

NAVIGATING THE New Economy

Risk, fraud, audits, nondues revenue, the economy: Just a few of the topics a group of association financial experts recently discussed. Learn what it all means for your association and how you can be better prepared. | Facilitated by Andrew S. Lang

We can all agree that each association's financial situation is unique. We can also certainly agree that each industry or profession an association represents has its own particular environmental factors to deal with. Further, based on their situations and their experience, each association CEO, CFO, and financial advisor makes different decisions, leading to very different results.

But a few association financial experts can offer a 10,000-foot view of the association sector as a whole. On behalf of *Associations Now*, Andrew Lang gathered a group of such experts recently to discuss what we're seeing in associations today, what we expect the near future to bring, and what associations should be doing to prepare for it.

Andrew S. Lang, LangCPA Consulting, LLC: Let's start with arguably the most important question: What kind of economy will associations face next year? Does anybody have a reliable source who's willing to predict at this point what they think is going to happen?

John Langan, LarsonAllen LLP: I can tell you what our firm is working off of. We participate in the Major Firm Group, which is the 85 or so top CPA firms outside of the Big Four. They've surveyed those firms as to what their best guess is and what we're budgeting for, and it is that 2010 could be worse than 2009. Probably spring or summer we'll start to see some things come back in terms of employment; as we've seen, the unemployment picture will be the last one to turn.

Andrew Lang: So you're seeing mid-2010 for employment to come back. Do you want to venture a guess on when associations might be coming back?

John Langan: Six months later, maybe.

Tom Raffa, RAFFA PC: Certainly those associations that are dealing with foundation support are going to be in worse shape in 2010. Most foundations that I work with say even if the markets come back and their corpuses start to recover, they've already made the fewer commitments in 2010 to make up for [the downturn], because they had made previous commitments to spend in 2009 more than their returns would have allowed.

If associations have foundations that they're counting on for support for their (c)(3) subsidiaries or supporting organizations, they're probably going to be in worse shape in 2010 as well.

An Eye on Risk

Andrew Lang: Let’s turn to risk. We are seeing, I believe, the impact of reductions in finance staffs, and I would wonder what you are seeing in the way of reduction in financial controls.

Ted Browning, Johnson Lambert & Co.: Most clients I’m seeing understand that if they’re not careful they can create a bind in their financial wherewithal, because most people have figured out the size of the numbers doesn’t change how many people it takes to keep track of everything. Boards are alert to that.

Andrew Lang: Has anybody seen frauds showing up?

Tom Raffa: We have, but I’m not sure that it’s a direct result of the economy or that it’s for lack of controls because of cutbacks in staff. I do think that within the sector there’s more awareness of it.

John Langan: I think we have heightened awareness of frauds in this economy by virtue of the increase in motivation for people to do something because of what’s happening in their personal situations. We have seen a few of those instances, and I would expect to see more if this [economy] drags on through next year.

Charles Tate, Tate & Tryon: Fraud occurs in two ways: There is outright theft, which typically occurs at the staff level and in most cases is not material to the financial statements, although very embarrassing to the organization. The other is fraudulent financial reporting, which is more insidious because it involves a material manipulation of numbers by senior management in order to achieve a desired result. Personal financial pressures could very well increase the temptation to steal. Likewise, when a manager’s job depends on meeting budget or keeping the organization afloat, an even greater temptation to fabricate financial results exists. The current economic environment will certainly affect the auditor’s risk-assessment process.

Andrew Lang: But are we talking about immaterial fraud, or are we talking about the pressures to meet budget and financial or accounting fraud?

Joan Schweizer, Deloitte & Touche

LLP: It’s more management override that we’re worried about, rather than petty theft. We have not seen a lot of—I’ll call it the “small fraud.” It happens. Clients catch it, and they move on. But where you’re going to see it, I think, is at the management-override level.

Tom Raffa: That’s a good point, because people need to understand that it’s not about just stealing money. It is about misreporting. I think there’d be less [misreporting] if there was an awareness about it. You constantly find people surprised when you say, “Well, you really shouldn’t be doing that, and you’ve got to make adjustments for it.”

John Langan: I think it’s an excellent point, because when we first started talking to the community about enhanced controls and fraud and the work we would do in that area, we talked about embezzlement. We put financial-reporting fraud to the side because we said, “Well, what’s their incentive in their bottom line?” Well, with incentive compensation plans and with management of program areas, that has raised an issue for our community that really was not there before.

Andrew Lang: So, speaking to the executives, we’re saying, “Remember that it’s fraud to manipulate your financial reporting. It can be fraud in the same way that embezzlement is fraud.”

What about reducing the risk of actual embezzlement? Has anybody gone out with things like risk-assessment processes?

Joan Schweizer: We are recommending that for our clients. I’ve only seen one client that’s actually done something, and it was fairly basic, but I think they’re working on expanding it.

The State of the Audit

Andrew Lang: Let’s move on to questions of audits. Do audit committees know what they’re looking for when they’re reviewing the audit reports, management letters, and 990s?

Charles Tate: Five years ago we were explaining [the numbers]: “Well, this item fluctuated by 10 percent because of this, and what this item is comprised

of is this.” But I find that today they’re more interested in the process. They’re more interested in controls. Not the specifics, but do they have controls? How did the audit go? How do we operate?

They’re probably no more sophisticated than they were years ago, except in the fact that they focus more on what the audit’s about rather than the numbers themselves.

Joan Schweizer: I think they’re more educated on what they need to be asking.

Tom Raffa: I’m seeing much better audit committees, especially in associations, because they’re dealing with this at their own corporate level. They have to face this under Sarbanes Oxley, and they come totally prepared with information. These folks know this stuff now.

Andrew Lang: How about the 990s? Are association executives familiar with the new 990 and what the changes are composed of? Do the audit committees know what they’re about to get into?

Joan Schweizer: They do know. I’m talking about the larger clients; the boards have been educated by their CFOs in terms of what’s coming, what they need to be looking out for, what’s going to be reflected in the 990s. From my clients’ standpoint, they’re very much aware of it, and the CEOs are aware of it as well.

Andrew Lang: From a smaller-client perspective, are you seeing that knowledge, or is it still to be hoped for?

Tom Raffa: We’ve done a lot of training and with a lot of turnout, so they’re at least aware of what’s there and that they need to know about it. We feel like it’s our responsibility to train them.

Nondues Revenue Trends

Andrew Lang: Changing direction, many associations receive more than 50 percent of their support from supplier members and outside sponsors, advertisers, and exhibitors. How are associations continuing to maintain this revenue while those companies are suffering?

John Langan: Short term, [supplier members] are scaling back on some things. Long term, I’m not sure there’s a lot being done to look at the sustainability

of an association model if [associations] can't maintain that outside income from current sources at a current level.

Andrew Lang: What about diversifying sources of revenue to mitigate potential loss of revenue? Associations price badly. That is money lying on the floor. If you adjust prices carefully you can raise prices without jarring members, and net income comes from that.

You're looking for win-wins, anything you can do for the member where the member is going to save money or be able to make more money, and the association can make an income stream doing that. Those opportunities exist, but you have to look for them.

Because of social media and listservers and things like that, we have many opportunities to get sponsorships for

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things we haven't had before. I'm talking to a lot of associations about getting sponsorships for hardcopy books they've never had sponsored. Sell the sponsorship for whatever the market will bear. If you can get \$500 for a month for a monthly alert, it is better than nothing. An electronic newsletter for a decent-sized association, you can get \$25,000 for six months or \$50,000 for six months. People are forgetting that just because it's a lousy market doesn't mean that the vendors of one sort or another don't still want the exposure. You have to look for your opportunities.

I see too many associations that are just looking at what they've done and what they could cut, not what they could be doing.

Finance and Association Strategy

Andrew Lang: That takes us to the next question, which is: Are boards taking

responsibility for unsustainable business models and making the hard calls to benefit their members?

Joan Schweizer: They are asking the questions that three years ago they were not asking: What is this costing us? Are we making money?

Andrew Lang: I would love to see the linking of products and services directly to programs and programs to the goals to make sure that [associations] are going after their strategic goals. It's a top-down prioritizing of resources instead of the usual, "Let's start with what we've been doing and decide what we're going keep doing."

Tom Raffa: Which is a great way to look at [budget] cutting, too, because it's basically nonelimination. It's saying, "I'm going pick the best [programs] that

fit into the strategic thinking. The rest of it's just mission creep."...

People then don't look to those reserves. All they see is that [reserves] have gone down, and they don't really go back to what the original purpose of those operating reserves were. If there's any time to use them, this may be the time.

Andrew Lang: How many of you are seeing boards approving deficit budgets in organizations that have traditionally been running up profits?

Charles Tate: Some.

Ted Browning: They're trying at least to break even.

Tom Raffa: But I don't think it's deliberate. I get these phone calls that say, "We're going to cut the budgets 50 percent." Meanwhile, they're sitting on \$40 million. And when they look at the budget and say, "Well, we can't cut it 50 percent, so there's going to be this deficit," there's no logic to say that it

ties to this reserve. Instead they should be saying, "It's time to use our reserve. We're going to use it in a smart way."

John Langan: Define breakeven. If they were living off of their reserves to some level or completely, then what is the bottom line for a given year? I see groups that will say, "Okay, the intermediate operating measure of operations can be a deficit or can be breakeven, and then we'll go to deficit because of what happened in the market." They will continue as they have done to try to cut their way into breakeven, hoping that they'll survive it and can ratchet back up.

But the question I get a lot is, "If we do want to invest in something that might be a new revenue stream, how much of our reserves do we use? What's our return on investment strategy?" What associations should be doing is asking, "What are we investing in? What's our timeframe? How much are we going put into it? How are we going to measure our success?" I think focusing on these questions is one of the real keys to smart association financial and strategic management now and in the future.

Andrew Lang: I could not agree with you more, John. I would add that whatever is going to be selected to pursue should not be driven by a top-down directive from the board or the chief elected officer. Creative new thinking is required, and "insider members" are not often the source of such ideas since they have spent years and years within the organization. In the period ahead, new products or programs requiring investment should be apolitical and carefully vetted from both a business and member-need perspective. **an**

Andrew S. Lang, CPA, is with LangCPA Consulting LLC in Potomac, Maryland. Email: alang@langcpa.com

Watch your mailbox: This discussion will continue in *Associations Now's* March 2010 *Guide to Insurance and Financial Services*.

Do you have the right investment policy? These association finance experts also discussed how their clients have adjusted their investment policies and portfolios in light of the current recession. To see what they had to say, visit www.asacenter.org/associationsnow and click the "Now Online" tab.

