

## NON-PROFIT

## POSSIBILITIES



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## Looking at Enterprise Risk Through a Non-Profit Lens

### OVERVIEW

A recent Eide Bailly-sponsored webinar on Enterprise Risk Management (ERM) drew participation from non-profit client leaders across the Firm. This response is just one of the many indicators that non-profits of all types and sizes are keenly interested in learning how ERM can provide new ways to continue fulfilling their missions and thrive through great uncertainty.

Tremendous challenges and opportunities exist for all organizations during these times, but in particular for non-profit organizations. While most organizations have response plans to address their most common risks, such as decreased cash flow, resignation of the CEO or the termination of a contract, many have not considered the “enterprise” risks that could seriously impact an organization’s survival or have a significant impact on the organization’s ability to achieve the goals and objectives necessary to fulfill their missions.

With the challenges already on the shoulders of non-profit leaders, why spend time now considering an ERM program? The goal is to identify, assess and respond to the organization’s most significant risks. Additionally, an ERM program will implement a continuous process that allows the organization to monitor its risks, including unlikely but high-impact risks. ERM also leads the organization to develop communication and response plans to become nimble and flexible to quickly respond to new and emerging risks. The implementation process includes education and development of a common foundation among the various departments of the organization to achieve these goals.

Throughout the ERM process, an organization creates consensus, sharing of ideas and new ways to address risks by viewing them through a new lens. This new lens allows the organization to see opportunities in the challenges it faces and identify

risk management efforts that are working well and those which need change.

For example, consider a non-profit organization that faces a steep decrease in the number of key volunteers needed to fulfill its mission and objectives. Through analysis, it is determined that the organization has not reached out to a particular generation that gets involved in volunteering for reasons different than the non-profit’s typical volunteers. It is determined that this risk has a high probability and high impact due to the reality of retiring volunteers. Therefore, the non-profit is willing to allocate resources and efforts to address this gap in volunteers. The organization creates an action plan for a new advertising campaign to reach the generation in a manner different from its previous approach. The new risk response then draws a three-fold increase in volunteers from the generation it could not previously reach. Without looking at the risk through this new enterprise-wide lens, it may have taken many years for the organization to respond to the risk and identify the window of opportunity they saw clearly with an ERM viewpoint.

There are several ERM steps critical to understand and respond to a risk facing the entire organization:

1. Identification of the risk (i.e., not enough volunteers in the long-term to support the cause)
2. Assessment of the risk (i.e., determined this risk has a high probability of occurring and a high impact to the organization if it does)
3. Developing a new risk response plan and taking action through executive support, allocation of funds and establishing a risk owner (i.e., a revised advertising campaign to appeal to the specific generation that was not participating)
4. Monitoring (i.e., as the revised advertising campaign evolved, the response also drew more donations, new ways to develop services appealing to this generation, and brought in

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## Determining Worker Classification

### OVERVIEW

The classification of a worker as an employee or independent contractor—always a hot topic for non-profits—is expected to heat up even more during the next several months. With the advent of health care reform requirements covering employees of “large” organizations, and the tough economic times leading to cost cutting, the proper classification becomes even more important with the IRS, state agencies and the Department of Labor.

Legislation introduced in both the House and Senate, titled the “Employee Misclassification Prevention Act,” would require organizations to maintain certain records for both employees and contractors and to notify these individuals of how they have been classified by the organization. If no records are maintained for a worker, it is presumed that the worker is an employee, with all the rights for the worker and requirements for the employer associated with that classification.

The Department of Labor (DOL) has suggested new rules be introduced for worker classification recordkeeping and other items of expense for workers. The proposed new rules are expected to be released later in August. Employers have always had significant potential liability for misclassification of workers, including penalties for unpaid payroll taxes (including interest charges), unpaid overtime, back pay, fines associated with failure to give proper notice to employees and fines for benefits not received. However, the new legislation suggests additional heavy penalties for misclassification of workers, starting at \$1,100 per employee for first offenders, to \$5,000 per employee for repeat or willful offenders.

So, what can non-profits do to ensure their workers are properly classified as employees or independent contractors? The two most common tests used to determine employment status are the DOL Economic Reality Test and the IRS Independent Contractor Test. Non-profits should review these tests to ensure all workers are properly classified and take steps to correct any misclassifications.

The DOL Economic Reality Test uses five factors to determine if an individual should be classified as an employee or contractor:

**1. The extent to which the services rendered are an integral part of the employer’s business** – The more integral these services are, the greater likelihood the individual should be classified as an employee.

**2. The permanency of the relationship** – The more permanent the relationship is expected to

be, the greater likelihood the individual should be classified as an employee.

**3. The degree of initiative, judgment or foresight the individual uses in performing the services** – When there are high degrees of these items, there is greater likelihood the individual should be classified as a contractor.

**4. The amount of investment in facilities and equipment by the individual** – The greater the investment in such items as office space, computer needs and office equipment, the greater likelihood the individual should be classified as a contractor.

**5. The existence of the opportunity for profit and loss on the individual’s part** – The greater this opportunity, the greater likelihood the individual should be classified as a contractor.

The IRS Independent Contractor Test is now used in place of the IRS 20-Factor Test. The new test has been simplified and refined to utilize 11 factors, instead of the previous 20. The 11 factors have been categorized into three main areas: behavioral control, financial control and the type of relationship between the employer and worker. An overview of the three areas and the factors associated with each are as follows:

**Behavioral Control** – Facts that illustrate if an organization has a right to direct or control how a worker performs specific tasks s/he has been engaged to perform.

**1. Instructions given to the worker from the employer:** This includes but is not limited to when and where the work is performed, tools and equipment used in performing the work, what workers to hire or assist with the work, which vendors to use, who must do a given job and the order in which the work is performed.

**2. Training provided by the employer:** Employers generally provide their employees with training on how to perform specific tasks. Contractors generally provide their own training.

**Financial Control** – Facts that illustrate whether the organization has a right to control the

business aspects of the worker's activities.

**3. The extent to which the worker has unreimbursed business expenses:** Independent contractors are more likely to have unreimbursed expenses than employees.

**4. The extent of the worker's investment:** An employee usually has no investment in his or her work, while independent contractors often have significant investments in such areas as facilities, computer and other equipment and supplies.

**5. The extent to which the worker makes services available to the market:** Independent contractors generally seek out business opportunities from multiple sources, while employees do not.

**6. How the organization pays the worker:** An employee is generally guaranteed a specific wage for a specific period of time (i.e., hourly, weekly or monthly). This is not the case with independent contractors, who are often paid on a "per project" basis or an hourly basis for a specified project.

**7. The extent to which the worker can make a profit or loss:** Due to many costs borne by the employer, employees generally do not have an opportunity to make a profit or loss. Independent contractors can make a profit or loss.

**Type of Relationship** – Facts which illustrate how the parties view their relationship.

**8. Written contracts describing the relationship:** Of the 11 factors, this is probably the least important, as the focus tends to be on the nature of the work relationship, not what the employer and worker call the relationship.

**9. Whether the non-profit provides employee-type benefits:** The majority of independent contractors provide and pay for their own benefits. Employers provide benefits only to employees.

**10. The permanency of the relationship:** When a work relationship is expected to continue over time, rather than for a specific project or period,

the workers are generally considered employees. Independent contractors are hired for a specific time period or to complete a specific project.

**11. The extent to which services performed are a key aspect of the non-profit's business:** If a worker provides services that are critical to the non-profit's business activity, it is likely that the non-profit will direct and control the worker's activities, qualifying the worker as an employee.

The DOL Economic Reality Test and the IRS Independent Contractor Test provide non-profits with excellent guidance in determining worker status. Non-profits should also use a "gut check" in making this determination, following the rule that if an individual looks like, or seems like an employee, then most likely they are an employee and should be classified as such. Specifically, non-profits may encounter the following:

- *Hiring someone to plan and execute the annual fundraising gala* – This individual should be classified as a contractor.
- *Hiring students to work over the summer, under the direction of the executive director* – These individuals should be classified as employees, even though employment is of a temporary nature.
- *Hiring an outside resource to provide bookkeeping services for eight hours a week* – In this situation, a full analysis of the individual's responsibilities, accountabilities and reporting relationships should be undertaken to determine the correct classification. The IRS Independent Contractor Test will be useful in determining the appropriate classification for this individual.

If you have questions regarding worker classification, please contact your Eide Bailly representative. ■



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**Beth Bird, CPA**  
Partner  
Eide Bailly LLP  
952.918.3565  
bbird@eidebailly.com

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Managing Editor: Liz Stabenow  
Assistant Editor: Bonnie Oelschlager  
Send comments to:  
[possibilities@eidebailly.com](mailto:possibilities@eidebailly.com)

An Independent Member Firm  
of HLB International



4310 17th Ave S  
PO Box 2545  
Fargo ND 58108-2545

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*Enterprise Risk—from page 1*

emerging leaders to support and sustain the mission, vision and goals of the organization. The organization would continue to expand their strategic objectives to include this initiative in their yearly objectives.)

In this case, the organization looked at the risk in a new way—through a new lens—across the enterprise. It determined the potential adverse impact of this risk to the entire organization for the long-term. The organization tapped into its best practices of structuring an advertising campaign for its mission, specifically designed to draw the attention of the generation it was trying to attract.

The ERM process consists of the following steps:

1. Establish the foundation
2. Identify the enterprise risks
3. Assess the risk to the entire organization
4. Develop a risk response plan for the desired change and/or outcome
5. Take action on the plan
6. Monitor the plan so it has the support and resources needed to link it to the strategic objectives for the organization's success and growth

While this is a broad example of how ERM can identify high impact, high probability

risks, it can also help to understand the high impact, low probability risks. This type of risk is what the general public is responding to with the present economic challenges. It seemed impossible that the economy could be negatively impacted so quickly, so dramatically and across so many industries. Many individuals were not prepared for the “perfect storm” of risks impacting their incomes, retirement plans and general security of their professions. By understanding and preparing for events such as these, better decisions can be made with more confidence and less risk to organizations.

As the participants from our enterprise risk management webinar mentioned, board members are looking at how new and emerging risks can be addressed to align with their organizations' strategies. They discovered that ERM is a vehicle with a new lens to bring non-profits' risks into focus. ■



**Mary Peter**  
Director of ERM  
Eide Bailly LLP  
952.918.3662  
[mpeter@eidebailly.com](mailto:mpeter@eidebailly.com)

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