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## Internal Financial Controls – Protecting Your Organization

20 February 2018




Presented by:  
Shelley Martin, CPA, CA  
Project Co-Coordinator, BY THE BOOK\$

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- Directory of Services
- Treasurers for Tomorrow
- Skills-Building
- Networking

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## Housekeeping

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### Charities in Canada

- Canada's charitable and nonprofit sector is the 2nd largest in the world; the Netherlands is the largest; the United States is the 5th
- there are an estimated 170,000 nonprofits and charities in Canada
- half of these (54%) are run entirely by volunteers
- 2 million people are employed by these organizations representing 11.1% of the economically active population
- the sector represents \$135 billion or 8.1% of the GDP (larger than the oil and gas or finance industries)
- smaller provinces have a higher number of organizations relative to their populations
- the top 1% of organizations command 60% of all revenues

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### Internal Controls – Why Should We Care?

From a study conducted in 2008  
'Best estimates of financial loss through **employee theft, fraud and embezzlement** put the range at **5-7% of the gross revenue** in the (nonprofit) sector. (*Chen, Qiu, Steven Salterio, and Pamela Murphy. "Fraud in Canadian Nonprofit Organizations as seen through the eyes of Canadian Newspapers 1998-2008." Philanthropist 05 May 2009: n. pag. Print.*)

**This equates to BILLIONS in Canada each year!**

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### 2016 ACFE Report - Fraud

According to the ACFE Report to the Nations on Occupational Fraud and Abuse, fraud cost not-for-profit organizations (NPOs) a median financial loss of \$108,000 in 2014. While this is already a significant loss, the number could be higher as most cases of fraud are either hidden or unreported.

In addition to the immediate financial loss, other long-term costs of fraud include negative publicity and damage to the organization's reputation. This results in a loss of trust among donors and grantors, and disrupts the NPO's business operations and ability to perform its mission.

The not-for-profit sector's high susceptibility to fraud is frequently due to its reliance on volunteers and community members. In many instances, charities also give a vast amount of power to their founder and executive director. With insufficient to no internal controls in place, NPOs become tempting targets for fraud.

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## Errors

### More than \$58,000 still unaccounted for at Mile One Centre

City of St. John's can't say if money even exists

BY ASHLEY FITZPATRICK

The City of St. John's is not able to tell taxpayers who has the \$58,089 that is missing from the Mile One Centre books.

More to the point, the city's internal auditor can't say if there's stolen money, or if it comes down to an accounting error, after the discovery of "errors and omissions in the coding of accounted expenses" for cash accounts and disbursements.

The internal auditor's office reviewed thousands of documents, including but not limited to log sheets, deposit slips, sales reports and accounting summaries.

"This detailed review of documents and discussion with management and staff has revealed numerous internal control weaknesses related to cash controls," reads a memo emailed to council by Internal Auditor Sean Jones on Sept.

onced with the general ledger at the end of the year, for example, they are now being addressed each month.

However, according to Jones, the way cash was being handled and accounted for in the past makes it impossible to definitively determine now if the roughly \$58,000 is here, there or anywhere at all.

The \$58,000 figure is at least two

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## Risks of Poor Internal Control Systems

- Employee Fraud / Theft / Embezzlement
  - Run out of cash
- Inappropriate/ineffective asset use
  - Difficulty obtaining funding
  - Lose Charitable or NPO Status
- Reporting errors
- Lawsuits

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## Internal Controls System

Designed to:

- ✓ Prevent and detect (un)intentional errors
- ✓ Ensure timely and accurate reporting of financial information.
- ✓ Sound accountability
- ✓ Safeguard the Board and Staff

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### Components of Good Internal Control Systems

- Environment ('Tone at the Top')
- Risk assessment
- Control activities
- Information and communication
- Monitoring activities

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### Control Activities

- Assigning responsibility
- Segregation of duties
- Documentation
- Physical controls
- Human resource controls
- Review and reconciliation



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### Control Activities

Assignment of responsibility

- Assign an individual responsible for an activity
  - If more than one people assigned, need to be able to identify who performs activity i.e. cashiers
- Level of authority taken into account
  - i.e. only project managers can approve expenditures

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### Control Activities

Segregation of Duties

- No **one** person should:
  - Perform all functions within an accounting cycle
  - Have the ability to cover up an (un)intentional accounting error



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### Control Activities

Segregation of Duties

- ✓ What can happen if the same person approves payment and signs the cheque?
- ✓ What can happen if the same person who authorizes the transaction records it in the accounting records?
- ✓ What practices do you have in your organization?

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### Control Activities

Segregation of Duties

**Preventative Measures!**

1. Person who approves payment does not write the cheque.
2. Person who authorizes the transaction does not record it in the accounting records.
3. The person that records revenue is not the same person that makes the deposit.



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### Control Activities

Documentation

- Evidence that transactions occurred
- Pre-numbered (to account for continuity)
  - i.e. cheques, cash receipts
- Originals, not photocopies!
  - i.e. expenditure reimbursements



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### Control Activities

Physical Controls

- Locks
- Safe locked and in low-traffic area
- Unique usernames and passwords re: accounting system (confidential!)
- Time-tracking system for employees



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### Control Activities

Human Resource Controls

- Hiring people with appropriate knowledge and skills
  - Verification of credentials
  - Reference checks
  - Criminal checks
  - Credit checks!
- Mandatory vacations/rotation of duties
- Bonding of employees handling cash



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## Control Activities

### Review and Reconciliation

- Internal reviews
  - Regular checks, surprise checks
  - Review of bank reconciliation!
  - Internal audit departments
- External reviews
  - Audit



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## Limitations to Internal Controls

1. Cost vs. benefit
  - Size of organization
  - Too costly to mitigate risk 100%
2. Errors happen!
  - Lack of training
  - Employee fatigue
  - Employee morale/indifference

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## Limitations to Internal Controls

3. Collusion
  - Two or more persons decide to work together to circumvent controls
  - Reduces effectiveness of segregation of duties
4. Management override
  - Management simply fails to follow internal control procedures

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### Cash Receipts

- ✓ Treasurer **or designate** receives all incoming cash
  - Limit handling of cash; or
  - Method of identifying who receives
- ✓ Treasurer **or designate** issue receipts
  - Issued immediately where possible
  - In duplicate
  - Pre-numbered

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### Cash Receipts

- ✓ Deposit as soon as possible
  - Idle cash susceptible to theft
  - Idle cash doesn't earn anything!
- ✓ Cash receipts should be reconciled to deposit
  - By independent individual
  - Account for continuity of receipts

*Where there is senior staff these tasks may be assigned to staff with oversight by treasurer.*

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### Electronic Receipts

- ✓ Often recorded by Treasurer **or designate** when bank statement received
  - ✓ Receipt often issued at this time
- ✓ Bank reconciliations and bank statements should be reviewed by person independent from recording activity
  - i.e. Treasurer records, another board member reviews
  - Accountant records, Treasurer reviews

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### Cash Disbursements

1. Approved by Treasurer
  - May involve spending hierarchy
2. Require invoices/receipts for reimbursement
  - Original documents!
3. All payments made by cheque
  - Except petty cash items
  - Cheques are pre-numbered

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### Cash Disbursements

4. Dual signatures required
  - May involve spending hierarchy
5. Process to ensure invoices not paid twice.
  - Approval indicated on invoice (initial)
  - Cheque number written on invoice
  - Invoice attached to cheque for review/signature

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### Electronic Disbursements

- Same approval for payments
  - May be able to require additional approval at bank level (i.e. online banking) before payment is sent, as no signed cheque involved
- Review bank reconciliations and bank statements on timely basis
  - Ask questions!

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### Petty Cash

- ✓ Determine which items qualify
  - “On the spot” items
- ✓ Set dollar amount
- ✓ One person controls
- ✓ Secure location
- ✓ Complete ‘voucher’ with nature of expenditure, associated program (if appl.), and original receipt



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### Bank Reconciliation

- Reconciles balance per bank with balance per books
- These often don't agree (which is normal)

Critical internal control for cash!



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### Bank Reconciliation

- Reviewed by a person independent from the preparer
  - Verify that it reconciles! (Re-add, agree balances)
  - Is it prepared on a timely basis?
  - Reconciling items should be assessed for reasonableness, i.e. are they common, expected, etc.

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### Bank Reconciliation

- Review the bank statement:
  - Ideally, review copy received directly from bank
    - If not, ensure you have all pages
  - Look for unauthorized electronic payments/transfers
  - Look at ‘cancelled’ cheques for unauthorized suppliers, signatures, adjustments to amounts
    - ‘cancelled’ cheques are ones that have cleared the bank

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### Policy Development in General

Policies should detail, in writing:

- ✓ Who initiates transaction and documentation required
- ✓ Who approves and how approval is noted (i.e. approver’s initials on document)
- ✓ Thresholds for amounts (where applicable)
- ✓ Who records
- ✓ Who reviews

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### Other Financial Policies to Develop

- Approving expenditures
- Travel and expense reimbursement
- Payments to Directors
- Hiring contractors
- Budget preparation and approval
- Regulatory compliance

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## Resources

CSC NL *Cheque It Out*  
<http://communitysector.nl.ca/cheque-it-out>

Muttart Foundation  
<https://www.muttart.org/>

Charity Village  
<https://beta.charityvillage.com/app/>

Handouts (individual articles will be emailed to you)

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Please complete the feedback form provided.

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## Thank-You!

**Community Sector Council Newfoundland and Labrador**  
25 Anderson Avenue, St. John's NL A1B 3E4

**Shelley Martin**  
[shelleymartin@cscnl.ca](mailto:shelleymartin@cscnl.ca)

**Darlene Scott**  
[darlenescott@cscnl.ca](mailto:darlenescott@cscnl.ca)

709 753 9860  
Toll free: 1 866 753 9860  
[www.communitysector.nl.ca](http://www.communitysector.nl.ca)

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