

Critical Financial Controls

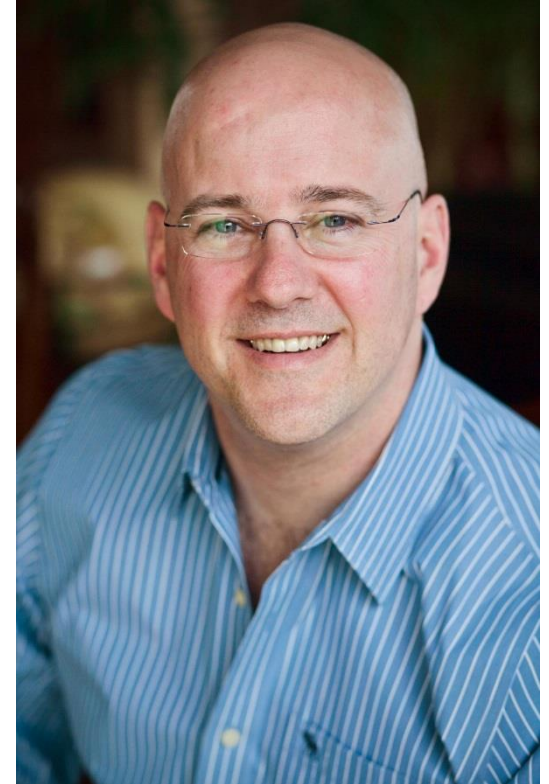
for Small to Medium Nonprofits and Charities

March 23, 2017



Gordon Holley, CPA, CA, FCPB

- Humanity Financial Management Inc.
 - Part-time, internal, professional accountants for NFPOs, Charities & Social Enterprises
- Protect assets and reputations of organizations and their directors
 - Complex financial reporting / QuickBooks / Sage 50
 - Review work of bookkeeper for accuracy and completeness
 - Design / re-design budgeting and reporting systems
 - Design / re-design policies, procedures & internal controls
 - Board / Treasurer / Bookkeeper financial management training and support
 - Certified Non-profit Accounting Professional training (Canada)



Critical Financial Controls Agenda - Part 1



- Why Should I care?
 - Stewardship / Fiduciary / Trustee / Guardian Role
 - Primary Financial Governance Risks
 - What's at stake?
 - Is my organization at risk?
 - Actual news stories

Critical Financial Controls Agenda - Part 2



- What can we do to protect ourselves?
 - Identify and manage specific financial risks
 - Implement strategies to mitigate risks (internal controls)
 - Get the right people with the right skills
 - Create robust budgeting and reporting systems
 - Create & document financial policies and procedures

Part 1

Why Should I Care?

Steward

1. the position and duties of a steward, a person who acts as the surrogate of another or others, especially by managing property, financial affairs, an estate, etc.
2. the responsible overseeing and protection of something considered worth caring for and preserving (Dictionary.com)

Fiduciary

Law. a person to whom property or power is entrusted for the benefit of another.

Trustee

1. a person, usually one of a body of persons, appointed to administer the affairs of a company, institution, etc.
2. a person who holds the title to property for the benefit of another

Guardian

1. a person who guards, protects, or preserves.
2. Law. a person who is entrusted by law with the care of the person or property, or both, of another, as a minor or someone legally incapable of managing his or her own affairs.

Primary Financial Governance Risks

- **Financial Risks**

- Occupational (Employee) Fraud / Theft / Embezzlement
- Running out of cash
- CRA Payroll reassessment
- Losing Charitable or NPO Status

- **Reputational risks**

- Inappropriate asset use
- Ineffective asset use
- Reporting errors



Reputation is Everything

“Armed with a strong reputation, a non-profit will be favorably positioned to access capital markets, recruit talented staff, attract capable trustees, and engender public support. Reputation may not be everything, but whatever occupies second place ranks far behind”

Governance as Leadership: Reframing the Work of Nonprofit Board, Richard Chait, William Ryan & Barbara Taylor (2005) John Wiley & Sons

What's at Stake?

Organizational Risk

- Reputation
 - Financial Scandals – Front page news
- Difficulty attracting:
 - Donors / Funders
 - Board members / staff
- Mission achievement
- Possible bankruptcy

Director Personal Risk

- Reputation
 - Financial Scandals – Front page news
- Personal financial liability
- Lawsuits

Is My Organization at Risk?

- Yes – all organizations are at risk – and virtually all have some level of employee theft.



- Those with appropriate and functioning financial internal controls have significantly less risk

Occupational (Employee) Theft

- CGA Canada Survey of Presence of Occupational Fraud in SMEs (Dec 2011)
 - One quarter (26%) of surveyed SMEs reported to have experienced at least one significant incident of occupational fraud in the past fiscal year!
 - 37% - BC
- Expect higher experience rates in non-profit sector:
 - Atmosphere of trust
 - Difficulty of verifying certain revenue streams (cash)
 - Weaker internal controls
 - Lack of business and financial expertise, and
 - Reliance on voluntary boards



Occupational (Employee) Theft

- Association of Fraud Examiners 2016 Global Fraud Survey
 - Median losses for nonprofits totaled \$100,000
- 5-7%* of gross annual revenue in all Non-profits
 - Canada – Charity Sector (\$250 Billion)**;
Annual loss = \$12,000,000,000 - \$18,000,000,000



**FRAUD
ALERT**

*Chen, Qiu, Steven Salterio, and Pamela Murphy. "Fraud in Canadian Non-profit Organizations as seen through the eyes of Canadian Newspapers 1998-2008." *Philanthropist* 05 May 2009: Print.

**Blumberg, Mark . "Blumbergs' Snapshot of the Canadian Charity Sector 2014." Canadian Charity Law. Blumbergs, 14 Apr. 2016. Web. 12 Mar. 2017.

<http://www.canadiancharitylaw.ca/blog/blumbergs_snapshot_of_the_canadian_charity_sector_2014>.

Occupational (Employee) Fraud

An Investigation of Fraud in Nonprofit Organizations: Occurrences and Deterrents (2006) The Hauser Center for Nonprofit Organizations – Harvard University

- Three major types of occupational fraud
 - Falsification of Financial Statements
 - Corruption
 - Asset misappropriations (97%)
 - Cash/cheques/credit cards/expense reports (95%)
 - Skimming (before recording)
 - Larceny (after recording)
 - Fraudulent Disbursements (75%)
 - Fraudulent Billing (50%)
 - Payroll Fraud
 - Expense Reimbursement Fraud
 - Cheque tampering
 - Fraudulent cash register disbursements



Who is Committing Occupational (Employee) Fraud?

- Fraud in Canadian Nonprofit Organizations (2009)
- “The most frequently reported fraud perpetrators held senior management positions such as CEO, CFO, or other managerial and financial positions in the nonprofit organization, worked for the organization for more than 10 years, and were between the ages of 30 and 50. Although senior people might be more able and motivated to commit fraud, younger people who commit fraud tend to defraud organizations of much larger amounts.”



Some Get Caught

Front Page News

The Trusted Grown-Ups Who Steal Millions From Youth Sports

Prosecutors in several states say embezzlement investigations involving youth sports have become common.

By BILL PENNINGTON JULY 7, 2016

Insider theft a big problem for small charities

Recession, lack of safeguards heighten risk for little nonprofits

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comments below

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Below:  Discuss  Related

- The bookkeeper of the Ann Arbor Amateur Hockey Association has pleaded guilty to taking more than \$934,000 from an account the association had established to build its own hockey rink.

By **Elizabeth Schwinn**

Special to msnbc.com

updated 12/22/2009 7:15:30 AM ET

Print | Font:  A + -

When the Fairmont Marion County Food Pantry in Fairmont, W.Va., discovered that \$53,792 was missing from its bank accounts in mid-March, it was forced to close its food pantry for six weeks, leaving as many as 150 needy individuals and families in the lurch.

- Tamaqua Elementary School in Tamaqua, Pa., had to cancel its field trips for the year after discovering more than \$34,000 had vanished. The former treasurer of Tamaqua's parent-teacher organization admitted the theft in Schuylkill County Court. She avoided jail time, but was ordered to repay the money she took.
- The former leader of the Marine Corps League in Sevier County, Tenn., has been fired and charged with the theft of nearly \$60,000 from the group's Toys for Tots campaign.
- An Oregon swing band for teenage musicians lost \$33,000, allegedly stolen by its founder, and now can't buy new instruments or music.
- A civic association trying to revitalize a downtown Atlanta neighborhood is trying to recover \$78,000 it says was stolen by its former treasurer.



Part 2

What Can We do to Protect Ourselves?

Critical Financial Controls Agenda - Part 2



- What can we do to protect ourselves?
 - Identify and manage specific financial risks
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 - Get the right people with the right skills
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5 Steps of Risk MGMT Cycle

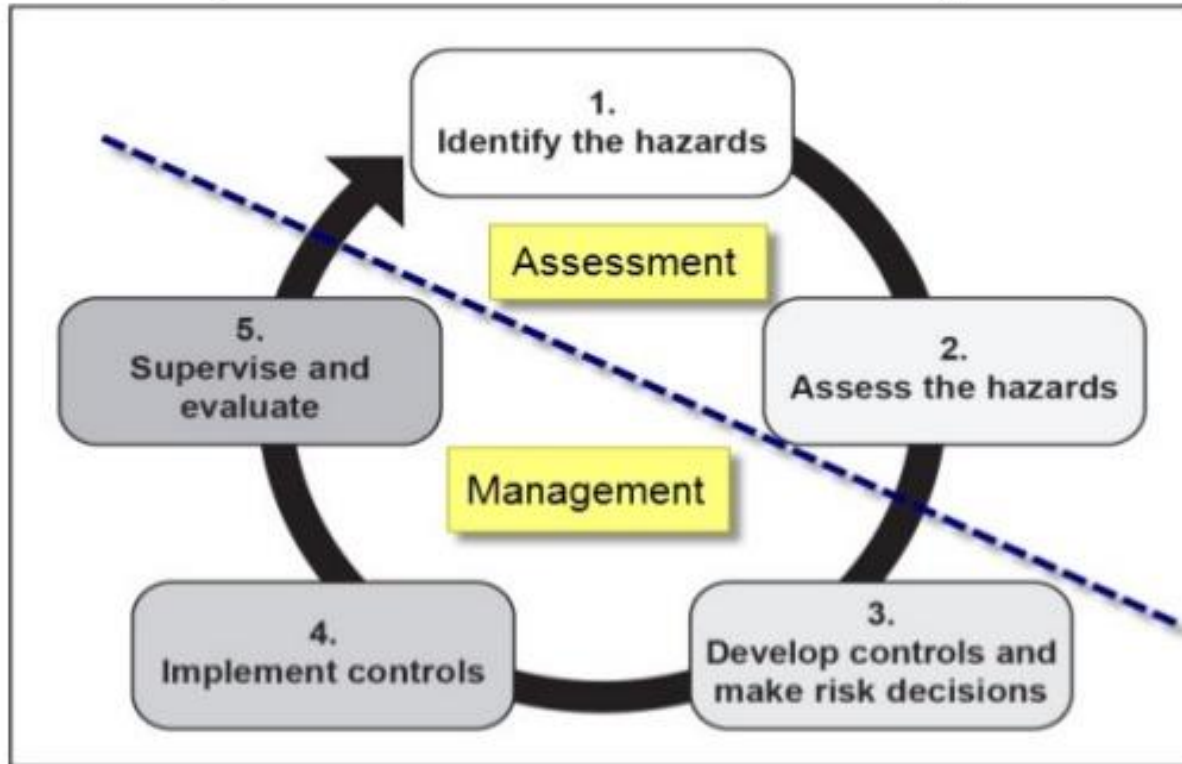


Figure 1-1. A cyclical, continuous process for managing risk

* Alejandro Perez, Military and Civilian Best Practices: Risk Management

Risk Register

Risk Id	Risks	Current Risk			Status	Owner	Raised	Mitigation Strategies	Residual Risk		
		Likelihood	Impact	Severity					Likelihood	Impact	Severity
Category 1: Project selection and Project finance											
RP-01	Financial attraction of project to investors	4	4	16	Open		01-march	<ul style="list-style-type: none"> Data collection Information of financial capability of investor Giving them assurance of tremendous future return. 	4	3	12
RP-02	Availability of finance	3	4	12	Open		03-march	<ul style="list-style-type: none"> Own resources Commitment with financial institution Exclusive management of investor. 	3	3	9
RP-03	Level of demand for project	3	3	9	Open		08-march	<ul style="list-style-type: none"> Making possibility and identification of low cost and best quality material. Eradication of extra expenses from petty balance. 	2	3	6
RP-04	Land acquisition (site availability)	3	3	9	Open		13-march	<ul style="list-style-type: none"> Making feasibilities Analysis and interpretation of feasibilities. Possession and legal obligation of land. 	2	2	4
RP-05	High finance costs	2	2	4	Open		15-march	<ul style="list-style-type: none"> Lowering operational expenses and transportation expenses Proper management of current expenses. 	1	2	2

* Kashif Mastan, Project Risk Register

Risk Categories

- Strategic
- Operational
- **Financial**
- People
- Regulatory
- Governance

Financial Internal Control Techniques

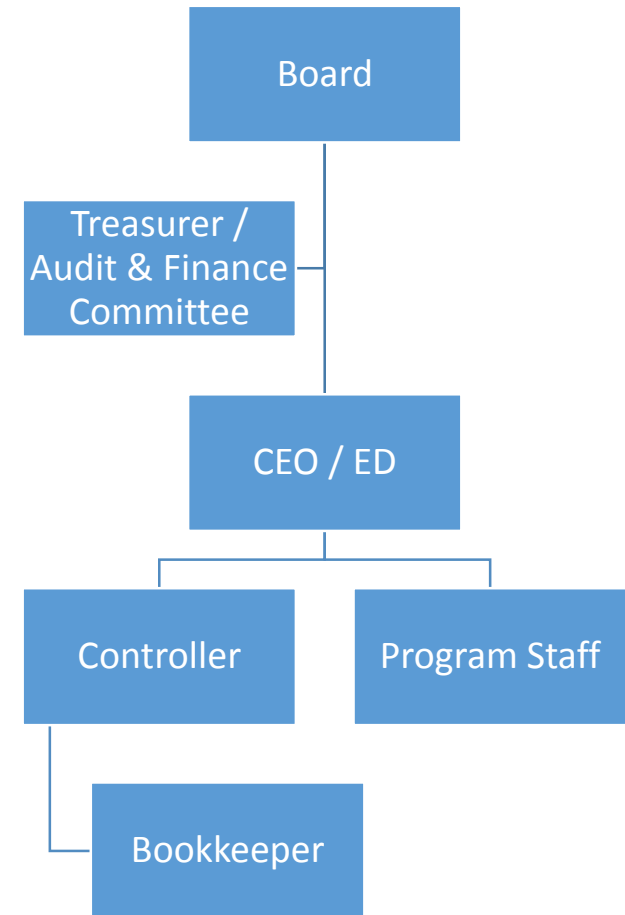
- **Supervision and review.** Monitoring by supervisors and managers.
- **Management & board reporting.** Feedback to supervisor and managers through written reports.
- **Human resources.** Trained, honest, dedicated and effective employees and managers.
- **Policies and procedures.** Written and oral policies and procedures understood by staff.
- **Analytical review.** To explain variances and results.
- **Segregation of duties.** So that different individuals are involved in doing the transaction and recording it.
- **Audit trails.** To trace transactions after-the-fact.
- **Reconciliations.** To ensure that records are maintained correctly.

*Sherman, Jeffery D. . Canadian Controllershship Guide.
Vol. 1. Toronto: Carswell, 2015. Print. Page 107

1. Get the Right People
with the Right Skills

Get the Right People with the Right Skills

The Board is responsible to ensure appropriate financial competency at all levels of organization



Get the right people with the right skills



- Critical controls:
 - Professional accountant as your volunteer Treasurer
 - Treasurer should not do bookkeeping
 - Bookkeeper should have charity / NPO experience
 - Consider hiring a part-time controller
 - Financial training for your board and staff

Professional CPA as Treasurer



Where to look:

- Accounting firms and accountants
- Charity Village
 - Free postings for volunteer positions
- CPABC Careers Site
 - https://careers.bccpa.ca/employer_login
- Go Volunteer (Vantage Point)
 - Must be a member of Vantage Point or another Go Volunteer member

Segregation of Duties & Appropriate Review

- Critical controls:

No **one** person should:

1. Perform all functions within an accounting cycle
2. Have the ability to cover up an intentional or unintentional accounting error



Segregation of Duties & Appropriate Review

- Better solution
 - Segregate preparation and review
 - E.g. bookkeeper prepares
 - Professional accountant (Treasurer or Controller) reviews
- Ensure reviewer has appropriate financial skills

2. Create Robust Financial Systems

Create Robust Financial Systems

Budgets and Cash Flow
Projections

Financial reporting system
including a relevant
Chart of Accounts

Accurate, timely
& complete

Variance reporting by:
- Funder & Contract
- Program & Project

Board Reporting
(& Understanding!)

Create Robust Financial Systems

- Critical controls

1. Create & approve budget before beginning of year
2. Prepare a cash flow budget too!
3. Use software that meets your needs
4. Ensure software set up properly
 - Chart of accounts
 - Programs / Projects / Funders / Contracts
 - Tax items
 - Payroll items
5. Ensure board is receiving the right reports and understands reports it is receiving

Create Robust Financial Systems

Provide Regular Board Reporting

1. Statement of Financial Position (with notes)

2. Actual vs. Budgeted revenues and expenses
(with explanations of significant variances – both
MDT or QTD and YTD)

3. Summary of CRA Compliance

3. Create & Document Basic Financial Policies

Create Basic Financial Policies

1. NO electronic access to bank accounts (“read-only” ok)
2. NO spending without approved budget
3. Segregation of Duties
4. Cash management / Petty cash procedures
5. Spending and signing authority
6. Transaction review and payment approval processes
7. Travel and expense reimbursement
8. Payments to Directors
9. Hiring staff and contractors
10. Regulatory compliance



Checklist for Basic Financial Management Internal Controls for
Small to Mid-Size Not-for-Profit Organizations
and Charities



www.humanityfinancial.ca



Checklist for Basic Financial Management Internal Controls for Small Not-for-Profit Organizations and Charities

Hire the right employees	4
Employee vs. Independent	5
Contractor Payments to volunteers	6
Revenue	7
Donations, cash receipts and collections	8
Credit card donations, transactions and merchant	9
statements Purchases, cash disbursements, cheques and	10
petty cash Credit cards and debit cards	11
Employee expense	12
reimbursements Employee travel	13
reimbursements Banking	14
Electronic banking	15
Bank statements, cancelled cheques,	16
reconciliations Payroll processing	17
Capital assets	18
Financial reports	19
Prevention, detection and	20
insurance Internal Control	21
Reference Resources	

Summary – Why Bother?

- Why Establish Financial Internal Controls?
 - Fulfill director fiduciary responsibility
 - Achieve organizational Vision & Mission
 - Protect assets and reputation of organization
 - Protect assets and reputation of directors
 - Other
 - Steward assets on behalf of stakeholders
 - Attract & retain better funders, board members, staff
 - Reduce risk of loss
 - Reduce risk of inappropriate or ineffective asset use
 - Meet expectations of external monitoring agents
 - \$12-\$18 billion dollars in additional revenue!

Resources on Risk Management

- Grant Thornton – Risky Business
 - <http://insights.grantthornton.ca/i/319479-risky-business/6>
- Carters
 - Legal Risk Management Checklist for Not-for-profit Organizations
 - <http://www.carters.ca/pub/checklst/nonprofit.pdf>
- CPA Canada
 - 20 Questions non-for-profit board directors should ask about overseeing management of risk
 - <https://www.cpacanada.ca/en/business-and-accounting-resources/strategy-risk-and-governance/not-for-profit-governance/publications/20-questions-for-nfp-directors-on-risk-management>

Resources on Internal Controls

- Larger Organizations
 - COSO Internal Controls – Integrated Framework
- Smaller Organizations
 - Humanity Financial Management - Checklist
 - <http://www.humanityfinancial.ca>
 - BoardSource Nonprofit Policy Sampler
 - <http://tinyurl.com/hczygon>
 - First Reference
 - <http://www.firstreference.com/products.aspx>

Thank You!

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