

Critical financial internal controls that could shelter the homeless and feed the hungry

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\$12-\$18 billion dollars of free money available for the taking (or holding on to)

If the title of this article caught your attention, read on. While it may sound outrageous, it's absolutely true: with better financial internal controls in the nonprofit sector, we could save more lives and improve the lives of millions of people struggling in Canada.

Best estimates of financial loss through employee theft, fraud and embezzlement put the range at 5-7% of the gross revenue in the sector¹. And according to multiple sources, on average, 25% of for-profit organizations experience a significant instance of employee theft, fraud or embezzlement every year. Based on empirical evidence, we think the experience rates are much higher in nonprofits and charities because of the following traits of organizations in our sector:

- Atmosphere of trust;
- Difficulty of verifying certain revenue streams (notably cash);
- Weaker internal controls;
- Lack of business and financial expertise; and
- Reliance on voluntary boards.

The charity sector in Canada had [gross revenue of nearly \\$250 billion in 2014](#) (not including the 85,000 or so not-for-profit organizations that are not registered charities). Calculating 5-7% of that total translates to approximately \$12 - \$18 billion dollars – this is the amount we lose every year.

And most losses through employee theft, fraud and embezzlement are absolutely preventable with appropriate and functioning financial internal controls.

Just think what we could do with an extra \$12 billion to \$18 billion dollars every year. Think of how many:

- homeless people we could shelter;
- hungry people we could feed;
- disadvantaged children and youth we could educate and support; and
- suicides and drug overdoses we could prevent.

And that's just the short list. This is essentially free money. It exists, we've already earned it. It is money that we let slip through our fingers because our financial controls aren't strong enough.

How do we fix our controls and get access to this "free" money?

Ultimately, our not-for-profit and charity boards are responsible to ensure our social sector organizations have appropriate and functioning financial internal controls. Unfortunately, more often than not, board members do not have the financial knowledge to know what they don't know. And there is no test. Many board members are silent when financial topics are discussed. They don't want to risk looking like they don't understand the issue or the report, so they just don't participate in financial topics or conversations. This is particularly true in smaller organizations which experience the highest number of fraud cases and the highest losses relative to their annual revenue. In these organizations the average loss was 119% of annual revenue!

How can board members help?

The reality is that in order to experience any significant reduction in employee theft, fraud and embezzlement we need to increase the financial skills of our board members. This can either be done by recruiting more board members with financial backgrounds (if every organization had a professional CPA as its treasurer, that would be a great start), or by providing financial resources and education to our existing board members.

Even if we stay at the highest level, board members need to realize that in order to effectively discharge their financial governance responsibilities, that they are responsible to ensure that:

- the board is receiving all of the financial information it needs (in appropriate and useful formats) to ensure the long term financial sustainability of the organization;
- there are appropriately skilled people (including the Treasurer) and appropriately designed systems (software, policies, processes and internal controls) in place to make sure that all financial information and reporting is relevant, timely, accurate and complete;

- financial risks are identified and managed and that the financial assets of the organization are appropriately protected through insurance and appropriate financial policies, procedures and other internal controls;
- the board has the financial management skills and understanding to properly understand, evaluate and act on all financial information and reporting that it receives; and
- the organization is in compliance with its regulatory environment (provincial or federal incorporation legislation, Canada Revenue Agency, Ministry of Finance, constitution and by-laws, organization policies, procedures and internal controls, etc.).

And accountability for the responsibilities listed above cannot be delegated. More of our board members need to have the courage to admit that their financial knowledge is not what it needs to be for them to play an effective financial governance role. Board members need to get the training they need to be more effective and they need to keep asking questions until they understand the relevance of all of the financial reports that they receive.

How can we support our board members?

Our organizations can support this process through the following actions:

- Have effective board member orientation sessions and ongoing financial governance training sessions – where they evaluate each new board member’s financial knowledge and provide each board member with the support that they need in order to feel confident that they understand their governance role with respect to the finances of their organizations;
- Send all financial reports out to board members well in advance of meetings and encourage board members to get answers to any questions they might have in private – prior to the board meeting – by connecting with the treasurer. This will allow them to ask “uninformed” questions in private without worrying about appearing incompetent in front of the rest of the board.
- Create a culture that supports board member learning and growth.

Some basic financial internal controls

In addition, there are at least three financial policies that virtually every board should implement:

1. No bookkeeper should have electronic access to the bank or be a signing authority on the bank account;
2. The Treasurer should not also be the bookkeeper – in order to be an effective internal control, the treasurer should be reviewing the work of the bookkeeper – it is impossible to be an effective internal control when you are charged with reviewing your own work.
3. All organizations should have appropriate policies for spending authority and transaction and payment approval. Board members need to understand their role as an

effective internal control when they are signing cheques and reviewing credit card transactions and expense reports. We need to train board members on what they should be looking for and what steps they need to take before signing a cheque or approving a payment.

So there it is. If we do three things – we could save lives and help a lot more people: Educate our board members about their financial governance responsibilities; support our board members in developing their financial governance knowledge; and implement some basic financial policies, procedures and internal controls.

So think about what your organization could do with an extra 5-7% revenue every year and how many more people your organization could support in the great work that you do.

An additional \$12 billion to \$18 billion of annual revenue in our sector would go a long way to saving more lives and increasing the level of services that we provide to people who are struggling and suffering in our country. And we already receive the money each year. With a little more effort around financial governance and internal controls, we could prevent some or all of it from slipping through our fingers and walking out the door.

Gordon Holley is the President and CEO of [Humanity Financial Management Inc.](#) As a CPA, CA for almost 25 years now, Gordon loves helping individuals and organizations that are trying to make the world a better place. In his role at Humanity Financial, Gordon sees the stress and anxiety produced by finances and financial reporting for many not-for-profit-organizations (NFPOs), charity board members, and senior staff. He excels at providing financial oversight to small to mid-size NFPOs and charities to help them better manage their internal finances and financial budgeting and reporting. Ultimately, his company hopes to instil confidence and credibility in organizations by streamlining their internal financial management so that they can focus their energies on their programs.

¹Chen, 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.

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https://beta.charityvillage.com/cms/content/topic/critical_financial_internal_controls_that_could_shelter_the_homeless_and_feed_the_hungry#.WfijxXZ4GUK