7 BEST PRACTICES FOR SMALL AND MID-SIZED NOT FOR PROFIT ORGANIZATIONS LOOKING TO ESTABLISH STRONG INTERNAL CONTROLS

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Our goal is to provide updates on topical accounting and tax issues. Information contained in this newsletter is not meant to be a comprehensive summary of the issues raised. Rather, we wish to bring what we believe to be important issues to the attention of our valued clients and readers. We would be pleased to discuss any questions that you, the reader, might have in greater detail.

For many small and mid-sized not-for-profit organizations (NPOs), the safeguarding of organizational assets from fraud and misuse, as well as managing the organization's financial risks, are often touted reasons for wanting to develop and implement a strong system of internal control. Boards and Executive management of NPOs must often balance this desire for strong internal control against both budgetary and human resource constraints. Despite these challenges, management and those charged with governance can still establish effective policies and procedures to effectively manage the risks of financial loss without compromising operational agility or efficiency.

UNDERSTANDING RISKS

An important first step in developing an effective system of internal control starts with a robust organizational risk assessment. This process requires input from both management and the Board to help identify and evaluate those areas that pose the greatest risk of financial loss or harm to the organization. Financial losses could range from the loss of revenue or a funder arising from non-compliance with a funding agreement – to the risk of incurring penalties and interest charges on the late payment of statutory or government remittances. The organization's risk assessment should include both an evaluation of the various laws and regulations that the organization must comply with as well as consideration of potential conflict of interest.

Once the risk assessment is complete, management and the Board should adopt a risk based approach to determining the number of controls required as well as their overall design and planned implementation.

SEGREGATION OF DUTIES

One of the most basic concepts within any internal control frameworks is separating duties to have more than one person complete a task or process. A familiar example is separating cash handling (receiving payments and preparing deposits or issuing payments) from cash ledgering (posting cash transactions to the accounts and reconciling the bank) to reduce the risk of fraud and error from occurring. Where possible, management should separate responsibilities in key financial processes and restrict access rights. For example, ideally, an individual responsible for preparing payroll (if separate from the internal accountant) should not be responsible for processing or initiating payment of payroll – or have access to the accounting software or online access to the organization's bank accounts.

For those NPOs with a small number of staff or where limited human resources exist, segregation of duties may simply not be possible. Despite this, NPOs can still involve Executive management and members of the Board in the review and approval of transactions and processes to ensure strong internal control is maintained. To follow are some of the most common and effective controls employed by small and mid-sized NPO's;

PREPARATION OF ANNUAL BUDGETS

A well thought out financial plan for the coming 12-month period should be prepared in advance of the start of the organization's fiscal or calendar year. The budget is typically prepared by management and provided to the board for review and approval. Submission and approval of the annual budget should be documented in the minutes of the board meeting as a formal board resolution. Key assumptions and estimates used to prepare the forecast should be clearly explained and documented. The annual budget package should

also contain details of major projects to be undertaken during the year including any one-time special projects and the sources of the funding. If there are plans for capital investments, a capital budget should be prepared and presented separately.

BANK AND CREDIT CARD RECONCILLIATIONS

Banks and credit cards should be reconciled monthly with only rare exceptions. Copies of the reconciliations prepared by accounting should be reviewed by senior management and/or a member of the board of directors to ensure accuracy with an eye to ensuring the legitimacy of card charges. Reconciliation should also include supporting documentation – such as copies of the monthly bank statement or credit card statement along with electronic images of cleared cheques. It is also important that the reviewer evidence the date of their review and their approval. Electronic stamps and signatures are ideal but a simple email stating the date of review as well as approval is also often used.

MONTHLY OR QUARTERLY BOARD REPORTING

Monthly or quarterly reports to the board should contain month or quarter to date along with year to date financial statements (statement of financial position and statement of operations) ideally with a comparison to budget. Major variances from expected or budgeted results should be clearly explained and documented.

Board reporting should also include a monthly or quarterly statement stating that the organization is in compliance with all statutory requirement for payroll withholdings and other government remittances. Late payments or arrears should immediately be brought to the Board's attention and the reasons for non-compliance fully understood and documented.

Other important operational reports (e.g. fundraising reports, incident reports, key dashboards or other operational metrics) should be updated and presented with comparative information or benchmarks. Significant variances or deviations from plan should be fully documented and explained.

DUAL CHEQUE SIGNING OR ELECTRONIC PAYMENT APPROVAL

A good control to ensure that payments are made to authorized vendors or suppliers for legitimate expenditures is to require dual signatures or electronic authorizations for cheques or payments. Typically, the secondary signature or approval is from a member of senior management or a member of the board. Limits can also be established to require secondary signing or electronic approvals for payments in excess of a certain threshold.

DOCUMENTED EVIDENCE OF REVIEW AND APPROVAL

Documented evidence of consideration as well as review and approval for non-routine, risky or sensitive matters should be documented in the minutes by way of formal board resolutions. Examples might include the approval of employee or Executive bonuses or the approval of a decision related to a major resource allocation or new funding initiative. Strong documentation will serve to protect both management and the board in the event a transaction or decision making process comes under future scrutiny.

CONCLUSION

The above is not an exhaustive list of controls that NPOs can adopt to help manage financial risks. One size does not fit all and the use of complimentary or compensating controls can often be used effectively in those instances where it is not practical to implement some of the best practices noted above.

If you have any questions concerning these or other best practices used by NPOs to manage financial risks we would be happy to meet with you to discuss further.

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