Staffed Watershed Organization Retreat
December 5-6, 2006 – Stevens Point

Issues You'd Rather Not Think About: Financial Controls, Employment Considerations and Liability Issues for Staffed Non-profits

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This document covers the basics on several administrative subjects that local groups face on a regular basis. While, several of the subjects are addressed in other River Alliance of Wisconsin tools, we thought this quick summary document would be helpful as well.

In the outline for each subject you will find definitions and best practices. This information was complied from several other publications. See the resource list for further information.

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Stop Fraud: Risk Management through Internal Controls

I. Internal controls are part of a good risk-management strategy

   a. Risk Management basics. Risk management involves taking a risk management technique and conducting a cost-benefit analysis that looks at the risk's magnitude (what's the damage if it occurs) and its frequency (how likely is it to occur) against the cost of mitigating the risk.
   b. Internal controls are risk management techniques designed to control fraud
   c. Need to use cost-benefit analysis described above to determine which internal controls are appropriate for your organization

II. Cannot completely eliminate the possibility of fraud – internal controls limit the chance it will occur by controlling the three conditions present that allow for fraud:

   a. Incentive/pressure
   b. Opportunity
   c. Attitude/rationalization

III. Basic types of internal controls

   a. Control over receipts
      i. Maintain a separate bank account for your organization
      ii. Issue receipts to contributors, even if they don't need a thank you letter
      iii. Endorse checks as soon as the mail is opened
      iv. Make deposits timely
      v. Two-person control if possible
         1. e.g. Two people open mail, create check log
         2. Not usually an option for a small org
   b. Control over disbursements
      i. Organization policy on who is allowed to sign checks
      ii. Checks over a certain amount (or maybe all checks for a small group that doesn't write a lot of checks) are countersigned by two people
         1. Be aware, most banks no longer check signatures
      iii. Invoices should be approved by someone other than the check writer prior to disbursement of the check
      iv. Controls placed on how payroll is disbursed

c. Other controls
    i. Record of fixed assets should be maintained and an inventory taken periodically (especially important for a small organization or for one where there is a lot of turnover).
    ii. Treasurer (or someone other than the bookkeeper) should conduct bank reconciliations
        1. Bank statement can be sent directly to the reconciler
        2. Reconciliation should include a review of cancelled checks
    iii. Limit access to petty cash and/or credit cards
d. Sarbanes-Oxley – it MIGHT apply to you
    i. Sarbanes-Oxley was response to Enron – generally doesn't apply to non-profits but does contain good practices for internal controls
    ii. Two items do apply to non-profits
        1. Whistle blower protection
        2. Document retention policy
    iii. IRS is also looking for conflict of interest policies for the Board that are renewed on an annual basis
e. Pass the risk on to someone else
    i. Use an outside accountant or bookkeeper
    ii. Use a payroll service
    iii. Have contributions sent to a lockbox at a bank – the bank actually does the processing of the donations for the organization

Employment Issues

I. Employee vs. Independent Contractor

a. The basic analysis is the degree of control of the individual over the worker, and is made on a case by case basis
b. The more control the employer has over the worker, the more likely the worker will be an employee
c. Factors that provide evidence of the degree of control
    i. Behavioral
        1. Instructions: Has the organization retained the right to control the details of a worker's performance?
            a. When and where to do work
            b. What tools or equipment to use
            c. What workers to hire or to assist with the work
            d. Where to purchase supplies and services
            e. What work must be performed by a specified individual
            f. What order or sequence to follow in completion of a given task
        2. Training: If the organization provides the worker with training about requires procedures and methods, that is an indication they are controlling the worker and the worker may be an employee
    ii. Financial control
        1. Unreimbursed expenses on the part of the worker demonstrate less control
        2. Though not necessary, significant investments on the part of the worker tend to indicate an independent contractor
        3. Opportunity for profit or loss
        4. Is the worker paid a flat fee or hourly wage?
        5. Does the worker do similar work for other organizations?
    iii. Relationship of the parties
        1. Is there a written contract that says the worker is an independent contractor? (though just calling the worker an independent contractor is not enough to make her one)
        2. Does the employer give the worker benefits?
        3. Is the relationship considered ongoing or for a limited period of time?
d. The organization does not need to withhold payroll taxes for an independent contractor
e. What if the independent contractor is really an employee?

   i. The IRS can find the organization (and possibly its Board of Directors) liable for back employment taxes

f. The definition of independent contractor is different, and less strict, for determining status in terms of unemployment insurance or the requirement for workers compensation insurance.

II. Other issues to consider (in no particular order)

a. Discrimination laws
b. Employment-at-will
c. Overtime/wage and hour laws
d. Employee handbooks
e. Pay-as-you-go reimbursement option for unemployment insurance for non-profits
f. Good hiring/firing practice

Liability and Insurance

I. Liability
   a. Corporations
      i. Nonprofit corporations can be sued for
         1. Failure to pay its debts
         2. Torts (e.g. negligence, personal injury, etc)
         3. Breach of contract
         4. Statutory violations (e.g. tax laws, workers comp laws)
         5. Vicarious liabilities (liabilities caused by actions of employees in the course of their work)
      ii. Limiting exposure to liability
         1. Honor the terms of all contracts and agreements
         2. Pay loans and bills on time
         3. Know and follow the statutes and regulations that apply to your organization
         4. Be aware of the safety issues that arise from your organization's activities
         5. Impose internal financial controls
         6. Report claims to insurance carriers quickly
         7. Ensure employees are properly trained
   b. Directors and Officers
      i. Liability is limited by state statute
      ii. Organization must indemnify directors in most instances against the cost of defending a liability lawsuit
      iii. Exceptions to liability protection
         1. Self-dealing: The director acts to benefit him or herself and against the best interests of the corporation
         2. Participation in a crime
         3. Willful misconduct
         4. Violation of tax or employment laws
   c. Employees
      i. Limited liability protection through agency law
   d. Unincorporated Association
      i. By state statutes, unincorporated associations can sue and be sued under their own name if they have at least three members and are organized for a nonprofit purpose
      ii. Members of the unincorporated association are provided limited liability protection akin to that provided by a corporation
II. Insurance types to consider
   a. General liability
   b. Business property
   c. Commercial Auto

   d. Directors and Officer
   e. Event liability

III. Waivers
   a. Important to have participants sign some sort of waiver at each event
   b. Waivers may not be upheld under Wisconsin law, but it is still better to have them than not
   c. Waivers should
      i. Include a specific waiver of negligence on the part of the organization
      ii. Include specific information regarding the risks of that specific day's events (i.e. not standard waiver for all events)
      iii. Appear on a separate page from any other material
      iv. Be verbally explained to the signer, allowing the signer to ask questions
   d. Wisconsin case law also seems to require the signer the chance to negotiate the terms of the waiver, though this seems highly impractical in almost all event situations

Lobbying

(Source: *Worry-Free Lobbying for Nonprofits: How to Use the 501(h) Election to Maximize Effectiveness,* Alliance for Justice)

I. To comply with IRS regulations, organizations must submit to one of two standards to measure compliance.

   a. The insubstantial part test: Requires "no substantial part of a charity's activities … be carrying on propaganda or otherwise attempting to influence legislation."
      i. "Substantial" is undefined and makes the amount of lobbying an organization can conduct unclear
   b. The section 501(h) expenditure test: Sets specific dollar limits, calculated as a percentage of a charity's total exempt purpose expenditures on the amount it may lobby
      i. 20% of the first $500,000 of exempt purpose expenditures, plus
      ii. 15% of the next $500,000 of exempt purpose expenditures, plus
      iii. 10% of the next $500,00 of exempt purpose expenditures, plus
      iv. 5% of the remaining exempt purpose expenditures up to a total cap of $1 million
   c. Other benefits of the 501(h) test:
      i. No limit on lobbying activities that do not require expenditures
      ii. Clear definitions of various kinds of lobbying communications
      iii. Higher lobbying dollar limits and fewer items which count towards the exhaustion of those limits
      iv. Less likely to lose exemption because of more lenient rules from IRS

II. Lobbying is communication that is intended to influence legislation, which includes action by a legislative body
   a. Legislative bodies are typically not judicial, executive or administrative bodies
   b. Two types of lobbying
      i. Direct Lobbying:
         1. A communication made to a legislator, an employee of a legislative body, or any other government employee who may participate in the formulation of the legislation
         2. Exceptions to the direct lobbying definition
            a. Nonpartisan analysis, study or research that presents all sides of any issue
            b. Responses to written requests for assistance from committees or other legislative bodies
            c. Challenges to or support for legislative proposals that would change the organization's rights or its right to exist

   d. Examinations and discussions of broad social, economic and similar problems

ii. Grassroots Lobbying
   1. Communication attempting to influence specific legislation by encouraging the public, other than the organization's members, to contact legislators about that legislation
   2. It must refer to specific legislation, reflect a view on it and encourage the recipient to take lobbying action on it

Resources useful in answering admin questions (and used for this talk):

- UW-Extension Small Business Development Center (http://www.wisconsinsbdc.org/) or 1-800-940-SBDC

- *A Guide for Wisconsin Nonprofit Organizaton,* Wisconsin State Bar publication

- *Financial and Accounting Guide for Not-for-Profit Organizations*, Gross, Malvern et. al., 7th Edition, Price Waterhouse Coopers

- Nonprofit Risk Management Center, http://www.nonprofitrisk.org/

- IRS website for nonprofits, http://www.irs.gov/charities/index.html