abila™

NONPROFIT CONTROLS:
ULTIMATE COMPILATION GUIDE
Financial Controls that Promote Clean Audits and Deter Fraud

DOCUMENTATION

FRAUD DETECTION

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Overview

According to the **2016 Global Fraud Study**, published by the Association of Certified Fraud Examiners, the most prominent organizational weakness that contributed to fraud in its study was a lack of internal controls, which was cited in 29.3 percent of cases, followed by an override of existing internal controls, which contributed to just more than 20 percent of cases.

29.3%
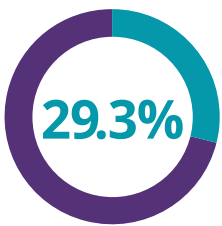
Lack of internal controls was cited in 29.3 percent of cases

20%

Override of existing internal controls, contributed to just more than 20 percent of cases

Unfortunately, there are many nonprofits, particularly smaller organizations, that run an informal shop and don't have prescribed controls in place. And, even if they do, they often allocate very limited resources to monitoring, enforcing, and updating them.

Good controls are derived from the right policies, practices, activities, and behaviors - together creating the framework of a well established control environment. Read on to learn how your organization can ensure everyday success and safeguard your mission through proper financial controls that promote clean audits and help deter fraud.

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Financial Controls

The National Council of Nonprofits describes effective financial controls as having three main attributes. Internal controls:

- Ensure safe care of your assets
- Divide responsibilities among several people
- Are fully disclosed to, and understood by, all concerned parties and key stakeholders

So what goes into a proper set of internal controls, policies, and procedures?

Control Environment

The control environment is the foundation to building an effective infrastructure of internal control. Good controls are derived from the right policies, practices, activities, and behaviors. Framework for the control environment needs to be established and delivered by organizational leadership and financial management, and should:

- Emphasize the importance of controls at every level of the organization
- Emphasize the key and vital role everyone within the organization plays in ensuring the standard of internal control is met
- Communicate a commitment of integrity, ethical values, and competence
- Develop policies and procedures around how the organization assigns authority and responsibility for key tasks and activities
- Share management's operating style and approach toward financial reporting and how information is processed through accounting and other personnel or departments

Policies

Policies and procedures should be developed based on how management assigns authority and responsibility in managing business risk. These policies and procedures should be well documented and accessible for new employees to review and learn, and existing employees to refer to and follow.

Policies and procedures should outline processes around:

- Writing and signing checks, and receiving, recording, processing, and depositing cash and receipts
- Ensuring grants and contributions are properly recorded and recognized
- Preparing monthly and quarterly reports
- Performing bank reconciliations
- Authorizing, recording, and processing payment of invoices and expenditures
- Identifying clear responsibilities for certain roles and departments
- Preparing for an annual audit process

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Financial Controls (continued)

Appropriate Segregation of Duties

To prevent fraud and errors, an organization must separate duties when it comes to authorizing and processing incoming and outgoing financial transactions. Proper segregation of duties promotes healthy checks and balances that alleviate the risk and concern for inaccuracies within balance sheets, fraudulent behavior, and missing money. A true determination of segregation of duties is the required action of more than one person or department when it comes to daily financial transactions.

Some examples of proper segregation of duties:

Payroll
- Person or department that authorizes employment for the organization DOES NOT have authority to process payroll data or issue paychecks

Accounts Payable
- Person who authorizes purchased goods or services DOES NOT record or provide approval for the invoice

Accounts Receivable
- Person responsible for receipt of payment and preparing a deposit DOES NOT take responsibility for recording and authorizing transactions, or for bank reconciliations

Checks
- Person handling money, such as a bookkeeper, SHOULD NOT also sign checks (if your organization is small, making this impractical, consider setting a threshold so larger checks get a second look and signature from someone in management)
- Larger checks over a certain amount should always require more than one signature

Proper Supporting Documentation and Security Measures

Supporting documentation helps detail specific procedures and requirements that ensure policies from upper management are reasonable and adequately carried out. Supporting documentation should help to provide the reason why a transaction occurred, as opposed to only having visibility into the fact that a transaction happened. One example of supporting documentation for your organization may be the requirement of a requisition containing specific details prior to a purchase order approval.

TIP!

The development of proper internal controls will help your nonprofit ensure accountability. But, not if they're buried in a file cabinet or on someone's hard drive. They should be reviewed, updated, distributed, and discussed on a regular basis. Stay alert, especially during times of change – in operations, programs, systems, or employees – that might impact the necessary process or controls.

Nonprofit Audit Preparedness

Proper internal controls, processes, and documentation will make for an easy audit process. An audit helps to instill confidence among donors, ensure compliance with accounting standards, and protect your organization against fraud. The best way to prepare for an audit is to consider the Three Ps - People, Processes, and Paperwork.

People:
Internal Audit Committee/Task Force Team

While the board of directors holds a majority of the fiduciary responsibilities for the nonprofit, oversight of finance and accounting functions, and the performance of an independent audit, an organization's audit committee helps to carry out key responsibilities in a more manageable manner. Main roles of the internal (or external) audit committee may include:

- Selecting the independent auditor
- Preparing necessary documentation prior to auditor's arrival
- Addressing complaints or questions about possible financial mismanagement
- Evaluating the independent audit
- Evaluating the independent auditor/firm post-audit
- Presenting final audit findings to executives and board of directors
- Ensuring recommendations provided by auditor are implemented
- Overseeing internal controls and risk management procedures for the organization

Processes:
The When, Where, Why, and How Things Happen

Auditors primarily examine financial records and practices to help assess and confirm an organization's financial position. Part of this process is understanding how your organization conducts business and handles key finance- and accounting-related tasks and activities. Your organization should be able to:

- Demonstrate strong and well-documented internal controls and segregation of duties in financial and accounting administration, transaction activities, petty cash management, and processing and approval responsibilities
- Provide an audit trail that clearly tracks transactions to sources of revenue
- Generate reports that quickly and efficiently show use of grant funds, programs, and other relevant activities

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Nonprofit Audit Preparedness (continued)

Paperwork:
The Virtual (or Physical) Filing Cabinet Repository

They say the devil's in the details, and if the documentation requirements for an audit are any indication, that's absolutely true.

Search online on the topic of audit documentation requirements and you'll find links to a multitude of lists compiled by CPAs, consultant groups, and others involved with nonprofits and nonprofit audits.

You can expect your auditor to have his or her own list of exactly what documents he or she needs to review, but in the meantime you can familiarize yourself with some of the most common pieces of physical or virtual paperwork:

- Bank statements and reconciliations
- Investment reconciliations and statements, plus reconciliations on realized gains and/or losses
- Fixed assets and depreciation schedules
- Accounts payable vendor lists
- Amortization schedules for debt, and copies of loan paperwork and/or notes payable
- Copies of lease agreements and insurance policies, plus schedule of prepaid expenses
- Payroll journals and employee timesheets
- Details on grant funds received and their requirements or restrictions

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Nonprofit Fraud

Don't fall for the misconception that fraud will never happen at your organization. Nonprofits are especially susceptible to fraud, and understanding how fraud can occur and how to mitigate risk is vital for any size organization.

Mitigating Fraud Risk

In the 2016 Global Fraud Study, published by the Association of Certified Fraud Examiners, the presence of anti-fraud controls was correlated with both lower fraud losses and quicker detection.

The study compared organizations that had specific anti-fraud controls in place against organizations lacking those controls, and found that where proper controls were present, fraud losses were 14.3 to 54 percent lower, and fraud was detected 33.3 to 50 percent more quickly.

There are many steps your organization can take today to help foster a fraud-free environment and mitigate further fraud risk, including:

- Work every day to foster an environment of awareness and a culture of open communications and transparency
- Your team members are, in actuality, your first line of defense, so equip them with policies, procedures, and passion to support your mission and keep it safe from dangers
- Keep lines of communication open and ongoing
- Provide a safe place and process for board members, management, staff, and even volunteers to voice and express concerns

- Ensure everyone is aware of what the red flags of fraud may look like
- Ensure everyone understands their role in fighting fraud
  a. Board members hold a fiduciary responsibility to the organization
  b. Management holds responsibility and oversight
  c. Staff and volunteers have a hand in responsibility
  d. All have a duty to be aware and to inform

The right technology can also help an organization be both proactive and reactive when it comes to detecting and deterring fraud, learn more in Section IV.

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Technology and Controls

The right technology infrastructure can mean all the difference between an effective and efficient organization and one that is just barely getting by with the day-to-day. A true fund accounting™ solution provides nonprofit organizations with more than just purpose-built technology designed to fit their unique needs and funding streams. With true fund accounting™ nonprofits can easily remain compliant, audit-ready, and fraud-free, 24/7.

Core benefits of using a true fund accounting™ solution to maintain proper financial controls:

- Granular control over permission and access levels
- Audit trails and auditability of your general ledger and system logs
- Configurable alerts, including alerts on key activities to detect and deter fraudulent behavior and check-writing alerts
- Sound accounting policies and procedures
- Security enhancements that mask employee- and vendor-sensitive information (such as Social Security numbers and bank account information)
- Security and workflow access controls
- Easy supporting documentation storage for accessibility by auditors
- Key budget alerts that ensure certain monies are not appropriated incorrectly

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