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It's Gravy Baby! | What is a Nonprofit Audit with Hannah Hugen – Transcript

Jess Birken 00:00:02 Welcome to Charity therapy, the podcast where we explore the ups and downs of the nonprofit sector and answer your burning questions. I'm your host, Jess Birken, owner of Birken Law Office, and I'm excited you're here. Imagine hanging out with me and my super smart, funny, nonprofit expert pals. You get to ask them anything about your nitty gritty nonprofit life and get their wisdom for free. Whether you're a seasoned pro or just strapping on your nonprofit boots, we're here to share stories and remind you you're not alone on this journey. So get ready to join the conversation and bring me the tough question. I ain't scared. Ready to rock? Let's dive in. Hello and welcome to this episode of Charity therapy. Today we have an amazing guest for the show, Hannah Hugen. Hannah is an auditor with Abdo where she helps nonprofits get through their tax prep and audits in one piece. Which, you know, it's not always a guarantee. So that's a good thing. Hannah, thanks so much for being here today.

Hannah Hugen 00:01:05 Yeah. Thank you so much for having me.

Jess Birken 00:01:07 I don't think we've ever had an auditor on the podcast. Yeah. So it's maybe a little intimidating for the people listening. They're like, oh God, do we have where's all the receipts? So yeah, I mean, just to just to riff on that a little bit. You know, it's it's no shocker that I think audits kind of feels like a scary, invasive word to a lot of nonprofits. And I know there are like a ton of nonprofits out there who are really too small to even have to do an independent audit. So for those folks and the people who are like, oh, that sounds scary, can you give us just like a quick rundown of, like what getting an audit actually is?

Hannah Hugen 00:01:56 Absolutely, yeah. I think auditors get a pretty bad rap. I don't think we're as scary as some people like to make us out to be. Basically, we're just a bunch of people that really like numbers, and we found a way to to help nonprofits with that love of numbers.

Hannah Hugen 00:02:11 So basically what an audit is, is it's an independent person coming in and taking a look at your books and giving the green light to back to the organization to make sure that everything is all good. So in technical definition, that would be we give reasonable assurance that the financial statements are free from material misstatement, which is basically, we are pretty good at making sure that there are no significant errors within the financial statements. But we don't we don't look at everything at all by any means.

Jess Birken 00:02:42 Yeah. So it's like you come in, you take a random sample in some different areas and say, show us these transactions. And you, you check to make sure that the nonprofit, you know, categorized the money, right, followed the right accounting rules. And as long as all of the sample items that you checked come back. Okay, then it's a good audit, right?

Hannah Hugen 00:03:08 Exactly. So yeah, it's it's pretty straightforward like that.

Jess Birken 00:03:11 There you go. I mean, as someone who worked inside of a nonprofit and we had a lot of federal grant money, so we had single audit and a regular independent audit.

Jess Birken 00:03:22 I feel like audit season lasted like 6 or 8 months.

Hannah Hugen 00:03:26 Oh, yeah.

Jess Birken 00:03:27 There was a lot of stress just trying to tie everything out and make sure everything was done right. Because of course, the the audit report is something that maybe your grant funders look at or a major donor might look at. So yeah, it's an important function. All right. Are you ready for the listener question?

Hannah Hugen 00:03:46 I sure am.

Jess Birken 00:03:47 Okay, Hannah, here we go. All right. We are a pretty new nonprofit. We got our tax exempt status just under two years ago. We filed the 1023 easy, since we thought we'd be bringing in less than \$50,000 for the foreseeable future. But now there's a new funding opportunity that I want to go for, and it would put us over the \$50,000 threshold that we committed to in our IRS application. I heard from a friend of a friend who's a CPA that it's recommended that we make sure to stay under 50 K for the first three years, because otherwise it will trigger an audit requirement.

Jess Birken 00:04:25 I don't want to give up on this opportunity, but I don't want to be investigated for wrongdoing either. We've been doing our best to keep everything tidy, but I'm sure we've made mistakes as a new organization, so I'm worried what an auditor would find. Do I have to say no to this funding opportunity? Oh, man. Okay, I have a lot to say about this. I'm guessing you're okay. You do too. So what?

Hannah Hugen 00:04:48 A couple things to ask.

Jess Birken 00:04:49 Yeah. Why don't you, kick us off?

Hannah Hugen 00:04:52 Yeah. So I believe that the the listener is talking about an IRS audit. Is that correct?

Jess Birken 00:04:57 I think that's what they mean. I mean, they don't really clarify. So I mean, I, I think we can reasonably assume that's what they mean. If you don't, if you did the 1023. So just to recap what I think the question is asking, they put in their application for tax exemption and they use the 1023 easy. And you can only use that application if you think that you're going to gross \$50,000 or less for the first three years.

Jess Birken 00:05:27 So this listener, I think what they're saying is we've heard that the IRS will know that we filled out our application this way, and now we're doing something else, and the IRS is going to come after us.

Hannah Hugen 00:05:44 Exactly. Yeah, there's a lot there. But I mean, yeah, it is it is possible that the IRS could audit the organization, but it's not disallowed to receive more than \$50,000.

Jess Birken 00:05:56 Yeah.

Hannah Hugen 00:05:57 Assuming your initial financial projections were reasonable and made in good faith, and that you can back that up. That's kind of the biggest things that we want to look at there is making sure that you can document that you made those estimates in good faith, in case for some reason, the IRS would decide to audit your organization. We just want to make sure all of our bases are covered there.

Jess Birken 00:06:18 Yeah, absolutely. So like what that could look like is maybe you put together a budget when you were putting together your application and you were like, this is what we think it's going to cost to run.

Jess Birken 00:06:30 And so this is what money we have to raise, and it's going to be less than \$50,000. And so you have some plan that you put together that shows that. But what I want to say about this is you're giving the IRS a lot of credit for being able to connect these dots, and I not you, but the listener. I don't think whenever I see a friend of a friend who's a CPA, I'm like, okay, we're we're already playing like the telephone game. and the idea that the IRS has enough resources and enough coordination to put it together that you might have possibly lied on your application. Feels very remote. Like I'm sure this happens all the time that somebody applies with a 1023, and then somebody gives them a big gift they weren't expecting or they luck into this opportunity. I have never, in my 20 years of practice been like you, you you better say no to that money. Because what if the IRS comes back and says, no, you didn't. But that said, I like what you're you're going with.

Jess Birken 00:07:45 It's like, can you actually show that that was what you really thought? Because there's definitely a lot of people who are lying on their. 1023 easy. That would be the main thing is like, were you lying and trying to, like, kind of pull a fast one to get a quick and dirty C3 determination letter without telling them everything that they might want to know if you were going to bring in more money.

Hannah Hugen 00:08:13 Exactly. And I think one other thing to note is, you know, if you do accept this contribution, your filing requirements will change. So you'll need to have the easy instead of the 999 likely easy or the 990 depending on assets. But I think that's a risk worth taking.

Jess Birken 00:08:31 Yeah, absolutely. So what Hannah is sort of saying is you're going to get over the threshold where maybe last year you filed a postcard which is three clicks of a mouse, and you're done. This year you're going to have to file a more complicated form. So, Hannah, what would you say to somebody who's, you know, the listeners sort of like, hey, I'm sure we've made mistakes.

Jess Birken 00:08:56 Right. And so as they're kind of getting ready for this next year where they're going to actually have to put numbers on a form. What advice would you sort of give this organization as far as like what to do about the mistakes they might

have made or the system they might be using right now, knowing that they're going to have to do more soon?

Hannah Hugen 00:09:20 Are you talking about filing like a 900 easy or or needing an audit?

Jess Birken 00:09:25 Just like as far as I mean, you're someone who looks at records and looks for mistakes that get made, right? So I'm thinking about like, how can they change things or what would you want them to change now that they're going to grow and it's going to be like more people are starting to look at your financials.

Hannah Hugen 00:09:45 Okay. Yeah. For sure. I mean, I think the biggest thing, if you think you're going to grow is to start now and getting your financial statements on the GAAP basis, which is the a cool method of accounting. I think that's important just because if you start or if you try to transition from the cash basis to the accrual basis when you need to.

Hannah Hugen 00:10:06 There's a lot more complexities in the organization. So I think that's one thing that you can do, at least on an annual basis, just to kind of try to get ready for that next big step. The other thing is documentation. So a lot of organizations that I run into that maybe invite me in to look at their books for the first time. As they're going through their first audit, they struggle with the documentation department. It's not super efficient, especially in some of these smaller organizations, to be documenting everything and making sure everything's organized and well kept. But it is super important when it does get time to to close the books and make sure everything is ready for somebody to take a peek at it. Yeah. And the final thing that I would say to implement now would be a relatively standard level of internal controls. One of the things I always like to say is trust is not an internal control. So you can't just, you know, it's the board chair. You trust him? You've known him your whole life.

Hannah Hugen 00:11:04 That that doesn't work. So you want to make sure that you have good separation of duties between the people that, you know, have access to the funds and then access to the accounting software as well.

Jess Birken 00:11:15 I love that trust is not an internal control. And if you are part of a nonprofit and you're thinking, I don't know what an internal control even is. Whip out the Google machine and start looking it up because it's really important. It's the thing that that makes sure that your treasure is not, you know, paying the mortgage with the nonprofit's money like their own personal mortgage. Not that I've seen that particular thing happen or anything. Yeah. Ask me how I know. So one thing I want to circle back to is you said to start using a cruel accounting versus cash, and for somebody who doesn't know what that is. My understanding is cash is like when you're brand new teenager and you get a checkbook and you're keeping track of your money in the bank. And it's like, I spent this money.

Jess Birken 00:12:07 So, like, I'm going to write it in my cheque register, and you're living in that, like, literally how much money is in the bank right now? Whereas accrual accounting is sort of like, well, yeah, this is how much money is in the bank. But we have invoices that are outstanding. So I basically have \$200 more than that. I just haven't received it yet. And so it's more like that. Accounts payable, accounts receivable. You know you have things that are going to be do you have liabilities and debts. You have things that might be a grant or a pledge or donation that's coming into you. And you count that money differently than just like the number on the bank account balance day to day.

Hannah Hugen 00:12:52 Exactly. Yep. Yeah, there's a lot of fun nuances to to GAAP accounting. I, I think they're really fun. Not a lot of other people tend to think just like I do.

Jess Birken 00:13:03 You know what, Hannah? That's okay. That's why you're an auditor.

Jess Birken 00:13:06 And I'm a lawyer.

Hannah Hugen 00:13:07 Because we're. Exactly.

Jess Birken 00:13:09 We're. We all have our different strengths and interests.

Hannah Hugen 00:13:13 Yeah. What is. Thank you.

Jess Birken 00:13:15 Since you said gap twice, and I think, like, for people who don't know. What is that?

Hannah Hugen 00:13:20 Yeah. It is generally accepted accounting principles.

Jess Birken 00:13:23 Okay.

Hannah Hugen 00:13:24 And so I tend to use way too many acronyms. So thanks for calling me out on.

Jess Birken 00:13:27 No problem. So if, if somebody is doing their nonprofit books on like a, a Google sheet or an Excel workbook, would that be following gap?

Hannah Hugen 00:13:39 It could. it's less likely, but but it it could.

Jess Birken 00:13:45 You're being very gracious right now. Oh, goodness. Yeah. So these are all things if you're if you're touching the books of a nonprofit and you don't know what some of these terms are, these, these would be good things to look up after this episode. So I mean, I think to put a pin in it, the listeners question, do I have to say no to this opportunity.

Jess Birken 00:14:04 Absolutely not. Get that money in the door. I think the main things here are you're about to grow. And the sooner that you get your house in order, the better off you're going to be. Right now, you only have two years of history, and that's sounds like a lot. 24 months of fixing things feels like a lot. But you know what's worse? Ten. So go ahead and and take that opportunity. But also, I think we gotta start leveling up now because you're entering a new level of of accounting and scrutiny. And hopefully at some point you're going to be required to have someone like Hannah come look at all of your materials and see if you're doing it right. And so this is like your first chance to practice so that someday when your auditor shows up and says, hey, show me these 25 transactions. It's it's gravy. It's gravy baby. So okay I've got a few takeaways here. Okay. So I think first is if you're a new organization, the sooner you can start using a cruel based accounting the better off you're going to be.

Jess Birken 00:15:19 once you start making that fundraising flywheel turn. Then second is document document document document. Start thinking somebody is going to be looking at this later. Start thinking paper trail. Start thinking what if an auditor wanted to see everything about this transaction? Do we have the receipt? Do we know what check paid it? Do we know what our process was? Storage is cheap. Dropbox is cheap. Google drive is cheap. There's no reason you can't be collecting all the information, even if it's a pain in the butt to do it. That's part of running an organization. And then I think, third, I'm going to use trust is not an internal control. Part of. I'm assuming being an auditor is figuring out whether the right internal controls are in place and were followed at the time that the transaction happened. And so just being like, yeah, Uncle Larry, he's great. He handles the books. That's not enough. We need to actually have a policy, have a procedure, and probably consult with, you know, your accountant, somebody who's a finance pro to ask them what would be appropriate policies for our organization.

Jess Birken 00:16:38 So yeah, I think those are the top three takeaways here. Anything else you think?

Hannah Hugen 00:16:43 Yeah I think you summed it up really, really well.

Jess Birken 00:16:46 Well awesome. Hannah, thank you so much for joining me. If folks want to connect with you, where can they find you online?

Hannah Hugen 00:16:53 Yeah. So they can find me. I have my LinkedIn. They could look up Hannah Hugen on LinkedIn. I think there's probably only one that's spelled like my name is spelled otherwise. I, I love answering these types of questions whenever they come up. I'd rather help a non-profit from the jump instead of come in and fix a mess. So you can always feel free to email me. It's Hannah at Abdo Solutions.

Jess Birken 00:17:19 Well, there you go folks. If you are declining grant opportunities because you're afraid of having to work with someone like Hannah, stop it. If you've got a nonprofit that needs some help, maybe they are running things like a checkbook seven years in, you know. Share this episode with them.

Jess Birken 00:17:42 Leave us a rating. Subscribe on your podcast app. And it really helps other nonprofits find the show. And if you have a question or a story to share, I would love to hear from you. So send me a note online at Charity therapy. And as always, thanks for listening.

About the Author



Hi, I'm Jess Birken.

I'm the owner of Birken Law Office, I help nonprofits solve problems so they can quit worrying and get back to what matters most – The Mission. I'm not like most attorneys, I actually have an outgoing personality, and – like you – I like to think outside the box. Most of my clients are passionate and have an entrepreneurial spirit. I'm like that too. My goal is to help you crush it. Getting bogged down in the minutia sucks the joy out of the important stuff. My clients want to do the work – not the paperwork.

Let's connect!

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