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WELCOME

2012 Schneider Downs Nonprofit Symposium

August 15, 2012



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Top Ten Technology Risks Facing Non Profit Organizations

Presented by Frank Dezort



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Overview

- Technology continues to increase in strategic importance and potential impact to the environment
- Regulatory requirements and scrutiny is ever increasing
- Senior management and the board of directors need to be active participants in ongoing risk discussions
- Ignoring these risks can impair an institution's mission, business objectives and damage their reputation



Top Ten Risks- Criteria

- How Did We Identify the Top Ten Technology Risks?
 - Industry trends and surveys
 - Regulatory requirements (FERPA, PCI, HIPAA)
 - Potential for reputational and financial impact
 - Guidance from audit methodology governing bodies (e.g., ISACA, AICPA, NIST)
 - What we are seeing
- This list is designed to get you thinking about your environments and is not in any particular order
- Risk items overlap in many key areas and compound certain risk elements



Top 10 Technology Risks

1. Legal and Regulatory
2. Data Security and Electronic Records Management
3. Social Networking
4. Mobile Devices
5. Malware
6. End-User Computing
7. Cloud Computing
8. IT Governance
9. Disaster Recovery and Business Continuity
10. Identity and Access Management



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1. Legal and Regulatory Compliance

- Family Educational Rights and Privacy Act (FERPA)
- Health Insurance Portability and Accounting Act (HIPAA)
- Health Information Technology for Economic and Clinical Health Act (HITECH)
- Payment Card Industry Data Security Standards (PCI-DSS)
- Various State Laws



FERPA

- Applies to both Institutions receiving Federal funds under any program administered by the Secretary of Education
- Mandates the protection of the privacy of educational records
- Gives students the right to view and correct the information contained in these records
- Allows for certain information that would not be harmful if made public to be disclosed without consent
- There is the potential for the full withdrawal of Federal funding
- An institution is highly unlikely to lose funding unless multiple violations occur without any corrective action taken



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HIPAA

- HIPAA Privacy Rule
 - Provides federal protections for personal health information (PHI) held by covered entities such as Health Care Providers, Health Plans and Health Care Clearing Houses
 - Gives patients rights with respect to that information
 - Permits the disclosure of “Directory Information” needed for patient care and other important purposes
- HIPAA Security Rule
 - Specific administrative, physical and technical safeguards to assure the confidentiality, integrity and availability of electronic PHI
- Security Breach Notification Requirements
 - All covered entities, business associates, vendors and third party service providers that have access to Personal Health Records are required to notify each individual or entity affected when unsecured PHI that is readable is breached within 60 days



HIPAA – Where we are Today

- Raised awareness and compliance
- Lack of proper education and fear of non-compliance affecting treatment



“Normally, I’d discuss your condition with these first-year residents, but because of confidentiality restrictions, all I can really tell them is that you’re a shoo-in for an invasive procedure.”



HITECH Act

- Expanded enforcement of HIPAA
 - State Attorney Generals are authorized to obtain statutory damages on behalf of its State's residents
 - Attorneys' fees are also allowed to be collected for pursuing civil actions for HIPAA privacy and security violations
 - The Secretary of HHS will be required to conduct periodic audits of covered entities and business associates for compliance and enforcement purposes
- Adoption of all Electronic Health Records (EHR) by 2014
- First federally mandated data breach notification requirements



Ohio House Bill 104

- State Breach Reporting Laws (Ohio House Bill 104)
- Requires consumer notification of individuals for breaches of electronic personal information
- Covered entities are government agencies, individuals and entities that conduct business in Ohio (Note: a physical presence is not required)
- Personal Information is defined as a person's name combined with any of the following information:
 - A Social Security Number
 - A Driver's License or State ID Number
 - An Account Number/Debit Card/Credit Card Number in Combination with any Required Access Code
 - If the information is encrypted/redacted the Law is not triggered



PCI-DSS

- Potential for reputational damage resulting in a loss of donations. Fines imposed by PCI-SSC and discontinued processing of credit card transactions.
- Any organization regardless of size or number of transactions, that accepts, transmits or stores any cardholder data is required to comply with the standards if they wish to continue accepting credit cards as a form of payment.





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2. Data Security and Electronic Records Management

- Key Risks
 - Regulatory fines and penalties
 - Reputational damage (donations/enrollment)
 - Increased cost of compliance
 - Lack of ability to identify types/location of confidential data and records
 - Lack of robust methodology to categorize sensitive data

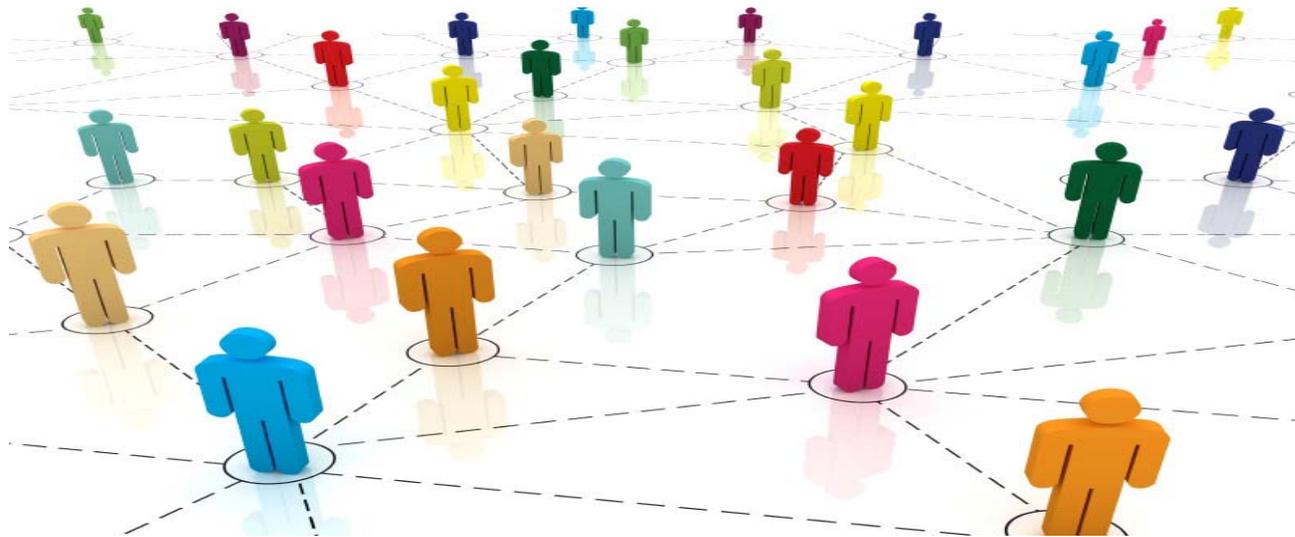


2. Data Security and Electronic Records Management

- Steps to Take
 - Electronic record management program, identify and classify your data first and assess gaps in controls
 - Identify specific data management controls to mitigate these gaps/risks
 - Data Loss Prevention (DLP)
 - Employee Awareness and Training Programs for data handling
 - Incident Response Protocols
 - Data Handling and Destruction Policies
 - Least Privilege, Reduce and Control Access to Data
 - Encrypt laptop hard drives, external hard drives, PDAs, and backup tapes where sensitive information might be stored
 - Encrypt fields in applications and databases where sensitive information is presented and stored
 - Restrict access to application modules and databases where sensitive information is accessible



3. Social Networking



- Key Risks
 - Viruses and Malware
 - Identity Theft and Information Scraping
 - Brand Hijacking and Lack of Content Control
 - Social Engineering and Phishing



3. Social Networking

- Steps to Take
 - Complete an inventory of social media usage, and existing policies, procedures and controls
 - Create an acceptable use policy (AUP) specifying the rules of behavior when using social media to guide what information can and cannot be posted on the social media website
 - Periodically warn users of the threat of identity theft from information shared on social media websites
 - Create a process to handle unauthorized or fraudulent postings



4. Mobile Devices

- Key Risks
 - Sensitive information that is not properly secured
 - Lost or stolen devices
 - Mobile viruses





4. Mobile Devices

- Steps to Take
 - Make a plan documenting expected mobile security controls
 - Protect sensitive information and minimize the impact of a lost device:
 - Password-protect all devices
 - Encrypt sensitive documents on the device
 - Enable remote wiping capabilities
 - Network-level scans are the most effective, centralized way of preventing viruses and other disruptions associated with mobile devices
 - Provide specialized training to mobile device users and administrators, including simple guidelines for the physical security of devices and a reporting mechanism in case of loss or theft



5. Malware

- Key Risks
 - Undetected compromise or attacks (attack signatures)
 - Failure to meet regulatory requirements (PCI, Privacy)
 - Loss or disclosure of sensitive or critical information assets





5. Malware

- Steps to Take
 - Take measures to protect the actual Network and PCs used by users
 - Anti-Virus, Anti-Spyware/Malware Software Packages
 - Use tools to monitor user behavior so that a check can be made on whether policy is being observed
 - Security monitoring and periodic penetration testing of the Network
 - Install the latest web browsers on PCs; they are likely to have better security controls than older browsers
 - Make users aware of the risks involved and give them examples of the types of attack and damages that can occur
 - Repeat awareness development and training at regular intervals
 - Implement Intrusion Detection/Prevention monitoring (Managed Security Services)
 - Monitoring of security patches and alerts



6. End User Computing

- Key Risk
 - End-user application files (e.g. Microsoft Excel and Access) that are in use are erroneously modified or lost, or stored in an unsecure method
 - Business interruption
 - Data theft
 - Financial misstatement
 - Presence of un-protected “Shadow Data”
 - University is un-aware of who has access to personally identifiable information.



6. End-User Computing

- Steps to Take
 - Test the output of all end-user files/applications prior to use and after any modifications and use version control to track changes to files
 - Restrict access to authorized users and periodically backup files
 - Require users to store sensitive data on secured Network locations and take inventory of your data (DLP tools can be of assistance here)
 - Require that data be stored per the policies surrounding handling and storage of confidential data
 - Conduct training and take action upon non-compliance



7. Cloud Computing/Third Party Management

- Key Risks
 - Loss of data confidentiality and integrity
 - Loss of data stewardship/governance
 - Unauthorized use and tampering with customer data
 - Isolation Failure
 - Failure to meet service level requirements
 - Theft of critical information





7. Cloud Computing/Third Party Management

- **Steps to Take**

- Require a Service Organization Controls report or implement a “right to audit” clause in all contracts
- If PHI is a concern consider if the vendor is a BAA and needs to sign an agreement
- Require contractual language surrounding confidentiality and non-disclosure
- Determine if sensitive data should be segregated to a “private cloud environment” or hosted environment
- Evaluate the financial solvency of vendors



8. IT Governance

- Key Risks
 - Lack of communication and planning does not allow IT to support the overall mission and business objectives
 - Insufficient funding
 - Misalignment of business goals and objectives
 - Purchase of technology solutions not in line with the mission/strategy
 - IT misaligned with business goals and strategy
 - Value provided by IT does not contribute to the overall mission
 - IT processes ineffective and inconsistent
 - IT presents increased risk to organization
 - Increased cost with minimal value





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8. IT Governance

- Steps to Take
 - Create long-term (3-5 years) and short term (1-3 years) strategic plans for both the business and IT and ensure that business goals can be supported with the planned IT staffing and budgetary levels
 - Create central project management and purchasing policies and ensure that standards for evaluation and selection are in place
 - Metrics established and regularly monitored demonstrating achievement of IT objectives; SLA – service level agreement
 - CIO attending executive board meetings to discuss IT's contribution to enterprise goals



9. DR/BCP

- Key Risks
 - Failure to provide products or services
 - Failure to meet contractual service level requirements
 - Survival of organization
 - Loss of customers/clients
 - Cash flow problems
 - Data loss
 - Financial misstatement
 - Business interruption
 - Critical business information is lost and cannot be recovered





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9. DR/BCP

- Steps to Take
 - Create a data retention and backup schedule
 - Daily backups of key business applications and data
 - Monitoring of backups
 - Backup restoration testing to ensure recoverability
 - Off-site storage of backup media
 - Business impact assessment process (Maximum Tolerable Outage)
 - Development of a Business Continuity Plan – Utilize internal resources as much as possible
 - Periodic testing of plan



10. Identity and Access Management

- Key Risks
 - Unauthorized or excessive access (student workers) to sensitive/confidential data
 - Segregation of duties issues exist
 - Fraud
 - Lack of reliance on system controls and need for manual controls
 - Compliance issues





10. Identity and Access Management

- Steps to Take
 - Perform segregation of duty analysis before granting additional access to an account
 - Use least privilege methodology
 - Implement a process for periodic review of access rights
 - Implement role based security
 - Multiple factor authentication – tokens, key fobs, digital certificates, biometrics
 - Centralized access provisioning



IT Controls – Steps to Success

- Lay the Foundation
 - Less than **one third** of organizations conduct regular IT vulnerability and IT risk assessments; these provide the foundation for new compliance, governance, or risk management initiatives.
- Establish Consistent Policies
 - Less than **half** of organizations have established consistent policies for compliance and risk management; industry frameworks such as ISO, ITIL, and COBIT provide reference and significantly accelerate the process.
- Assign an Owner
 - Less than **half** of organizations have established an executive or team with primary ownership of IT compliance and risk initiatives.



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Questions?



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Emerging NFP Matters / Accounting & Reporting Update

Presented by Kimberly L. James and Trevor P. Warren



Agenda for This Session

- Interest Rate Swap Overview
- Audit and Attestation Issues and Developments
- Upcoming Accounting and Auditing Pronouncements



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Interest Rate Swaps

Kimberly L. James



What is an interest rate swap?

- An agreement between two parties (known as counterparties) where one stream of future interest payments is exchanged for another based on a specified principal amount.
- Explained in layman's terms



Definitions

- Counterparty
- Notional amounts
- LIBOR



Pros and Cons of Interest Rate Swaps

- **Pros**
 - Commercial motivation
 - Comparative advantage
- **Cons**
 - Interest rate risk
 - Counterparty risk
 - Termination risk
 - Rollover risk



Generalities of Interest Rate Swaps

- Fixed rate payer – buyer
- Variable rate payer – seller
- At inception both parties are equal
- If rates go down – seller (variable) wins
- If rates go up – buyer (fixed) wins
- Principal is not swapped (separate contract) notional amounts
- Swaps are traded over the counter so there's always default risk



Negotiated terms

- Start date
- End date
- Settlement frequency
- Notional amount
- Published reference rate
 - Variable – LIBOR
 - Fixed – Utilize the US Treasury Bond for a similar maturity



Example of a Vanilla Swap

- Company A takes out a loan for \$10 million at a variable rate of LIBOR (3%) +2% with ABC Bank
 - Company A does not want to take the risk of a rate increase so they enter into an interest rate swap paying a fixed rate of 5% to ABC Financial Products.
 - In exchange ABC Financial Products will pay Company A, LIBOR +2% on a notional amount of \$10 million



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Example of Vanilla Swap - Year 1 - LIBOR 3%

1. Company A pays interest on debt (LIBOR 3% + 2%) = \$500,000
 - $\$10,000,000 \times 5\% \text{ (LIBOR + 2)} = \$500,000$
 - $\$500,000 / 12 = \$41,667$ per month
2. Company A interest payment to ABC Financial Products on interest rate swap
 - $\$10,000,000 \times 5\% \text{ (fixed rate)} = \$500,000$
 - $\$500,000 / 12 = \$41,667$ per month
3. ABC Financial Products interest payment to Company A on interest rate swap
 - $\$10,000,000 \times 5\% \text{ (LIBOR +2)} = (\$500,000)$
 - $\$500,000 / 12 = (\$41,667)$ per month

EFFECTIVE INTEREST RATE = 5% ($\$500,000 + 500,000 - \$500,000 = \$500,000 / \$10,000,000$)



Example of Vanilla Swap – Year 2 – LIBOR 4%

1. Company A pays interest on debt (LIBOR 4% + 2%) = \$600,000
 - $\$10,000,000 \times 6\% \text{ (LIBOR + 2)} = \$600,000$
 - $\$600,000 / 12 = \$50,000$ per month
2. Company A interest payment to ABC Financial Products on interest rate swap
 - $\$10,000,000 \times 5\% \text{ (fixed rate)} = \$500,000$
 - $\$500,000 / 12 = \$41,667$ per month
3. ABC Financial Products interest payment to Company A on interest rate swap
 - $\$10,000,000 \times 6\% \text{ (LIBOR + 2)} = (\$600,000)$
 - $\$600,000 / 12 = (\$50,000)$ per month

EFFECTIVE INTEREST RATE = 5% ($\$600,000 + \$500,000 - \$600,000 = \$500,000 / \$10,000,000$)



Example of Vanilla Swap – Year 3 – LIBOR 2%

1. Company A pays interest on debt (LIBOR 2% + 2%) = \$400,000
 - $\$10,000,000 \times 4\% \text{ (LIBOR + 2)} = \$400,000$
 - $\$400,000 / 12 = \$33,333$ per month
2. Company A interest payment to ABC Financial Products on interest rate swap
 - $\$10,000,000 \times 5\% \text{ (fixed rate)} = \$500,000$
 - $\$500,000 / 12 = \$41,667$ per month
3. ABC Financial Products interest payment to Company A on interest rate swap
 - $\$10,000,000 \times 4\% \text{ (LIBOR +2)} = (\$400,000)$
 - $\$400,000 / 12 = (\$33,333)$ per month

EFFECTIVE INTEREST RATE = 5% ($\$400,000 + \$500,000 - \$400,000 = \$500,000 / \$10,000,000$)



Accounting for an Interest Rate Swap

1. Accounting for payment of interest on debt:

- ✓ DEBIT – INTEREST EXPENSE \$41,667
- ✓ CREDIT – CASH \$41,667

2. Accounting for interest rate swap:

- ✓ Day one – there is no FMV assigned to the interest rate swap because no money has changed hands

- ✓ End of year 1 – Company A must report the fair market value of the financial instrument (interest rate swap) as determined by ABC Financial Products



Accounting for an Interest Rate Swap – Year 1

- ✓ End of year 1 – Company A must report the fair market value of the financial instrument (interest rate swap) as determined by ABC Financial Products (continued):

Assumptions at the end of year 1:

- Debt paid down to \$9,000,000 and the swap amortizes at same rate as debt
- LIBOR has increased to 4%

Pay - $\$9,000,000 \times 5\%$ (fixed rate) = $\$450,000 \times 9$ (years remaining) = $\$4,050,000$

Collect - $\$9,000,000 \times 6\%$ (LIBOR + 2%) = $\$540,000 \times 9 = \$4,860,000$

Difference = $\$4,050,000 - \$4,860,000 = \$810,000$ asset



Accounting for an Interest Rate Swap – Year 1

Pay - $\$9,000,000 \times 5\%$ (fixed rate) = $\$450,000 \times 9$ (years remaining) = $\$4,050,000$

Collect - $\$9,000,000 \times 6\%$ (LIBOR + 2%) = $\$540,000 = \$4,860,000$

Difference = $\$4,050,000 - \$4,860,000 = \$810,000$ asset

- ✓ DEBIT – FMV OF INTEREST RATE SWAP \$810,000
- ✓ CREDIT – GAIN ON INTEREST RATE SWAP \$810,000



Accounting for an Interest Rate Swap – Year 2

Assumptions at the end of year 2:

- Debt paid down to \$8,000,000 and the swap amortizes at same rate as debt
- LIBOR has decreased to 2%

Pay - $\$8,000,000 \times 5\%$ (fixed rate) = $\$400,000 \times 8$ (years remaining) = $\$3,200,000$

Collect - $\$8,000,000 \times 4\%$ (LIBOR + 2%) = $\$320,000 \times 8 = \$2,560,000$

Difference = $\$3,200,000 - \$2,560,000 = \$640,000$ liability



Accounting for an Interest Rate Swap – Year 2 (continued)

Pay - $\$8,000,000 \times 5\%$ (fixed rate) = $\$400,000 \times 8$ (years remaining) = $\$3,200,000$

Collect - $\$8,000,000 \times 4\%$ (LIBOR + 2%) = $\$320,000 \times 8 = \$2,560,000$

Difference = $\$3,200,000 - \$2,560,000 = \$640,000$ liability

- | | |
|--------------------------------------|-------------|
| ✓ DEBIT – LOSS ON INTEREST RATE SWAP | \$1,450,000 |
| ✓ CREDIT – FMV OF INTEREST RATE SWAP | \$1,450,000 |

(Initially reported an asset of \$810,000, now reporting a liability for \$640,000, total adjustment is \$1,450,000 to arrive at the liability balance of \$640,000)



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Audit and Attestation Issues and Developments

Trevor P. Warren



SAS 119 – Supplementary Information

- Effective for periods beginning after 12/15/2010
- Changes the audit report wording when supplementary information is presented
- Also applies to the opinion paragraph on the Schedule of Expenditures of Federal Awards in an A-133 Audit
- Specific new procedures that must be documented
- New representations to include in the management representation letter



Recent Auditing and Attestation Pronouncements

SAS 120 – Required Supplementary Information

- Effective for periods beginning after 12/15/10
- The auditor should include an explanatory paragraph in the auditor's report on the financial statements, after the opinion paragraph, to refer to the required supplementary information. The explanatory paragraph should include language to explain the circumstances. (i.e. procedures performed on RSI, RSI omitted, procedures not complete, etc.)



Recent Auditing and Attestation Pronouncements

SAS 125 – Alert That Restricts the Use of the Auditor’s Written Communications

Establishes an umbrella requirement to include an alert that restricts the use of the auditor’s written communication when the subject matter of that communication is based on :

1. Measurement or disclosure criteria that are determined by the auditor to be suitable only for a limited number of users who can be presumed to have an adequate understanding of the criteria,
2. Measurement or disclosure criteria that are available only to the specified parties,



Recent Auditing and Attestation Pronouncements

SAS 125 – Alert That Restricts the Use of the Auditor’s Written Communications (continued)

3. Matters identified by the auditor during the course of the audit engagement when the identification of such matters is not the primary objective of the audit engagement (commonly referred to as a by-product report).



Recent Auditing and Attestation Pronouncements

ASU 2010-20, under Topic 310, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses (continued)

- Requires an entity to provide greater level of detail about the credit quality of its financing receivables, including:
 - Credit quality indicators of financing receivables
 - Aging of past due financing receivables
 - Nature and extent of troubled debt restructurings
 - Roll-forward schedule of the allowance for credit losses



Recent Auditing and Attestation Pronouncements

ASU 2011-04 – Fair Value Measurements

- Most significant change to US GAAP; qualitative sensitivity disclosure for measurement uncertainty for level 3 measurement.
 - Identification of key inputs for which material changes in fair value would result if another feasible value for the input were used
 - Quantitative information indicating the numerical input used
 - Discussion and nature of the change in fair value if another feasible input amount was used (public companies only)



Recent Auditing and Attestation Pronouncements

ASU 2011-04 – Fair Value Measurements (continued)

- “The Boards concluded that the amendments in this Update will improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRSs”
- For nonpublic entities, the amendments are effective for annual periods beginning after December 15, 2011.



Recent Auditing and Attestation Pronouncements

ASU 2011-07 – Patient Service Revenue and Bad Debts

- Bad debt as a contra-revenue amount rather than operating expense; also quantitative and qualitative disclosures
- Effective date:
 - Non public: Effective for fiscal years ending after December 15, 2012, and interim and annual periods thereafter
 - Early adoption permitted
 - Change in presentation of bad debt applied retrospectively for all periods presented; new disclosures provided prospectively, beginning with year of adoption



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Recent Auditing and Attestation Pronouncements

ASU 2011-09 – Multiemployer Plan Disclosures

- Enhance disclosures to allow financial statement users to better assess risks an entity faces by participating in a multiemployer plan
- New disclosures include the following:
 - The amount of employer contributions made to each significant plan and to all plans in the aggregate
 - An indication of whether the employer’s contributions represent more than 5% of the total contributions to the plan
 - Expiration date(s) of collective bargaining agreements and minimum funding arrangements
 - Indication of which plans, if any, are subject to a funding improvement plan



Recent Auditing and Attestation Pronouncements

ASU 2011-09 – Multiemployer Plan Disclosures (continued)

- Effective dates for nonpublics - years ending after 12/15/12
- Early adoption permitted
- Applied retrospectively for all prior periods presented



Recent Auditing and Attestation Pronouncements

Other matters:

EITF Issue 12-A: Not-for-Profit Entities - Classification of Gifts of Securities in the Statement of Cash Flow

- There is diversity in practice as to how NFPs classify in the statement of cash flows the cash receipts received from the sale of donated securities that are directed upon receipt for sale and for which the NFP has the ability to avoid significant investment risks and rewards through near immediate conversion into cash



Recent Auditing and Attestation Pronouncements

EITF Issue 12-A: Not-for-Profit Entities - Classification of Gifts of Securities in the Statement of Cash Flow (continued)

- At the March 15, 2012 EITF meeting, the Task Force reached a consensus-for-exposure:
 - cash receipts of NFPs resulting from the sale of donated securities that are directed upon receipt for sale should be classified as operating cash flows
 - Donor restricted use of the contributed resource to a long-term purpose (for example, the acquisition, construction, or improvement of long-lived assets or to establish or increase a permanent or term endowment), then those cash receipts would be classified as financing cash flows.

Comment deadline week of July, 16, 2012; September 11, 2012 EITF meeting



On the Horizon



AICPA A&A Guide – NFP Entities

- Audit Guide Revision Task Force
- Overhauling the Guide
- Adding new content for new accounting, auditing, industry and regulatory issues that have developed since the Guide's original issuance in 1996



OMB Proposed Changes

- OMB Advance Notice of Proposed Guidance – Reform of Federal Policies Relating to Grants and Cooperative Agreements; cost principles and administrative requirements (including Single Audit Act)
- \$600B spent on grants and cooperative agreements
- Change grant policies to increase efficiency and effectiveness; eliminate unnecessary requirements; lower cost



OMB Proposed Changes (Continued)

- **Increase Single Audit threshold to \$1M**
- **Create A-133 “lite” for \$1M-\$3M**
- **Better focus for A-133 audits of > \$3M**
- **Changes to Cost Principles**
 - Consolidate into a single document
 - Using flat indirect rates instead of negotiated rates



Government Auditing Standards

- Changes to independence rules
- Must document consideration of management's ability to effectively oversee non-audit services & other issues related to independence
- Routine assistance and consultation during audit not considered nonaudit service
- AICPA GAQC has created practice aid, available on GAQC website



“Clarified” Auditing Standards

- AICPA has redrafted all of the auditing sections in the Codification of SASs to apply the “clarity” drafting conventions and converge with International Standards on Auditing
- Effective periods ending after 12/15/2012
- Practice aids:
 - AICPA - Summary of Changes in Requirements Resulting from Issuance of Clarified SASs No. 117 through No. 120 and No. 122 through No. 125.
 - Visit AICPA website for various other materials
 - Suggested implementation timeline



Government Auditing Standards Overview

- Commonly referred to as Yellow book, GAGAS and GAS
- Standards written and revised by the Government Accountability Office (GAO)
- The requirements and guidance in *Government Auditing Standards* apply to audits of governmental entities, programs, activities, and functions, and of governmental assistance administered by contractors, nonprofit entities, and other nongovernmental entities, when the use of *Government Auditing Standards* is required or is voluntarily followed.
- The Single Audit Act Amendments of 1996 and Circular A-133 require the use of *Government Auditing Standards*.



Revised Standards Implementation

- December 2011 – Final Revised Yellow Book auditing standards issued
- Superseded 2007 revision
- Effective for audits of periods ending on or after December 15, 2012 (December 15, 2011 for performance audits)
- Early adoption is NOT permitted



FASB Not-for-Profit Advisory Committee

- Established in October 2009 to serve as a standing resource for FASB in obtaining input from the NFP sector on existing guidance, current and proposed technical agenda projects, and longer-term issues affecting organizations.
- Provide focused input and feedback to FASB board and staff
- Assist FASB board and staff in its communication and outreach activities to the NFP sector
- Several on-going projects including:
 - Requiring or providing for MD&A (many larger NFPs already do this)
 - Defining an operating measure (what would it look like, would it be required?)
 - Improving disclosures on liquidity (more descriptive notes, classified “balance sheet”)



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Defining Retirement Plan Success and Navigating Toward That Destination

“Recalculating Route”

Presented by:

Jeffery A. Acheson, QPFC, AIF®

Partner

Schneider Downs Wealth Management Advisors, LP

SD Retirement Plan Solutions Division





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Current Destination

“The Golden Years”

Current Statistics

“Not So Golden”



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According to the Employee Benefit Research Institute's (EBRI) study of its 2010 year-end database

- Average Account Balance \$60,329¹
- Median Account Balance \$17,686¹
- 17% of balances > \$100,000¹
- 39.2% of balances < \$10,000¹
- **50% of all Americans have TOTAL SAVINGS of < \$10,000!²**



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Is Social Security the Savior?

- People typically need 65-85% of pre-retirement earnings to maintain their standard of living
- Social Security only replaces 40% of the average person's income²
- The Social Security Normal Retirement Age is 66 for people born 1943-1954
 - Gradually increasing to 67 for persons born after 1954
- According to the Social Security Administration the **maximum** benefit in **2012 = \$2,525 monthly**
 - The **average benefit** for all retired workers in 2012 = \$1,229



Financial Crisis..???

- Only 14% of people say they are very confident they will have enough money to live comfortably in retirement
 - Down 9% since 2002²
- One of Americans biggest economic fears is not having enough savings for retirement
 - **92% of people** think there is a retirement crisis in America²
- The retirement income deficit - the difference between what people have saved for retirement and what they should have at this point - is calculated to be...

\$6.6 trillion



Recalculating Route

- First we have to know where we are going





The Importance of Planning

Some people think that retirement planning isn't important because they won't live until retirement.

- The Facts ...**

Of 100 People Who Are Age:	Their Odds of Living to Retirement at Age 65 Are:		Has a Life Expectancy of Age:	
	<i>men</i>	<i>women</i>	<i>men</i>	<i>women</i>
30	84%	87%	78	82
40	85%	88%	78	82
50	88%	90%	79	83
60	94%	95%	81	84

Source: Commissioners' Standard Ordinary Mortality Table; based on composite data (combination of smokers, non-smokers and smoking status unknown); age nearest birthday, 2001



How Much Capital Will You Need at Retirement?

- *Amount of capital needed to provide \$1,000 of monthly income @ 6% for 25 years*
 - ✓ Capital Preservation Method
 - **\$200,000**
 - ✓ Capital Depletion Method
 - **\$155,000**



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How Can Employers Help?

SEVEN ATTRIBUTES

OF

AN EXCELLENT

DEFINED CONTRIBUTION PLAN



Measuring Defined Contribution Plans

- Evaluating key characteristics
 - “How does our plan compare to other plans?”
 - “Is our plan considered a savings plan or a retirement plan?”
 - “How do we measure plan success?”
 - “What can we do to facilitate positive participant outcomes?”



Measuring Defined Contribution Plans

- Attributes of the Average Defined Contribution (DC) plan:
 - Mediocre Overall Participation
 - Low Salary Deferral Rates
 - Inadequate Investment Diversification Within Participant Accounts
 - Murky Fee Disclosure by Service Providers
 - Overwhelming Number of Investment Options



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Measuring Defined Contribution Plans

- Attributes of an “Excellent” Defined Contribution (DC) plan:
 - A Retirement Income Mindset
 - A Thoughtfully Designed Investment Menu
 - Best-of-Breed Investment Options
 - Appropriate Participant Investment Diversification
 - Effective Employee Education
 - High Participation Rates
 - High Contribution Rates



Excellence Attribute #1: A Retirement Income Mindset

- **Average Plans**



- Quarterly statements to participants simply showing their account balance, contributions and investment returns
- No projection of retirement income readiness



Excellence Attribute #1: A Retirement Income Mindset

Step One: change participant attitudes

- Changes in human behavior only happen when “current self” doesn’t like vision of “future self.”
- **Excellent Plans**
 - Provide retirement income projections to participants as a standard reporting feature



Excellence Attribute #1: A Retirement Income Mindset

Step One: change participant attitudes

- **Action Items:**
 - *Center your participant education around the Target Replacement Income (TRI) theme*
 - *Work with a recordkeeper who enhances participants' statements with automated retirement income readiness projections*
 - *Measure your plan's progress toward overall TRI*



Excellence Attribute #2: A Thoughtfully Designed Plan Menu

- **Average Plans**
 - Offers in excess of 22 options
 - Too many similar or overlapping funds
- Most participants find this confusing and overwhelming
 - Average Participant account holds < 5 funds





Excellence Attribute #2: A Thoughtfully Designed Plan Menu

Step 2: Make it simple with a three tier approach

- **Excellent Plans**

- Analyze participant demographics recognizing prevailing participant profiles:
 - Profile #1: Do it for me (60%-70%)
 - Profile #2: Do it with me (20%-30%)
 - Profile #3: I'll do it myself (5%-10%)
- Designs a tiered menu structure to accommodate the multiple profile needs



Excellence Attribute #2: A Thoughtfully Designed Plan Menu

Step 2: Make it simple with a three tier approach

- **Action Items:**
 - *Analyze your participant profiles*
 - *Design a menu to satisfy the multiple profiles' needs*
 - *Tier 1: Target date mutual funds*
 - *Tier 2: Risk-based asset allocation funds or models*
 - *Tier 3: "Best-in-Class" Investment Options*
 - *Provide adequate choice for the minority who demand it without overwhelming the majority who don't*



Excellence Attribute #3: Best-of-Breed Investments

- **Average Plans**
 - As of 2008:
 - 55% of all DC investment assets were affiliated with the recordkeeper
 - Revenue sharing is the primary driver of the investment options offered by many providers



Excellence Attribute #3: Best-of-Breed Investments

Step 3: Move outside the recordkeeper's "box."

- **Excellent Plans**
 - Offer funds based solely on investment merit and analysis
 - *Fiduciary Point: Department of Labor does not demand perfection, only "adherence to documented processes and procedures".*
 - Understands no SINGLE Investment Manager can reign supreme in all asset classes
 - Uses platforms that provide access to the best available investment options and strategies at the most reasonable cost.
 - *Fiduciary Point: Department of Labor mandate is "Fees should be fair and reasonable for services provided" not "Lowest Cost"*



Excellence Attribute #3: Best-of-Breed Investments

Step 3: Move outside the recordkeeper's "box."

- **Action Items:**
 - *Use the recent DOL 408(b)(2) service provider fee disclosures to separate and evaluate*
 - *Investment fees*
 - *Recordkeeping fees*
 - *Administrative fees*
 - *Evaluate the fairness of how participants pay for administration and recordkeeping*
 - *Benchmark current investment menu performance*



Excellence Attribute #4: Appropriate Participant Diversification

- **Average Plan**
 - Only 8.2% of plan assets in a target date fund
 - Very few participants using auto-pilot managed accounts
 - Majority of participants lack an appropriate allocation relative to their years to retirement
 - Participants tend to demonstrate a “set-it” and “forget-it” mentality to account management



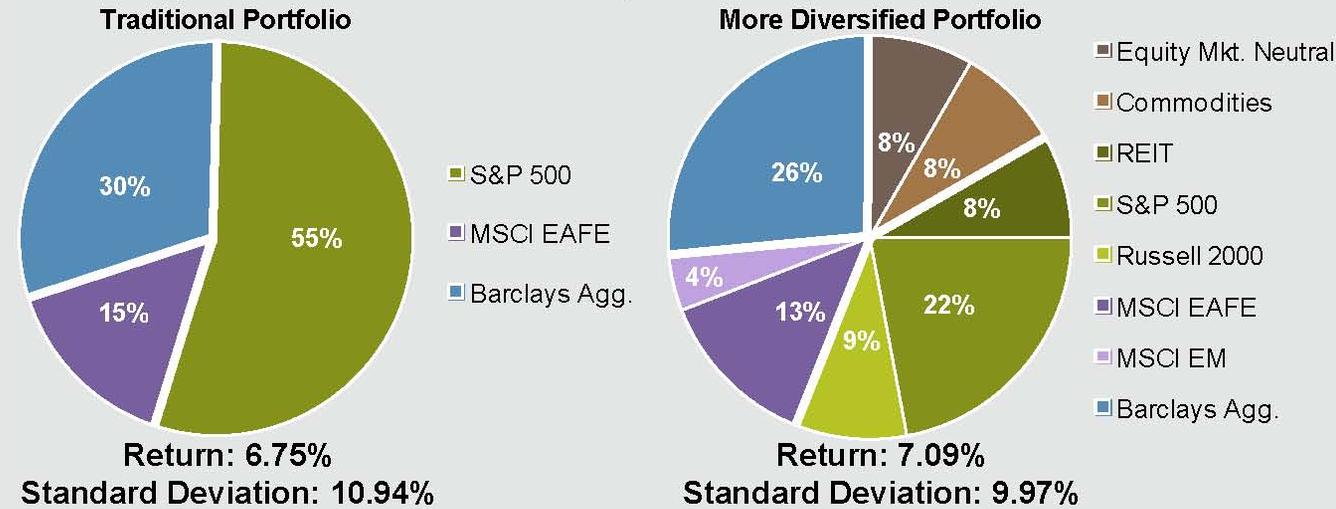
Excellence Attribute #4: Appropriate Participant Diversification

Step 4: Be a guide to your participants

- **Excellent Plans**
 - Plan sponsors embraces asset allocation solutions
 - Over 60% of participants utilize an asset allocation strategy of some type

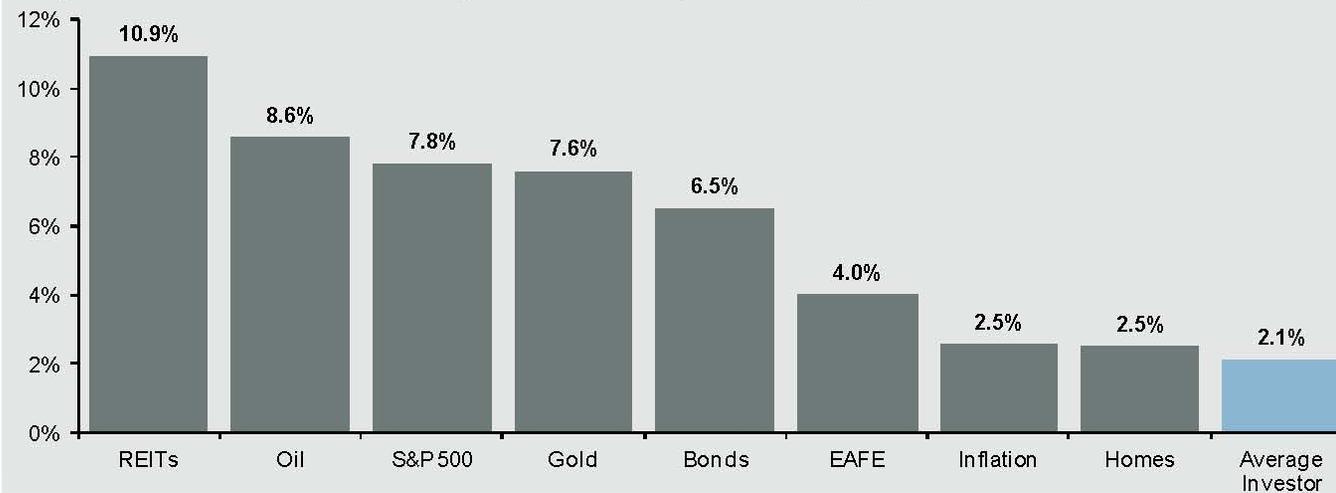
Diversification and the Average Investor

Maximizing the Power of Diversification (1994 – 2011)



(Top) Indexes and weights of the traditional portfolio are as follows: U.S. stocks: 55% S&P 500, U.S. bonds: 30% Barclays Capital Aggregate. International stocks: 15% MSCI EAFE. Portfolio with 25% in alternatives is as follows: U.S. stocks: 22.2% S&P 500, 8.8% Russell 2000; International Stocks: 4.4% MSCI EM, 13.2% MSCI EAFE; U.S. Bonds: 26.5% Barclays Capital Aggregate; Alternatives: 8.3% CS/Tremont Equity Market Neutral, 8.3% DJ/UBS Commodities, 8.3% NAREIT Equity REIT Index. Return and standard deviation calculated using Morningstar Direct. Charts are shown for illustrative purposes only. Past returns are no guarantee of future results. Diversification does not guarantee investment returns and does not eliminate risk of loss. Data are as of 6/30/12.

20-year Annualized Returns by Asset Class (1992 – 2011)

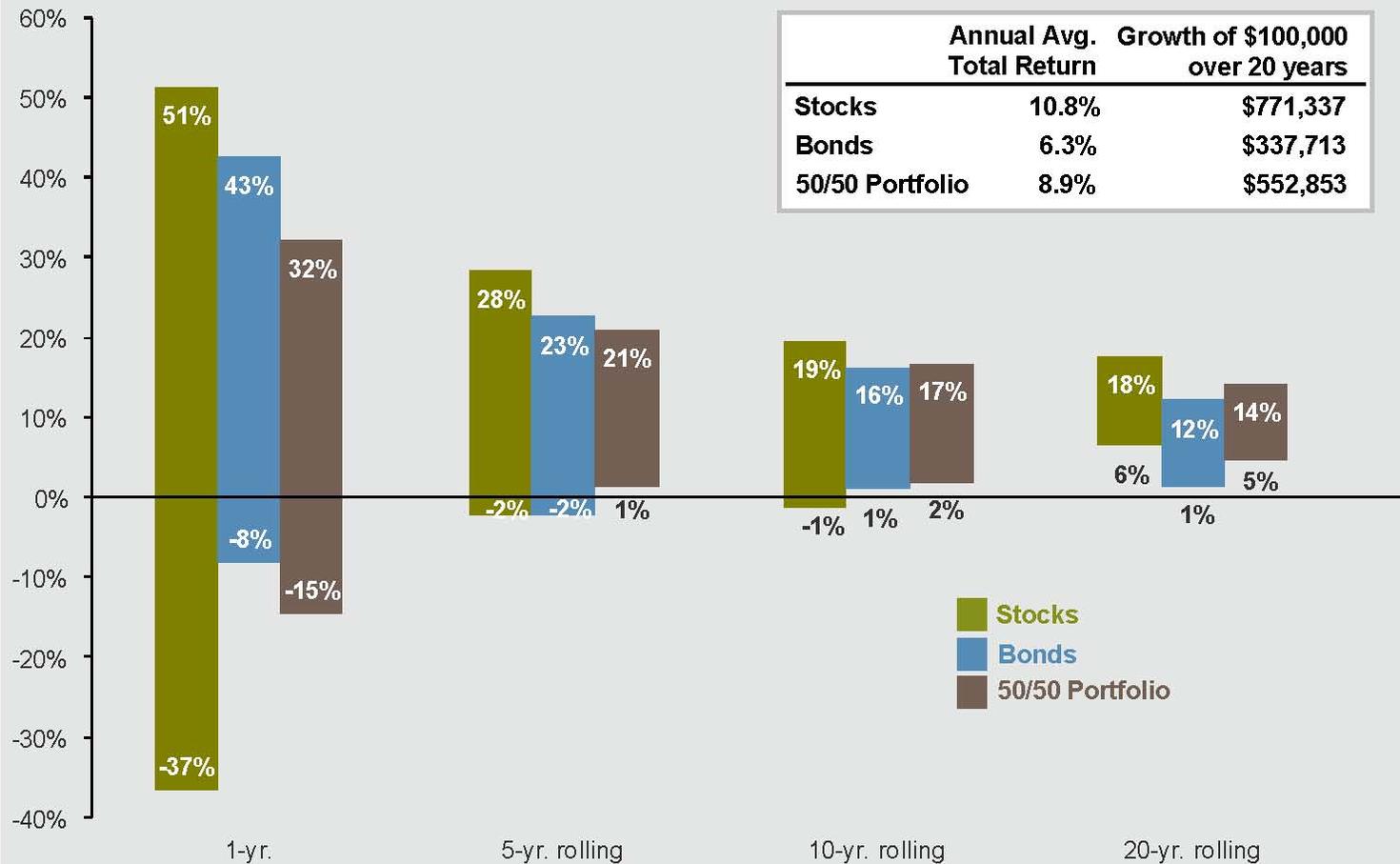


(Bottom) Indexes used are as follows: REITS: NAREIT Equity REIT Index, EAFE: MSCI EAFE, Oil: WTI Index, Bonds: Barclays Capital U.S. Aggregate Index, Homes: median sale price of existing single-family homes, Gold: USD/troy oz, Inflation: CPI. Average asset allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total return where applicable) and represent the 20-year period ending 12/31/11 to match Dalbar's most recent analysis.

Historical Returns by Holding Period

Range of Stock, Bond and Blended Total Returns

Annual total returns, 1950 – 2011



Sources: Barclays Capital, FactSet, Robert Shiller, Strategas/Ibbotson, Federal Reserve, J.P. Morgan Asset Management.

Returns shown are based on calendar year returns from 1950 to 2011.

Data are as of 6/30/12.

Asset Class Returns

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012YTD	2Q12	10-ys '02 - '11 Cum.	10-ys '02 - '11 Ann.
DJ UBS Cmnty 23.9%	M S C I E M E 56.3%	REITs 31.6%	M S C I E M E 34.5%	REITs 35.1%	M S C I E M E 39.8%	Barclays Agg 5.2%	M S C I E M E 79.0%	REITs 28.0%	REITs 8.3%	REITs 14.9%	REITs 4.0%	M S C I E M E 277.2%	M S C I E M E 14.2%
Barclays Agg 10.3%	Russell 2000 47.3%	M S C I E M E 26.0%	DJ UBS Cmnty 17.6%	M S C I E M E 32.6%	M S C I E A F E 11.6%	Market Neutral 1.1%*	M S C I E A F E 32.5%	Russell 2000 26.9%	Barclays Agg 7.8%	S&P 500 9.5%	Barclays Agg 2.1%	REITs 164.2%	REITs 10.2%
Market Neutral 7.4%	M S C I E A F E 39.2%	M S C I E A F E 20.7%	M S C I E A F E 14.0%	M S C I E A F E 26.9%	DJ UBS Cmnty 11.1%	Asset Alloc. 23.8%	REITs 28.0%	M S C I E M E 19.2%	Market Neutral 4.5%	Russell 2000 8.5%	Asset Alloc. -2.1%	Asset Alloc. 86.3%	Asset Alloc. 6.4%
REITs 3.8%	REITs 37.1%	Russell 2000 18.3%	REITs 12.2%	Russell 2000 18.4%	Market Neutral 9.3%	Russell 2000 -33.8%	Russell 2000 27.2%	DJ UBS Cmnty 16.7%	S&P 500 2.1%	Asset Alloc. 5.1%	S&P 500 -2.8%	Barclays Agg 75.4%	Barclays Agg 5.8%
Asset Alloc. -5.4%	S&P 500 28.7%	Asset Alloc. 12.5%	Asset Alloc. 8.0%	S&P 500 15.8%	Asset Alloc. 7.3%	DJ UBS Cmnty -36.6%	S&P 500 26.5%	S&P 500 15.1%	Asset Alloc. -0.2%	M S C I E M E 4.1%	Russell 2000 -3.5%	Russell 2000 72.8%	Russell 2000 5.6%
M S C I E M E -6.0%	Asset Alloc. 25.2%	S&P 500 10.9%	Market Neutral 6.1%	Asset Alloc. 14.9%	Barclays Agg 7.0%	S&P 500 -37.0%	Asset Alloc. 22.5%	Asset Alloc. 12.7%	Russell 2000 -4.2%	M S C I E A F E 3.4%	Market Neutral -3.6%	Market Neutral 72.1%	Market Neutral 5.6%
M S C I E A F E -15.7%	DJ UBS Cmnty 22.7%	DJ UBS Cmnty 7.6%	S&P 500 4.9%	Market Neutral 11.2%	S&P 500 5.5%	REITs -37.7%	DJ UBS Cmnty 18.7%	M S C I E A F E 8.2%	M S C I E A F E -11.7%	Barclays Agg 2.4%	DJ UBS Cmnty -4.6%	M S C I E A F E 64.8%	M S C I E A F E 5.1%
Russell 2000 -20.5%	Market Neutral 7.1%	Market Neutral 6.5%	Russell 2000 4.6%	Barclays Agg 4.3%	Russell 2000 -1.6%	M S C I E A F E -43.1%	Barclays Agg 5.9%	Barclays Agg 6.5%	DJ UBS Cmnty -13.4%	Market Neutral -2.3%	M S C I E A F E -6.9%	DJ UBS Cmnty 58.0%	DJ UBS Cmnty 4.7%
S&P 500 -22.1%	Barclays Agg 4.1%	Barclays Agg 4.3%	Barclays Agg 2.4%	DJ UBS Cmnty -2.7%	REITs -15.7%	M S C I E M E -53.2%	Market Neutral 4.1%	Market Neutral -2.5%	M S C I E M E -18.2%	DJ UBS Cmnty -3.7%	M S C I E M E -8.8%	S&P 500 33.4%	S&P 500 2.9%

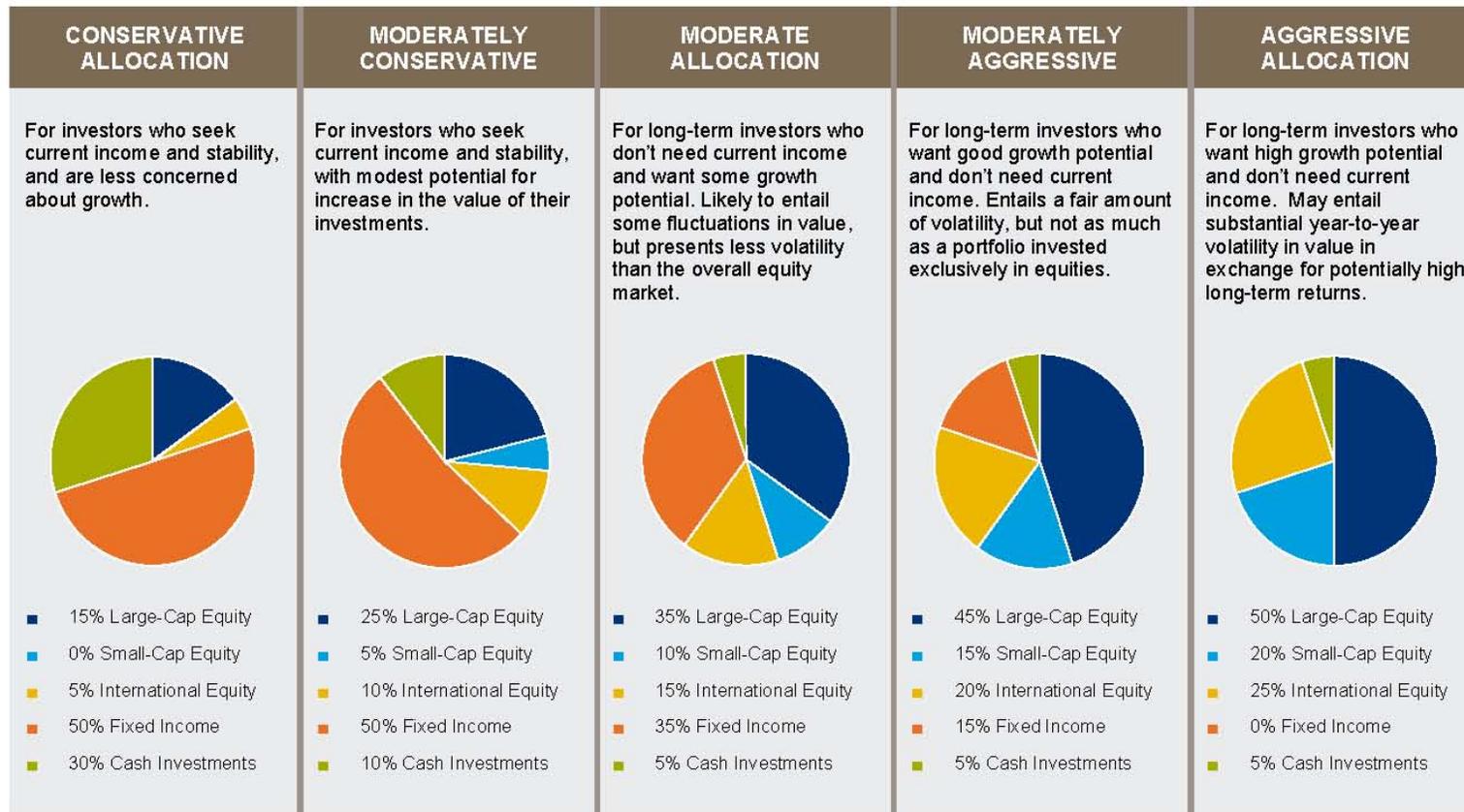
Asset Class

Source: Russell, MSCI, Dow Jones, Standard & Poor's, Credit Suisse, Barclays Capital, NAREIT, FactSet, J.P. Morgan Asset Management.

The "Asset Allocation" portfolio assumes the following weights: 25% in the S&P 500, 10% in the Russell 2000, 15% in the MSCI EAFE, 5% in the MSCI EMI, 30% in the Barclays Capital Aggregate, 5% in the CS/Tremont Equity Market Neutral Index, 5% in the DJ UBS Commodity Index and 5% in the NAREIT Equity REIT Index. Balanced portfolio assumes annual rebalancing. All data except commodities represent total return for stated period. Past performance is not indicative of future returns. Data are as of 6/30/12, except for the CS/Tremont Equity Market Neutral Index, which reflects data through 2/29/12. "10-ys" returns represent annualized total return. These returns reflect the period from 1/1/02 - 12/31/11.

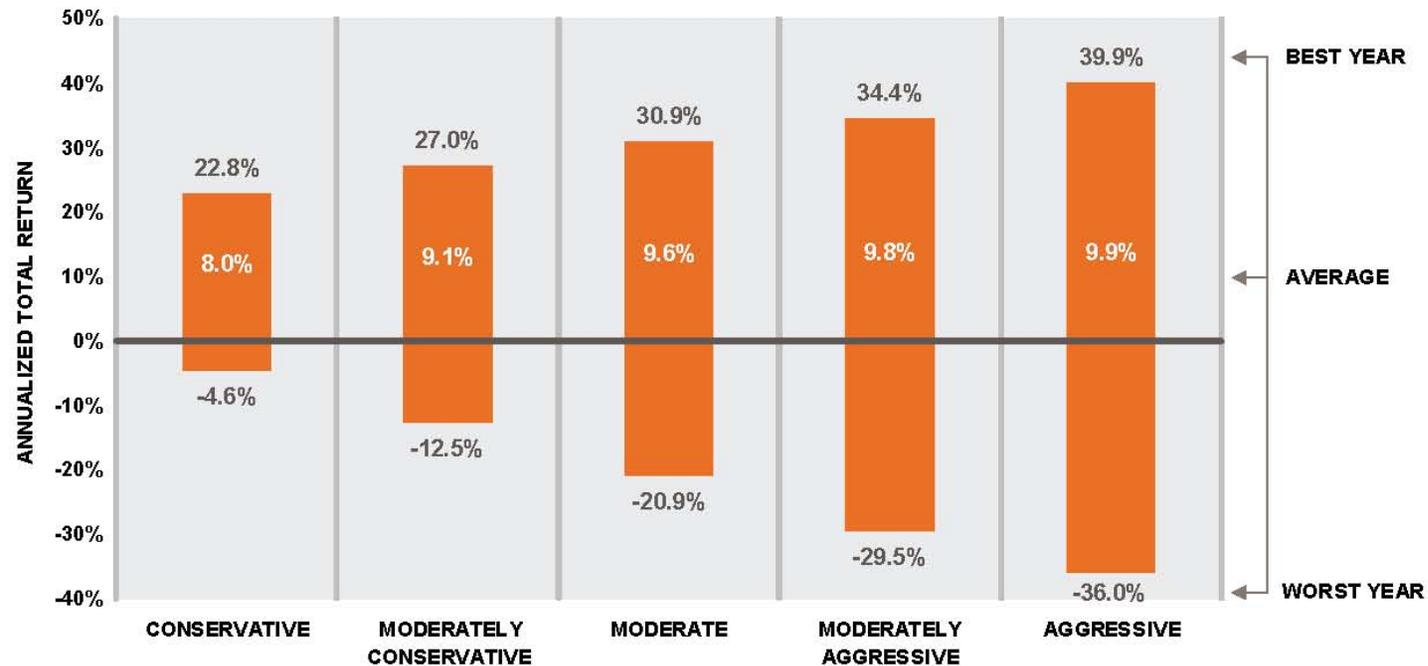
Please see disclosure page at end for index definitions. *Market Neutral returns include estimates found in disclosures. Data are as of 6/30/12.

Implement an asset allocation plan suited to your investment profile and financial goals



Higher returns come with increased short-term volatility

Model asset allocation plans (1970 - 2011)



Source: Schwab Center for Financial Research with data provided by Morningstar, Inc. The return figures represented are the compound average, minimum, and maximum annual total returns of hypothetical asset allocation plans. The asset allocation plans are weighted averages of the performance of the indices used to represent each asset class in the plans and are rebalanced annually. Returns include reinvestment of dividends and interest. The indices representing each asset class are S&P 500® Index (large-cap stocks), Russell 2000® Index (small-cap stocks), MSCI EAFE® Net of Taxes (international stocks), Barclays Capital U.S. Aggregate Index (bonds), and Citigroup U.S. 3-month Treasury bills (cash investments). The Conservative allocation is composed of 15% large-cap stocks, 5% small-cap stocks, 50% bonds, and 30% cash investments. The Moderately Conservative allocation is 25% large-cap stocks, 5% small-cap stocks, 10% international stocks, 50% bonds, and 10% cash investments. The Moderate allocation is 35% large-cap stocks, 10% small-cap stocks, 15% international stocks, 35% bonds, and 5% cash investments. The Moderately Aggressive allocation is 45% large-cap stocks, 15% small-cap stocks, 20% international stocks, 15% bonds, and 5% cash investments. The Aggressive allocation is 50% large-cap stocks, 20% small-cap stocks, 25% international stocks, and 5% cash investments. CRSP 6-8 was used for small-cap stocks prior to 1979, Ibbotson Intermediate-Term Government Bond Index was used for bonds prior to 1976, and Ibbotson U.S. 30-day Treasury Bill Index was used for cash investments prior to 1978. Indices are unmanaged, do not incur fees or expenses, and cannot be invested in directly. **Past performance is no indication of future results.**

charles SCHWAB



Excellence Attribute #4: Appropriate Participant Diversification

Step 4: Be a guide to your participants

- **Action Items:**
 - *Conduct a re-enrollment campaign after menu make-over and offer a choice of:*
 - *Re-executing their existing allocation*
 - *Selecting a new allocation*
 - *Defaulting to the plan's Qualified Default Investment Alternative (QDIA) options*



Excellence Attribute #5: Effective Employee Education

- **Average Plan**
 - Does not differentiate between retirement planning, financial education and investment education
 - Investment and financial education tends to cause employees to disengage
 - Retirement planning specific to individualized situations tends to cause engagement



Excellence Attribute #5: Effective Employee Education

Step #5: Focus on personal planning not general education

- **Excellent Plans**

- Assist participants with being aware of all plan tools and resources available to help successfully develop and implement a personalized retirement planning strategy, including:

- Educational Materials
- Educational Meetings
- Financial Advisors
- Planning Calculators



Excellence Attribute #5: Effective Employee Education

Step #5: Focus on personal planning not general education

- **Action Items:**
 - *Focus employee education on:*
 - *How to establish a personal retirement income goal*
 - *How to calculate the savings rate and investment strategy needed to reach that goal*
 - *Provide regular updates on personal plan progress and “gap” analysis solutions*



Excellence Attribute #6: High Participation Rates

- **Average Plan**
 - Participation rates: 70%-74%
 - Falls short in increasing participation rates more than 1%-2% per year



Excellence Attribute #6: High Participation Rates

Step #6: Give participants a chance for success

- **Excellent Plans**

- Strives for participation rates above 90%
- Utilizes auto-enrollment plan designs
- Tenaciously focus on increasing, attaining and sustaining high participation rates by constantly projecting “future self” scenarios

*in addition to employer matching contributions





Excellence Attribute #6: High Participation Rates

Step #6: Give participants a chance for success

- **Action steps:**
 - *Decide if auto enrollment is right for your plan*
 - *Consider doing a complete re-enrollment during next open enrollment cycle*
 - *At the very least, use easy enroll materials, processes and campaigns*



Excellence Attribute #7: High Contribution Rates

- **Average Plan**

- Participants grossly underestimate how much they need to save
- Average deferral rate is below average (6.8%)
 - Repercussions
 - Non-highly compensated EEs are not tracking toward retirement readiness
 - Highly compensated EEs “may” find their deferral limits reduced due to failed discrimination testing



Excellence Attribute #7: High Contribution Rates

Step #7: Help participants understand the price of retirement success

- **Excellent Plans**
 - Educate participants that 10% + salary deferrals are probably needed to achieve retirement readiness goals
 - Utilize multiple tools in the communication process
 - Constantly consider alternative plan designs to encourage increasing deferrals from the Non-Highly Compensated Employees (NHCEs) and allows maximum deferrals for the Highly Compensated Employees (HCEs)



Excellence Attribute #7: High Contribution Rates

Step #7: Help participants understand the price of retirement success

- ***Action Steps:***

- *Structure company communications around a targeted “personal” savings rate*
- *Explore the effectiveness of auto-escalation deferral plan designs*
- *Evaluate paired or combo plan designs to help HCEs maximize their deferral opportunities*



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Excellence Attribute #7: High Contribution Rates

Recent Paired/Combo Plan/Platform Designs:

- 403(b) + 457(b) plan combo to double HCE deferral opportunity
- 401(a) + 403(b) redesign into a single Safe-Harbor 401(k) plan to streamline administration, reduce costs, improve investment options and enhance employee planning opportunities
- Converting a 401(a) plan into a 401(k) plan, terminating existing 403(b) plan with the intention of reinstalling the 403(b) in 12 months with an HCE only design to allow them maximize deferrals between 401(k) and 403(b)
- 457(f) plans designed to provide “Golden Handcuff” incentives as part of an overall compensation package for non-profit CEO
- “Open architecture” investment platforms as alternatives within 403(b) plans to expensive and poorly serviced variable annuity contracts.



Closing Thoughts

- In every aspect of our lives, we strive for excellence so why should our retirement plans be any different?
- Excellent plans do not happen by accident. Begin with the end in mind and calculate backwards
- Be realistic, don't sugar-coat the truth - get help from professionals who truly understand the gravity of the task ahead and the solutions available to achieve financial success.



Conclusion

Everybody has a retirement plan, some are created by design and some are created by default.

Designed plans have pre-determined costs while default plans have undetermined consequences.

What kind of plan do you have?

Do you need to recalculate your route?



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Thank you for your time!

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- ¹ *Employee Benefit Research Institute No. 366* (see www.ebri.org *Issue Brief*) by the Employee Benefit Research Institute, December 2011
- ² *The Retirement Crisis and a Plan to Solve It*, by Chairman Tom Harkin, The Retirement Crisis, see www.help.senate.gov, July 2012



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Board Expectations Panel



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Secrets of Successful Nonprofits Panel



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2012 Tax Matters Update for Tax-Exempt Organizations

Presented by Tod E. Wilson



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2012 Tax Matters Update

Agenda

- 2011 Form 990 changes
- IRS FY 2011 Annual Report and FY 2012 Work Plan
- Affordable Care Act
- Political and Lobbying Activities
- UBI
- Hospitals/Schedule H



2011 Form 990 Changes

Governance:

- Questions of Independence
- Policies must be adopted by end of fiscal year
- Must provide a copy of Form 990 to entire board prior to filing to answer affirmatively on Form 990



2011 Form 990 Changes

Compensation:

- Reportable compensation – Box 1 or 5 of Form W-2 (whichever is greater)
- Short year returns that do not include a calendar year end
- Increase or decrease in the actuarial value of defined benefit plan
- Independent contractor compensation calendar year reporting



2011 Form 990 Changes

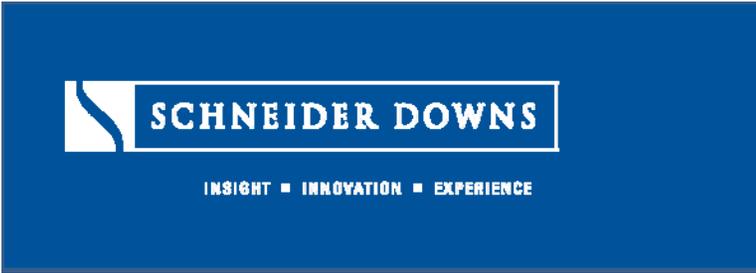
Statement of Revenue:

- Do not net losses from uncollectible pledges, refunds, reversal of grant expenses, etc. on Line 1
- Clarifies reporting for donations of services, materials, equipment and facilities
- Reporting of Medicare and Medicaid payments
- K -1 Reporting – postponed until 2012

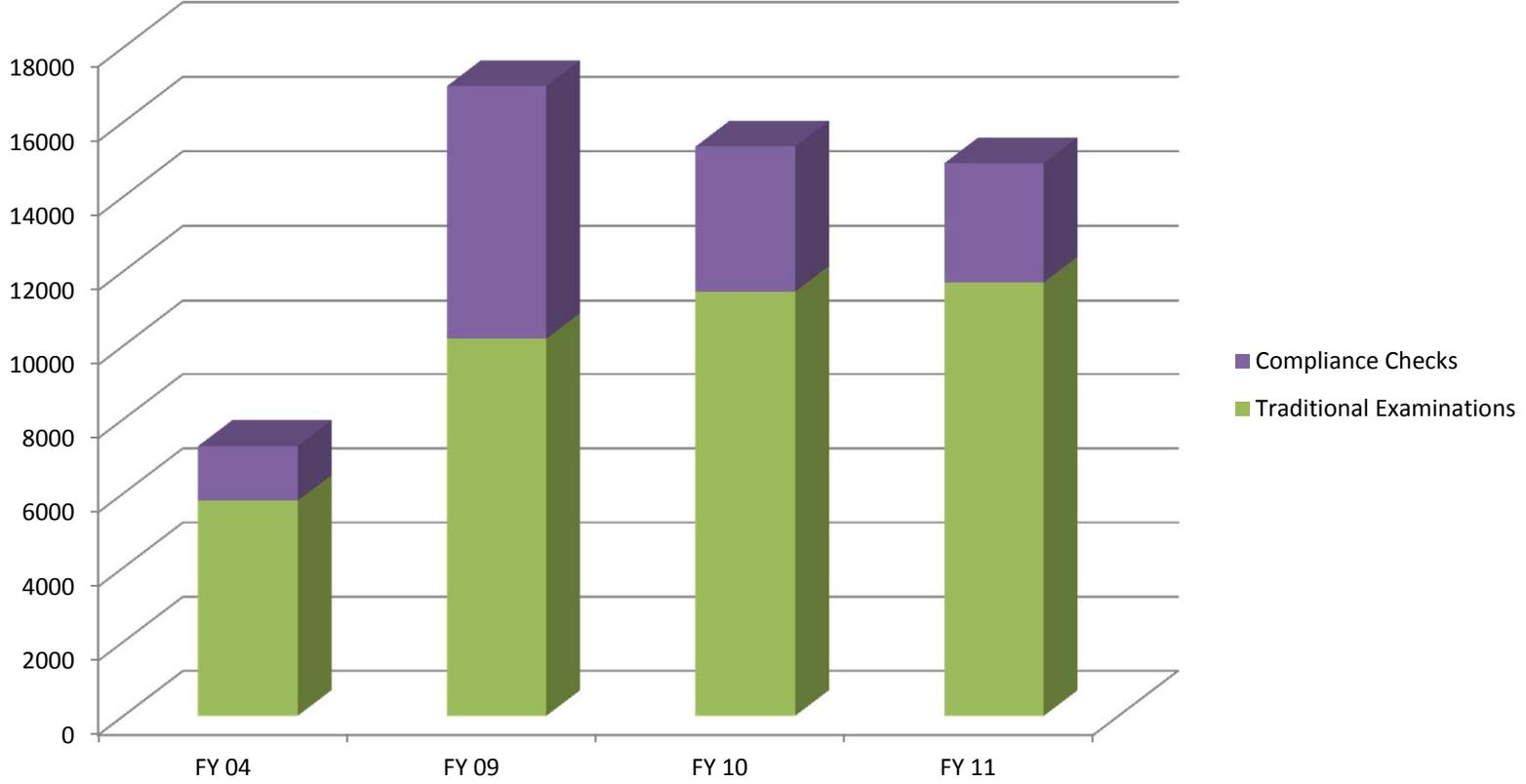


Exempt Organization Statistics

- Fall of 2011 there are 1,186,915 recognized tax-exempt charitable organizations, including private foundations
- Health care organizations constituted largest category in terms of total assets (39 percent; \$990.7 billion) and revenue (58%; \$803.9 billion)
- Educational organizations ranked second on terms of assets (\$840.8 billion)
- Human service organizations filed 38% of all Forms 990 and 990-EZ constituting the largest proportion among the categories



IRS FY 2011 Annual Report – Total Number of Returns Reviewed





IRS FY 2012 Work Plan – 4 Main Focus Areas

- **Focus Area #1 – Legislative Implementation**
 - Auto-Revocation for Non-Filers
 - Requirements for qualifying hospitals for 501(c)(3) exemption
 - Requirements for qualifying exempt health insurance issuers
 - Addressing “accountable care organizations”
 - Addressing new reporting requirements (2 related to preceding, 1 related to small employer health care credit)



IRS FY 2012 Work Plan – 4 Main Focus Areas

- **Focus Area #2 – Compliance: Using the Form 990**
 - 501(c)(4), (5) and (6) self-declarers
 - Political Activity
 - 990-T and UBIT
 - Governance



IRS FY 2012 Work Plan – 4 Main Focus Areas

- **Focus Area #3 – Collaborative Efforts**
 - International
 - Academic Institutions Initiative
 - National Research Program
 - EO Examinations Resource Page on www.irs.gov



IRS FY 2012 Work Plan – 4 Main Focus Areas

- **Focus Area #4 – General Work**
 - Colleges and Universities
 - Disaster Relief Communications
 - Group Rulings
 - Mortgage Foreclosure Assistance
 - State-sponsored Workers Compensation Organizations - (501)(c)(27)
 - Private Foundations
 - Exempt Organization Services and Assistance



Affordable Care Act – Small Employer Credit

- Phase I
 - 2010-2013
 - 2 to 10 employees – average wages below \$25,000 – Max tax credit of 25% ER premium
 - Phase out to fewer than 25 employees and average wages of \$50,000
 - Must pay 50% of total premium
- Phase II
 - 2014 and beyond
 - 2 to 10 employees – average wages below \$25,000 – Max tax credit of 35% ER premium
 - Phase out to fewer than 25 employees and average wages of \$50,000
 - Must pay 50% of total premium
 - Can only take the credit for 2 years



Affordable Care Act – Small Employer Credit

- Small nonprofit organizations with 50 or fewer employees will not pay a penalty if they do not offer health insurance benefits to employees
- 2014 – Small nonprofits will be eligible to purchase health insurance through health exchanges
- 2014 – Insurance companies will be prohibited from raising premiums on nonprofit organizations if one or more employees have serious medical conditions



Employer-Provided Health Care Benefits

- PPACA requires reporting on Form W-2 of the cost of employer-sponsored health coverage as of January 1, 2011
- IRS Notice 2010-69 delayed this reporting until January 1, 2012
- IRS Notice 2011-28 makes reporting optional at least for 2012 for small employers filing fewer than 250 Form W-2s
- See IRS Notice 2012-9 for additional guidance on common paymaster and dental/vision coverage issues



Employer Provided Health Care Benefits Reporting

- **Reporting requirements under IRC 6051(a)(14)**
 - Cost of coverage under employer-sponsored health plan must be reported on Form W-2
 - Report in Box 12 with the code DD
 - This reporting does not affect the taxability of coverage
 - Purpose is to provide employees with useful and comparable information on the cost of health care coverage



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Charitable Giving Tips

- Qualified Organization
- Donor must itemize
- Only amount in excess of FMV is deductible
- Value stock and noncash contributions at FMV (clothing & household items must be in good or better condition)
- FMV is willing buyer/willing seller
- To deduct monetary gift, donor must maintain bank record, payroll record or written communication from exempt organization
- Deductions equaling \$250 or more (cash or property), donor must have written acknowledgement that states whether the charity provided any goods and services in exchange for the gift
- Items of \$5,000 or more must complete Section B of Form 8283 which generally requires an appraisal by a qualified appraiser



Politics and Lobbying – Not the Same Thing

- Political activity – influencing, or attempting to influence, the selection, nomination, election, or appointment of any individual to any Federal, state or local public office
- Lobbying-generally, any attempt to influence legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of legislation
- Different types of organizations = different lobbying rules



501(h) Election

- Looks only at dollars spent
- Requires a one-time election (Form 5768)
- Provides clearer lobbying definitions
- Measures both *direct* and *grassroots* lobbying
 - Direct – attempt to affect legislation through direct contact with legislative bodies, or others involved in formulating legislation
 - Grassroots – attempt to affect legislation by affecting public opinion



Non 501(c)(3) Lobbying

- Not restricted as long as related to exempt purpose
- Sec. 162(a) denies a deduction for most lobbying and political expenditures
- Denial applies to dues paid to lobbying organizations
- Organizations may elect to pay a 35% “proxy” tax instead
- Exceptions
 - Local legislation
 - De minimis exception – in-house expenditures of \$2,000 or less
 - Political expenditures already taxed under Sec. 527
 - Organizations where “substantially all” (90% or more) dues were not deductible by members



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Notification Requirements

- Notify members of nondeductible dues (invoice or acknowledgement)
- Calculation is always a rolling estimate – “true up” annually, revise percentage
- Overages may be rolled forward (“waiver”)
- May an “underage” be rolled forward
 - Discussion in IRS EO CPE article for 2003 says “yes”



Simple, All-Purpose Notification

“Dues payments, contributions or gifts to XYZ Association are not tax deductible as charitable contributions for federal income tax purposes. However, they may be deductible as ordinary and necessary business expenses subject to restrictions imposed as a result of XYZ’s lobbying activities as defined by the Budget Reconciliation Act of 1993. XYZ estimates that the nondeductible portion of your 20XX dues—the portion that is allocable to lobbying is ___ %.”



Hospitals

Affordable Care Act added section 501(r) which adds additional requirements for hospitals to qualify for tax exemption – proposed regulations issued in June 2012

- Financial assistance policy
- Emergency care policy
- Billing and collections
- Charges for medical care

Note: must report each on a facility by facility basis

Community health needs assessment effective for tax years beginning after 3/23/12

Hospitals must attach a copy of audited financial statement to the 990



UBI = Net Loss

Recent study by the IRS shows many EO's report UBI but show a net loss

Thoughts expressed by IRS representatives:

- The process of building a business
- Maybe EOs are not good at operating businesses
- Expense allocations are overly aggressive



What is and isn't UBI

- Passive income (interest, dividends, annuities, royalties and rents) is not UBI
UNLESS debt-financed or from a controlled organization
UNLESS services or personal property (rents)
UNLESS 501(c)(7) – investment income taxable
- Qualified sponsorship payment is not UBI
UNLESS advertising
UNLESS exploited exempt activity income (endorsement)
- Partnership income is not UBI
UNLESS trade or business income or S-Corp – MUST see K-1s
- Qualified convention or trade show income is not UBI



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Recent Rulings of Interest

- Organization's exempt status revoked for incorporating in another jurisdiction
 - Must file a new application for tax-exempt status
- Debt-financed land not subject to UBIT
 - “Neighborhood land rule” exception
- U. S. Tax Court (*Patel v. Commissioner*) – denial of charitable deduction for fire department use of property (gift of partial interest not-deductible)
- U.S. Tax Court (*Durden v. Commissioner*) – denial of charitable deduction for improper acknowledgement of gift (two letters – corrected letter not contemporaneous)



Other Items of Interest

- Expanded Work Opportunity Tax Credit available for hiring qualified veterans – must be hired before 1/1/13 – credit claimed against employer share of social security tax
- IRS official says at recent ABA meeting that identity of “anonymous donors” must be reported on Schedule B if identity is known to the organization
- Charity Watch article “The Alice in Wonderland World of Charity Valuation” – be careful valuing gifts in kind
- PLR 201224036 – organization cannot qualify as exempt charitable entity if primary activity is illegal (marijuana clinic – California, of course)



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Questions?



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Mergers and Acquisitions

Presented by Maureen L. Thomas



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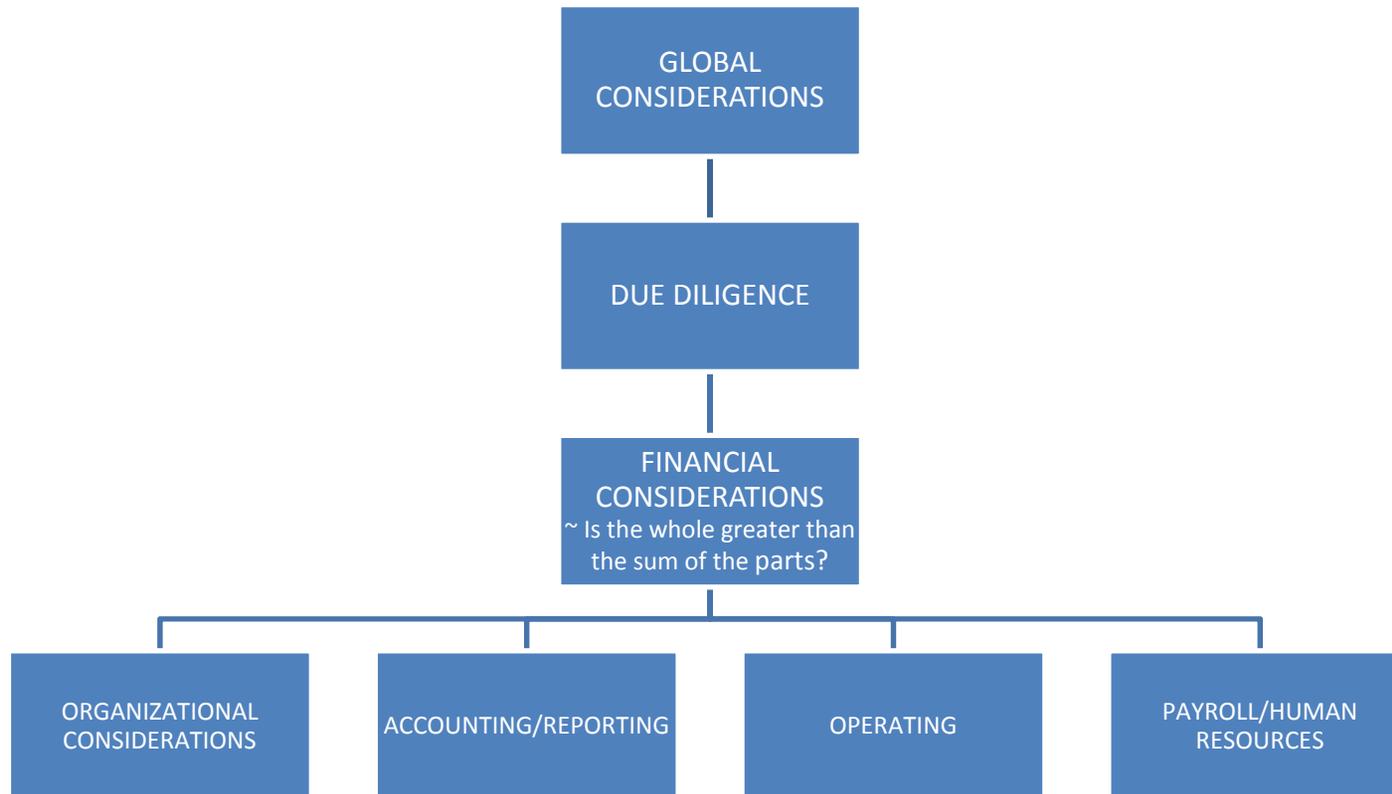


CONSIDERATION OF A MERGER/ACQUISITION

- INCREASED NONPROFIT MERGER/ACQUISITION ACTIVITY
 - Current economic climate
 - Retiring executives
- POTENTIAL BENEFITS OF A MERGER/ACQUISITION
 - More efficient use of backend resources
 - Opportunity to share knowledge and expertise
 - Opportunity for expansion or addition of new services
 - Possibility of securing larger grants
 - Less duplication of services



CONSIDERATION OF A MERGER/ACQUISITION





GLOBAL CONSIDERATION

- Culture and identity of the merged organization
- Leadership at the management and governance levels
- Impact on members
- Mission and vision synchronization

Document to be considered:

- Incorporation documents
- Historical audits and management communications (Certified Public Accountants and regulatory)
- Board/Committee Meeting minutes
- Federal tax filings



Due Diligence: Leveraging Perceived Control

- The acquirer's relative position
 - Maximize value
 - Understand the known and unknown
- The target's motive
 - Maximize value
 - Minimize change



Due Diligence: The Key to a Understanding the Transaction

- Business due diligence consists of the following:
 - Financial and accounting diligence
 - Side by Side Analysis
 - Cost /Benefit Analysis
 - Search for latent liabilities/issues
 - Legal/Engineering diligence
 - Environmental diligence
 - Valuation
 - Intellectual property evaluation
 - Human resource diligence
 - Working Capital
- Avoid relying on representations, warranties and indemnification clauses



ORGANIZATIONAL CONSIDERATION

- Consistency of organizational fiscal year end
- Board and committee structure
- Utilization of technology
- Insurance (general liability, D&O, casualty)
- Budgeting process
- Forecast/projections
- Any outstanding legal matters



ACCOUNTING/REPORTING

- Accounting system compatibility
- Chart of Accounts
- Unique funder reporting requirements
- Financial management policies and procedures
- Expectation for financial reporting (internal and external)
- Any tax issues (not-for-profit merges with for-profit)
- Any outstanding legal matters



ACCOUNTING/REPORTING (Continued)

Documents to be considered:

- Accounting policies/procedures manuals
- Loan agreements
- Lease agreements
- Insurance policies
- Significant contracts/agreements (Funding sources, leases, employment contracts)



OPERATING

- Significant vendor contracts
- Asset Composition (fixed assets/capitalization/depreciation policy, leases, and investment policies)
- Debt (existing covenants, established relationships, ongoing commitment)
- Liabilities (deferred revenue, benefit plan, accruals, payroll, tax matters, contingent liabilities)
- Revenues (sources of funding, compliance requirements, continuation/cessation of programs, fundraising if any, unrelated business income)
- Any outstanding legal matters



PAYROLL/HUMAN RESOURCES

- Payroll system (external service provider, pay rates and frequency)
- Benefit package considerations (vacation, sick PTO, health/life/disability insurance, 401(k)/403(b) – matching, DB)
- Any outstanding legal matters

Documents to be considered:

- Personnel handbook (uniformity of policies, governance and operational)
- Benefit plan documents



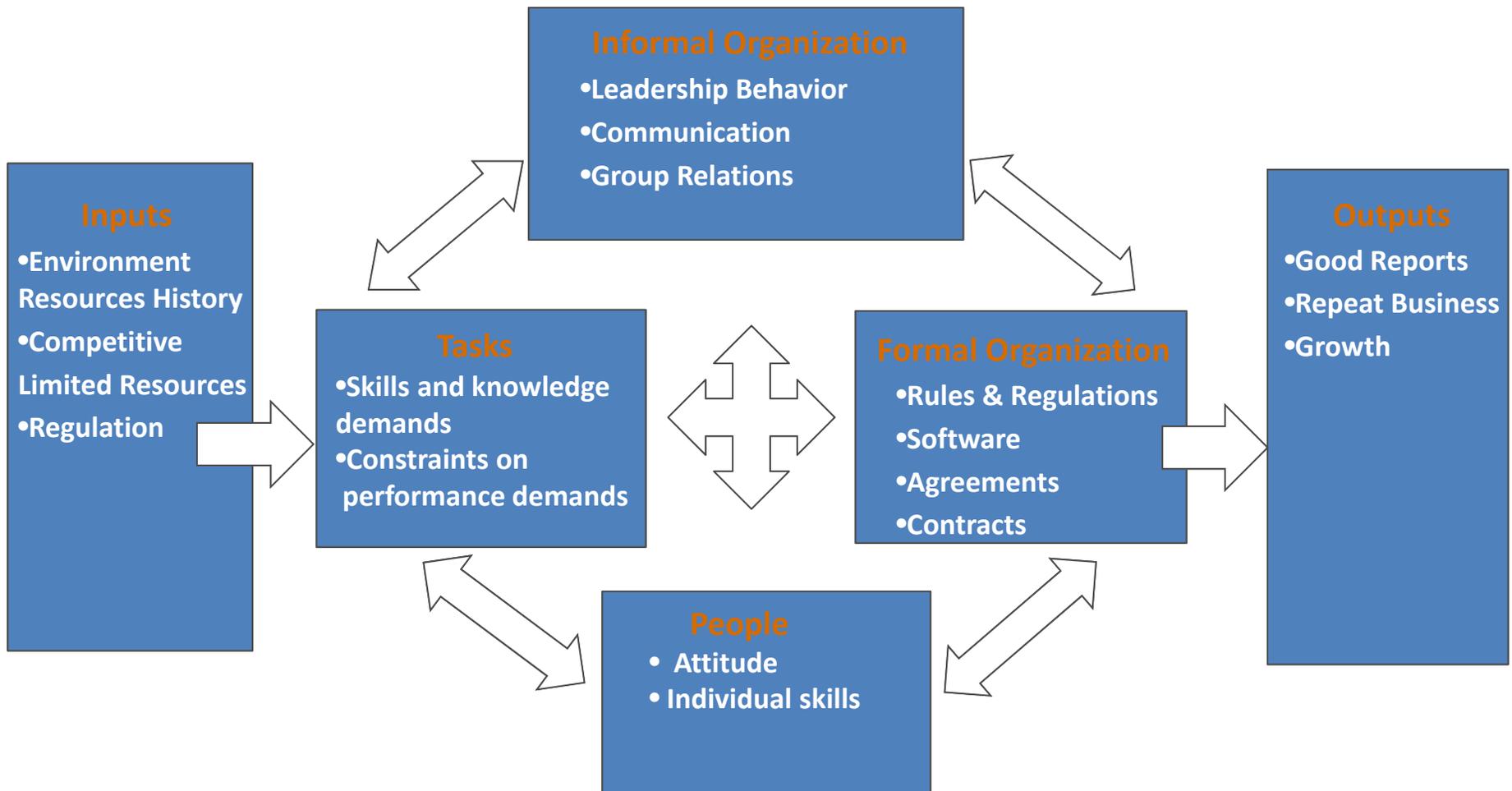
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Post Integration Issues



Check Organizational Congruence Surrounding Goals and Outputs





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QUESTIONS?



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Don't Be Fooled...You Are At Risk

Presented by Angela M. Gillis



Agenda

- Today's Nonprofit Organization
- Challenges
- Fraud – Overview / Examples
- The Fraud Risk Assessment
- System of Internal Controls
- Governance
- Questions





Today's Nonprofit Organization

- A \$665 billion industry – a tempting opportunity for fraud
- Strengthening communities
 - 1.3 million nonprofits
 - Volunteering and charitable giving
- Harnessing the energy and commitment of donors and volunteers
- Fiduciary duty



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Challenges

- Varies amongst organizations
- Economy and external funding
- Dwindling government aid
- Resource management
- Generational tensions
- Donor demands
- Innovation and competition
- Public scrutiny
- Fraud





Fraud Overview

- Definition (Webster's Dictionary):

“any act, expression, or concealment calculated to deceive another to his or her disadvantage.

- In the nonprofit sector:

“use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the organization's resources or assets.”



Fraud Overview (Cont'd)

- Nonprofit vs. for-profit
 - Frequency
 - Emotional response
 - Length of fraud
 - Theft of donated dollars



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Fraud Overview (Cont'd)

- The Damage
 - Lost revenue, donations
 - Negative publicity
 - Lower employee morale
 - Cost of litigation and investigation
 - Disruption to business operations



Fraud Overview (Cont'd)

- Motivation
 - Living beyond their means
 - Overwhelming desire for personal gain
 - High personal debt
 - Feeling entitled
 - Excessive gambling habits
 - Substance abuse
 - Undue family or peer pressure



Fraud Overview (Cont'd)

- Three major types:
 - Misappropriation of Assets
 - » Skimming
 - » Larceny
 - » Fraudulent disbursements
 - Corruption
 - Financial Statement Fraud



Fraud Overview

- Detailed Examples:
 - Forging checks payable to cash, oneself and/or personal vendors
 - Pocketing cash receipts
 - Issuing extra paychecks through payroll to oneself
 - Submitting fraudulent expense reports
 - Submitting fraudulent invoices from fictitious or legitimate vendors
 - Abusing organization's credit card accounts for personal use
 - Theft of organization's equipment or inventory



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Fraud Overview (Cont'd)

- Studies show that in the nonprofit community
 - Average age – 41 years old
 - Women earning less than \$50,000 and employed less than 3 years are most likely to commit fraud
 - Management level was most common fraudster
 - Majority of discovery through tips



Fraud Examples

- Hartville Homes – Canton, OH - \$1.8 million embezzlement
- Grove City Food Pantry – Grove City, OH - \$213,000
- Madison County Humane Society – IN - \$65,000
- Arlington Community Action Program – D.C. – failure to maintain proper internal controls



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The Fraud Risk Assessment



The Fraud Risk Assessment

- Critical part of a risk management process
- Why organizations elect not to do it ...
 - Don't understand the process and benefits
 - Believe they already adequately understand risk profile
 - Lack of resources
- Who is involved?
 - Staff/consultants
 - The Board
 - Executive management



The Fraud Risk Assessment (Cont'd)

- Benefits of a Risk Assessment
 - Identify, analyze, prioritize and measure risks
 - Provide a basis for possible compliance, training and ethics programs
 - Refine or develop risk mitigation and monitoring strategies
 - Identify areas for deeper internal reviews
 - Develop a benchmark for ongoing risk assessment
 - Develop measurement criteria



The Fraud Risk Assessment (Cont'd)

- The ACFE 2010 Global Fraud Study – checklist
- Assessment of fraud risk
- Design effective prevention
- Sample questions
 - Anti-fraud training
 - Fraud reporting mechanism
 - Tone at the top
 - Level of job satisfaction and morale



The Fraud Risk Assessment (Cont'd)

- Methodology
 1. Identify risks

Financial Capture and Reporting	Market/Price
Operational/Transaction	Legal/Regulatory Compliance
Corporate Culture	Reputation
Technology	Vendor/Sub-contractor
Liquidity	Fraud
Corporate Strategy	External Competitors/Economy/Innovations
Interdependency on Other Business Units	Other



The Fraud Risk Assessment (Cont'd)

- Methodology (Cont'd)
 2. Talk to employees
 - » Principal areas of risk
 - » How risk is addressed/mitigated
 - » Ideas
 3. Rate the inherent risk
 - » Assess likelihood
 - Remote, reasonably possible, likely
 - » Assess severity of impact
 - High, moderate, low



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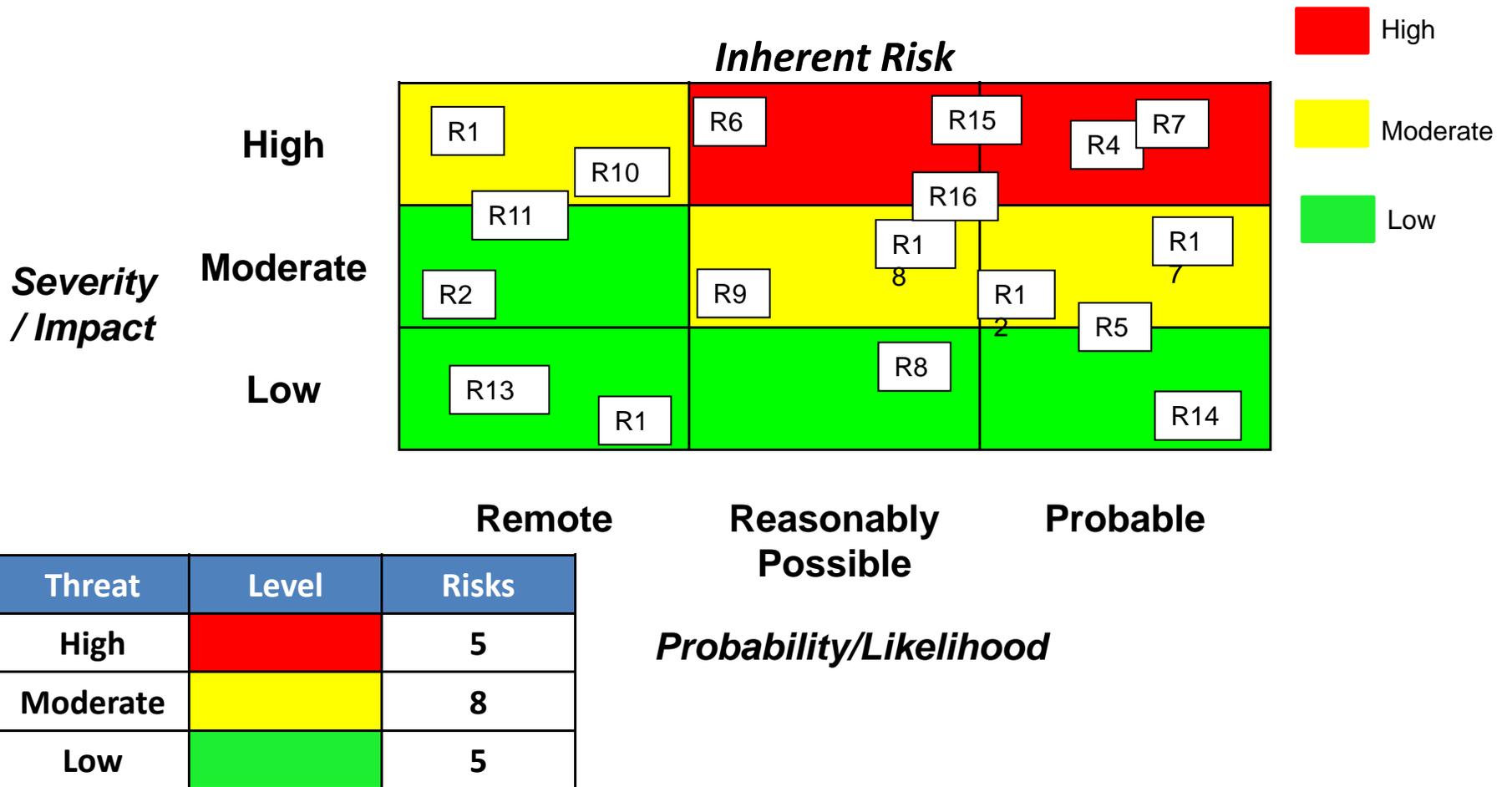
The Fraud Risk Assessment Example

Activity Name	Fraud Risk Assessment
Preparer	XXXX
Preparation Date	X/X/20XX
Updated by	XXXX
Last Revision Date	X/X/20XX

Potential Fraud Risk	Examples	Susceptible Process	Fraud Type	Potential Impact/Severity (H,M,L)	Probability of Fraud Occurrence (H,M,L)	Inherent Fraud Risk (H,M,L)	Controls to Mitigate Inherent Risk	WP REF	Residual Fraud Risk (H,M,L)	Comment / Control Gap
Improper application of GAAP	Secure credit based upon improper accounting (falsify meeting the debt)	Financial Reporting	Fraudulent Financial Reporting	H	M	H	Insert Control 1 Insert Control 2		H	
Inappropriate top-sided journal entries	Manipulation of financial performance	Financial Reporting	Fraudulent Financial Reporting	H	H	H	Insert Control 1 Insert Control 2		L	
Willfully miscalculating tax liabilities	Understating tax liabilities	Financial Reporting/Procurement/Tax	Fraudulent Financial Reporting/Corruption	H	L	L	Insert Control 1		L	
Theft fixed assets	Taking of inventory without authorization, improper disposal of fixed assets	Fixed Asset Management/Financial Reporting	Fraudulent Financial Reporting/Misappropriation of Assets	H	L	L	Insert Control 1 Insert Control 2 Insert Control 3 Insert Control 4 Insert Control 5		L	
Embezzlement	Check kiting; forgery	Procurement	Misappropriation of Assets	M	M	M	Insert Control 1 Insert Control 2 Insert Control 3		L	
Vendor abuse	Bribery, related-party collusion, extortion, kickbacks, preferential treatment, skimming, fictitious vendor billings	Procurement/Legal	Corruption/Misappropriation of Assets	H	L	M	Insert Control 1 Insert Control 2 Insert Control 3		L	
Related party transactions	Transactions not at "arms-length"	Procurement/Legal	Corruption	H	L	L	Insert Control 1		L	
Theft of proprietary confidential information	Trade secrets and customer lists sold to a competitor	Sales Management, Production	Theft of Sensitive Data	M	H	M	Insert Control 1 Insert Control 2 Insert Control 3		L	
Use of company assets for personal gain	Using company vehicles at side-business	Fixed Asset Management	Misappropriation of Assets	M	L	L	Insert Control 1		L	
Theft from company's operating account	Fraudulent disbursements to fictitious vendors	Cash and Treasury Management/ Accounts Payable	Fraudulent Financial Reporting	H	H	H	Insert Control 1		M	
Intentional manipulation, corruption and/or destruction of data	Destruction of customer records	Data Processing	Theft of Sensitive Data	H	M	H	Insert Control 1		M	



Fraud Risk Assessment – Simplified Heat Map





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The Fraud Risk Assessment (Cont'd)

- Methodology (Cont'd)
 4. Take steps to address or mitigate risk
 - » Strong system of internal controls
 - » Conduct due diligence and legal review
 - » Conduct audits (external and internal)
 - » Strong internal policies
 - » Set the right tone at the top
 - Executives and the Board
 - Committees with charters



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System of Internal Controls



System of Internal Controls

Fraud Control Types

Preventive - control identifies the exception/unexpected condition prior to completion of the activity (e.g., posting of a journal entry, receipt of inventory, tracking AR/AP)

- Most proactive measure – “before the horse is out of the barn”
- Minimizes the chance that fraud can occur

Detective - control identifies the exception/unexpected condition post completion of the activity (e.g., reconciliations, loan file review, financial statement analysis, budget to actual comparisons).

- Can be a strong deterrent
- Puts those within the organization on notice
- Serves to mitigate damage that otherwise could have occurred



System of Internal Controls (Cont'd)

Persuasive - control attempts to persuade good governance and business morality throughout the company.

- Control attempts to persuade good governance and institutional morality throughout the company
- It's a “do the right thing” company mindset
- “Tone at the top” that overlays the company
(Internal Audit, Risk Management)

Competence – possessing expertise, activities do not have separate and distinct controls embedded within them

- Understanding of the environment
- Recognizing odd or unusual activities
- Willingness to challenge and report concerns



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System of Internal Controls (Cont'd)

- Control measures to consider:
 - Dual signatures and authorizations
 - Require backup documentation
 - Never pre-sign checks
 - Segregation of duties (see next slide)
 - Conduct background checks
 - Fair bidding process
 - Fixed asset inventories
 - Encourage whistleblowers
 - Automated controls



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System of Internal Controls (Cont'd)

- Segregation of duties
 - Money Coming In – No single individual should be responsible for receiving, depositing, recording and reconciling the receipt of funds.
 - Money Going Out – No person should be responsible for authorizing payments, disbursing funds and reconciling bank statements.
 - If not enough staff on hand, a board member should reconcile the bank and credit card statements.
 - Require employees with financial positions to take an uninterrupted 2-week vacation.



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System of Internal Controls (Cont'd)

- Control measures to consider:
 - Delegation of authority policy / matrix
 - Employee education
 - Dual control
 - Updated anti-virus programs
 - Transaction and daily limits
 - Reconciliations
 - Internal Audit





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Governance



Governance

- Emergence of governance “best practices”
- Considerations of best practices:
 1. Aspirational goals vs. legal requirements
 2. One size does not fit all
 3. Variances may be necessary



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Governance (Cont'd)

- Best practices
 - Strategy, mission and core values
 - Board review of consistency with charitable mission and vision
 - An appropriate balance between the CEO and Board chair roles
 - Board oversight obligations
 - Financial accountability and transparency
 - Establish appropriate committees
 - Code of ethics/compliance



Governance (Cont'd)

- Best practices
 - Conflict of interest policy
 - Expense reimbursement / gift acceptance policies
 - Whistleblower hotline





Summary

- Identify your weaknesses (risks)
- Accept your weaknesses
- Tackle your weaknesses – build your defenses
- Enjoy your security and success





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Questions?