountability through a code of conduct and open communication.

2. Implement Internal Controls

Separate financial duties so that no single person controls an entire transaction process. Require dual approvals, restrict access to sensitive data, and rotate job responsibilities to deter long-term schemes.

3. Encourage Reporting

Set up anonymous reporting hotlines or other secure channels. Tips are the most common way fraud is detected—making it vital that employees feel safe to report concerns.

4. Conduct Surprise Audits

Periodic, unannounced audits and reconciliations can uncover inconsistencies before they escalate into significant losses.

5. Perform Background Checks

Vet both employees and third-party vendors through background and reference checks. Due diligence at the hiring and contracting stages helps identify potential risks early.

6. Mandate Time Off

Require employees in sensitive roles to take vacations or rotate responsibilities periodically. Fraud schemes often rely on uninterrupted control.

Conclusion

Occupational fraud can affect organizations of all sizes, but it’s not inevitable. With the right mix of prevention, detection, and a strong ethical foundation, companies can protect themselves from financial and reputational harm while building a culture of trust and transparency.