Financial Internal Controls: Protecting your Assets and Reputations

Gordon Holley, CPA, CA, FCPB, Humanity Financial

October 5, 2021
Gordon Holley, CPA, CA, FCPB

- Co-founder, President & CEO of Humanity Financial Management
- 30 year CPA, CA
- 45 years board experience
Who We Are

We build financial systems, skills and capacity within social purpose sector and Indigenous organizations.
Certified B Corporation®

Largest Certified B Corp accounting firm in Canada.

B Corps are required to balance purpose and profit.
We work with wonderful organizations

That’s why we love our work and you’ll be in great company.
Agenda

Today’s Session:
1. Overview of Financial Risk & Controls
2. Effective Financial Governance

Thursday’s Session:
1. Compliance with Funding Contracts
2. Compliance with Regulators (including CRA)
Overview of Financial Risks & Controls

Setting the stage
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
Board Financial Roles & Responsibilities

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

Guardian
- a person who guards, protects, or preserves.
- 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
“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?

<table>
<thead>
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<th>Organizational Risk</th>
<th>Director Personal Risk</th>
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<tr>
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<td>• Financial Scandals – Front page news</td>
<td>• Financial Scandals – Front page news</td>
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<td>• Difficulty attracting:</td>
<td>• Personal financial liability</td>
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<td>• Donors /Funders</td>
<td>• Lawsuits</td>
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<td>• Board members / staff</td>
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<td>• Mission achievement</td>
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<td>• Possible bankruptcy</td>
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</table>
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

Economic crime *is on the rise*

PwC’s 2018 Global Economic Crime and Fraud Survey finds that 55% of Canadian respondents say they’ve experienced economic crime in the past two years. But what about the other 45%? Have they avoided falling victim – or simply don’t know about it?

- Expect higher experience rates in non-profit sector
Occupational (Employee) Theft

- Median Loss - $95,000
- Average Loss - $639,000

*Association of Fraud Examiners, 2020 Report to Nations*
Occupational (Employee) Theft

- Nonprofits more vulnerable
- Fewer Anti-fraud Controls in place

*Association of Fraud Examiners, 2020 Report to Nations*
Detection Methods

- External audits at 3.7% are not an effective internal control
  - Tips – 37.3%
  - Internal Controls - 37.1%
  - Other - 25.6%
Occupational (Employee) Fraud

• 5-7%* of gross annual revenue in all Non-profits
  • Canada – 2018 Charity Sector ($284 Billion)**; Annual loss = $12,000,000,000 - $18,000,000,00

Who is Committing Occupational Fraud?

“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.”

*Organization fraud in Canadian Nonprofit Organizations as seen through the eyes of canadian newspapers, 1998 – 2008, Qiu Chen, Steven Salterio, & Pamela Murphy Queen’s University, Kingston, Ontario*
Cyber Security On the Rise

• Top reported economic crimes and frauds*?
  • Cybercrime – 46%
  • Asset misappropriation – 38%
  • Consumer fraud – 36%

• Primary Cyber Security Risks
  • Loss of donor or employee data
  • Financial loss (Phishing / identify theft / internet purchases)

• Should be prominent in risk management plans / internal controls

• Check with auditor / insurance provider
Questions?
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
Employee Theft “Shockingly Common” at Nonprofits


“The whole thing has been a nightmare,” said Mark Alston-Follansbee, executive director of the Somerville Homeless Coalition, whose former chief operating officer is accused of embezzlement.
Insider theft a big problem for small charities

Recession, lack of safeguards heighten risk for little nonprofits

By Elizabeth Schwinn
Special to msnbc.com
updated 12/23/2006 7:18:36 AM ET

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.
Overview of Financial Risks & Controls

Setting the stage
What Can We Do to Protect Ourselves?

- Identify and manage specific financial risks
  - Mitigate risks with appropriate internal controls
- 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
Identify & manage specific risks
Effective Internal Controls Reduce Risk

High Risk • Effective Internal Controls

Low Risk
5 Steps of Risk MGMT Cycle

1. Identify the hazards
2. Assess the hazards
3. Develop controls and make risk decisions
4. Implement controls
5. Supervise and evaluate

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

* Alejandro Perez, Military and Civilian Best Practices: Risk Management
<table>
<thead>
<tr>
<th>Risk Id</th>
<th>Risks</th>
<th>Likelihood</th>
<th>Impact</th>
<th>Severity</th>
<th>Status</th>
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<th>Owner</th>
<th>Mitigation Strategies</th>
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<td>Financial attraction of project to investors</td>
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<td>4</td>
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<td>Giving them assurance of tremendous future return</td>
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<td>Own resources</td>
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<td>Commitment with financial institution</td>
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<td>Exclusive management of investor</td>
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<td>RP-02</td>
<td>Availability of finance</td>
<td>3</td>
<td>4</td>
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<td>Making possibility and identification of low cost and best quality material.</td>
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<td>Eradication of extra expenses from petty balance.</td>
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<td>RP-03</td>
<td>Level of demand for project</td>
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<td>Open</td>
<td>13-march</td>
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<td>Making feasibilities</td>
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<td>Analysis and interpretation of feasibilities.</td>
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<td>Possession and legal obligation of land.</td>
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<td>Proper management of current expenses.</td>
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<td>High finance costs</td>
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<td>Lowering operational expenses and transportation expenses</td>
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* Kashif Mastan, Project Risk Register
Risk Categories

• Governance
• Strategic
• Operational
• Programs
• Financial
• People
• Regulatory
Questions?
1. Get the right people with the right skills
The board is ultimately responsible to ensure appropriate financial competency and oversight at all levels of the organization.
People & Committees

- CPA as Treasurer?
- Board members with financial experience
- Credible Finance and Audit Committee(s)?
- CEO / ED with financial skills and experience
- CFO / Controller?
- Capable bookkeeper who understands BG Clubs and risks
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
- More levels of review = Better!
Critical Financial Roles

**Bookkeeper**
- Pay bills
- Data entry
- Reconciliations
- Payroll / T4s
- Worksafe BC
- Sales tax
- Basic reporting

**Controller (CPA?)**
- Accuracy and completeness of financial reporting
- Reviews work of bookkeeper and supports bookkeeper
- Financial Internal controls
- Tracks financial KPIs
- Budgets and variances

**Chief Financial Officer (CPA?)**
- Financial health and performance improvement
- Designs financial KPIs
- Risk Management
- Asset Planning & Preservation
- Manage Banking relationships
- Manage external lawyer relationships

**Treasurer (CPA?)**
- Chair’s Finance and/or Audit Committee(s)
- Ensures Board meets financial fiduciary responsibilities
- Interprets financial reporting and advises board
- Facilitates strategic thinking within board about financial vitality
- Develops financial literacy of board
- Advises mgmt. team on financial reporting
Professional CPA as Treasurer

Where to look:

- Accounting firms and accountants
- Charity Village
  - Free postings for volunteer positions
- Provincial CPA Job Boards
- Go Volunteer (Vantage Point)
  - Must be a member of Vantage Point or a Go Volunteer member
Questions?
2. Create robust budgeting and reporting systems
Create Robust Financial Systems

- Financial transaction processing systems
- Financial budgeting & reporting system including a relevant Chart of Accounts
- Variance reporting by:
  - Funder & Contract
  - Program & Project
- Board Reporting (& Understanding!)

Accurate, timely & complete
3. Create and document financial policies and procedures
Create 10 Basic Financial Policies

1. NO electronic access to bank accounts (“read-only” ok)
2. NO spending without approved budget
3. Segregation of Duties & appropriate review
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
Developing Your Own Financial Policies

- **Borrowing from other organizations**
  - Not usually a good fit (unless they are a very similar organization)

- **Starting from scratch (modeled on templates)**
  - Develop policies to address specific areas of risk
  - Formal Risk Identification and Risk Management process
  - Review
    - Statement of Financial Position
    - Statement of Operations

- **Work with an external consultant**
Checklist for Basic Financial Management Internal Controls for Small to Mid-Size Not-for-Profit Organizations and Charities
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<td>Revenue</td>
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<td>Donations, cash receipts and collections</td>
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<td>Credit card donations, transactions and merchant statements</td>
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<td>Purchases, cash disbursements, cheques and petty cash</td>
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<td>Credit cards and debit cards</td>
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<td>Employee expense reimbursements</td>
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<td>Employee travel reimbursements</td>
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<td>Banking</td>
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<td>Bank statements, cancelled cheques, reconciliations</td>
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<td>Capital assets</td>
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<td>Financial reports</td>
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<td>Prevention, detection and insurance</td>
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<td>Internal Control Reference Resources</td>
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Financial Management Roles and Responsibilities Guide
# Roles & Responsibilities: The 12 Most Common Financial Management Tasks

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<td>Human Resources (Financial Management) - Evaluation, Development and Succession Planning</td>
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</tr>
<tr>
<td>Financial Performance Management and Reporting System Design, Selection and Implementation</td>
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<td>Strategic Planning</td>
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<tr>
<td>Annual Operating Plan and Budget</td>
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<tr>
<td>Initiates Financial Transactions (Approved in Budget)</td>
<td>10</td>
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<tr>
<td>Calculates / Pays / Collects Money &amp; Files Returns</td>
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<td>Basic Bookkeeping and Accounting – Records and Allocates Transactions</td>
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<td>Internal-Use Financial Statement Preparation, Analysis and Reporting</td>
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<tr>
<td>External-Use Financial Statement Preparation and Reporting</td>
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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.
Enterprise Risk Management Framework

Committee of Sponsoring Organizations (COSO) / ISO 31000

- Internal environment
- Objective setting
- Event identification
- Risk assessment
- Risk response
- Control activities
- Information and communication
- Monitoring
Summary – Why Should we Care?

Why Establish Financial Internal Controls?

• Fulfill director fiduciary responsibility
• Steward assets on behalf of stakeholders
• Achieve organizational Vision & Mission
• Protect assets and reputation of organization
• Protect assets and reputation of directors

Other

• 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!
Summary – What Can We Do to Protect Ourselves?

- Implement strategies to mitigate risks (internal controls)
- Identify and manage specific financial risks
  - Get the right people with the right skills
  - Create robust budgeting and reporting systems
  - Create basic financial policies
Resources on Risk Management

- **CPA Canada**
  - 20 Questions non-for-profit board directors should ask about overseeing management of risk
  - Not-for-profit governance: Summary Resource Guide
Resources on Risk Management

- Larger Organizations
  - COSO Internal Controls – Integrated Framework

- Smaller Organizations
  - Humanity Financial Management - Checklist
  - [http://www.humanityfinancial.ca](http://www.humanityfinancial.ca)
  - BoardSource Nonprofit Policy Sampler
    - [http://tinyurl.com/hczygon](http://tinyurl.com/hczygon)
  - First Reference
In this workbook:

1. Treasurer Roles and Responsibilities for NFPOs and Charities
2. Financial Management Roles and Responsibilities Guide
3. Comparative Nonprofit Finance Team Position Descriptions
4. Checklist for Basic Financial Management Internal Controls for Small to Mid-size Not-for-profit Organizations and Charities

Provided separately as Microsoft Word documents:

1. Senior Bookkeeper/Accountant Position Description
2. Treasurer Position Description

Links to external third-party resources:

<table>
<thead>
<tr>
<th>Organization</th>
<th>Title</th>
<th>Link</th>
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<tr>
<td>1 The Bridgespan Group</td>
<td>Non-profit Job Description Toolkit</td>
<td><a href="https://www.bridgespan.org/insights/library/hiring/nonprofit-job-description-toolkit">https://www.bridgespan.org/insights/library/hiring/nonprofit-job-description-toolkit</a></td>
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Questions?
Time for Coffee
October 5, 2021

Financial Governance: Protecting your Assets and Reputations

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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
**Legal Status**

- Unincorporated; or
- Corporation (non-share capital)
  - Federal Not-for-profit Corporations Act
  - Provincial Societies Act; or
- Trust
- Cooperative

**Accounting & Tax Status**

- Canada Revenue Agency (CRA)
  - Either a Non-Profit OR a Registered Charity, but not both
- CPA Canada
  - Not-for-profit Organizations
Charity Regulation

• Regulated by both
  • Legal: Provincial (or Federal) incorporation law
  • Tax: Canada Revenue Agency

• Often conflicting rules
  • CRA administrative policy often at odds with common law as established by case law

• Incorporation legislation varies significantly by jurisdiction
  • Audit/Review Engagement requirement
  • Operating a business
  • Earning a profit
  • Payments to directors
Members vs. Directors

**Members**
- Are not the legal agents of the society
- Receive notice of AGM and any special meetings
- Receive financial statements and auditor’s reports
- May attend and participate in discussions at the meeting
- Elect the directors of the society
- Vote to approve or reject bylaws
- Provide expertise if required

**Directors**
- Are the legal agents of the society
- Hold positions of trust
- Manage the society
- Responsibilities outlined in by-laws
- Establish policies
- Make strategic decisions and implement policies
- Understand their position descriptions
- Serve defined terms of office
- Approve an annual budget and secure the needed financial resources
- Report to the membership
Individual Board Member Responsibilities

**Duty of Care**
- Ensure the organization has the resources it requires
- Be prepared for & attend meetings

**Duty of Loyalty**
- Put the organization's interests above your own
- Avoid conflicts of interest

**Statutory Duties**
- Ensure compliance with regulatory environment, constitution & bylaws, board governance policies
Board Financial Governance Roles

1. Organization has appropriate financial resources to achieve its mission
2. Financial risks are identified and managed
3. Money is spent effectively to maximize mission achievement and impact
4. Robust financial budgeting and reporting systems
5. Organization has people with appropriate financial skills
6. Board has appropriate financial skills
7. Board receiving appropriate financial information
8. Documented financial roles and responsibilities, policies, procedures and processes
9. Organization is in compliance with regulatory environment
Financial Roles and Responsibilities

- Board & Board Members
- Treasurer
- Executive Director / CEO
- CFO
- Controller
- Bookkeeper
- Audit Committee
- Finance Committee
- Program Managers
- Other Staff/Contractor
- Program Managers
- Finance Committee
- Audit Committee
<table>
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<th>Membership</th>
<th>Audit Committee</th>
<th>Finance Committee</th>
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<tr>
<td></td>
<td>• Member of the board, in good standing, and independent</td>
<td>• At least one financial “expert”</td>
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<th>Committee Procedures</th>
<th>Audit Committee</th>
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<td></td>
<td>• Establish pre-determined meeting calendar</td>
<td>• Financial Reporting</td>
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<td>• Review charter annually, assess adequacy</td>
<td>• Budgeting</td>
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<td>• Review effectiveness with self-assessment</td>
<td>• Asset Management</td>
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<th>Audit Committee</th>
<th>Finance Committee</th>
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<td>• Audits – external and internal</td>
<td>• Financial Reporting</td>
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<td>• Budgeting</td>
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<td>• Risk Management / Internal Controls</td>
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<th>Oversight of Operating Results</th>
<th>Audit Committee</th>
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<td>• External reports</td>
<td>• Internal reports</td>
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<td>• Audited Financial Statements and CRA T3010</td>
<td>• Balance Sheet, Budget Comparison and Cash Flow</td>
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<td>• Monitoring third-party investment advisor</td>
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Director Rights, Duties and Practices

- Recommended Reading

Governance Framework*

Society Members

Operational Policies & Procedures

Board of Directors

Management (CEO or ED)

Employees & Volunteers

Finance & Audit Committee

Auditor

Legislation & Common Law

Constitution & Bylaws

Governance Policies & Procedures

Operational Policies & Procedures

* Adapted from Miller Thompson
Governance Framework*

- Funders
- Auditor
- Finance & Audit Committee
- Employees & Volunteers

- Society Members
- Board of Directors
- Management (CEO or ED)

- Legislation & Common Law
- Constitution & Bylaws
- Governance Policies & Procedures
- Operational Policies & Procedures

* Adapted from Miller Thompson
Nonprofit Capacity

Think of your agency’s operating capacity as the “table legs” that support your mission and programs.

The stronger and more robust your table legs, the better your ability to accomplish your mission.
Lifecycle Capacity Placement

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Excerpts from the book Nonprofit Lifecycles: Stage-based Wisdom for Nonprofit Capacity
What are the **three keys** to Effective Financial Governance?

- Long-term Financial Sustainability
- Annual Financial Performance Management
- Financial Risk Management - Asset and Reputation Protection
Effective Governance

Visioning & Planning

Monitoring and Control

Policy Making

Effective Financial Governance

Long-term Financial Sustainability

Annual Monitoring and Control

Financial Risk Management – Asset and Reputation Protection
Long-term Financial Sustainability

- Enduring vision, mission, values, impact
- Long-term strategic plan (4-6 priority goals)
- Evaluation and impact measurement
- Funding model and diversity of revenue streams
- Benchmarking
- Strategic operating reserves / lines of credit
Annual Performance Monitoring and Control

- Integrated annual operating plan and budget
- Goal achievement processes
  - Project management / implementation
  - “SMART” Goals
- Performance planning and improvement processes
- Regular board updates and reporting
- Corrective action as required
Financial Risk Management – Asset and Reputation Protection

- Financial risk identification & management
- Right people with right financial skills
- Right financial roles and responsibilities
- Right financial systems (budgeting, accounting, reporting)
- Right financial governance policies
- Right financial processes and procedures
- Financial skills training and education
- Financial compliance with regulations & funders
- Board mandate, Board Work plan, Board calendar
Documenting Financial Roles & Responsibilities

• Detailed position descriptions for Treasurer, and everyone else with financial responsibilities
• Ensure all people have appropriate financial skills and experience
• Background checks?
• Matrix / checklist (e.g. monthly, quarterly, annual)
• Build in segregation of duties and adequate review processes
• Provide training and access to technical support
• Needs internal audit function to periodically ensure everyone is doing their jobs, and adequate reviews are being done.
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- Financial governance
- Financial operations
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  - Bookkeeping and accounting
  - Financial transaction processing
- Investment Management
- Gift & Grant Compliance

Internal audit processes and procedures
The Guide will assist NPO directors to understand:

- The role and responsibilities of the board, management and the auditor in financial reporting;
- The concepts and terminology of financial reporting in the NPO sector;
- The ways in which contributions (i.e., donations) to the organization can be accounted for; and
- The various financial statements they will encounter in their role as an NPO director.
Sources of Information on Internal Controls

- Association of Certified Fraud Examiners (ACFE)
  - 2020 Annual Report to the Nations

- CPA Canada
  - Webinar – Internal Controls and fraud prevention for small and medium not-for-profit organizations ($275)

- Committee of Sponsoring Organizations of the Treadway Commission (COSO)

- IRCC
  - Internal Controls and Fraud Prevention Cover Letter
  - Recipient Guide on Best Practices for Internal Controls and Fraud Prevention
Links to Resources

- Accounting Policies and Procedures Manual

- Nonprofit Job Description Toolkit
Questions?
Thank You

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