COMPETIFY HUB

Audits, Ethics, and Internal Controls Combined Study Guides/Reading

Introduction to Audits & Reviews Guide

Understanding Why Audits Matter and What They Involve

Target Audience: Board members, executive directors, finance staff, nonprofit stakeholders
Time to Read: 20-25 minutes
Skill Level: Beginner-Intermediate

What is an Audit?

Audit = Independent accountant thoroughly examines financial records and reports

Goal: Verify that financial statements are accurate and complete

Key word: INDEPENDENT (not biased)

WHY AUDITS MATTER

For the Organization

Benefits: - Verifies financial accuracy - Identifies problems (fraud, errors) - Improves internal controls - Catches mistakes early - Demonstrates accountability - Satisfies funder requirements - Builds donor confidence - Required for 501(c)(3) status (over certain size)

Costs: - Financial cost ($3,000-$15,000+ depending on size) - Staff time (10-20 hours) - Sometimes finds problems requiring correction

For Donors

Assurance: "My donation was used properly" - Professional verification - Numbers are accurate - Money wasn't wasted or stolen

For Grantors

Requirement: Usually required for grants over $500,000 - Verify grant spending proper - Ensure financial controls adequate - Protect their investment

For the Public

Trust: "This organization is financially healthy" - Organization is legitimate - Fiscal responsibility demonstrated - Good governance

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TYPES OF FINANCIAL REVIEWS

Type 1: AUDIT (Most Rigorous)

What it involves: - CPA independently examines all financial records - Tests transactions thoroughly - Verifies assets physically exist - Examines internal controls - Issues formal audit report

Cost: $5,000-$25,000+ **Time:** 40-80 hours of auditor time **Result:** "Unqualified opinion" (everything is accurate)

Required for: - Organizations over $500,000 in revenue (varies by state) - Most nonprofits over $1,000,000 - Grantors often require - State may require

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Type 2: REVIEW (Moderate)

What it involves: - CPA examines financial records - Makes inquiries of management - Performs limited testing - Less thorough than audit - Issues review report

Cost: $2,000-$8,000 **Time:** 20-40 hours **Result:** "Limited assurance" (likely accurate but not fully tested)

Used for: - Smaller nonprofits ($100,000-$500,000) - Organizations with less complex finances - When audit is overkill

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Type 3: COMPILATION (Least Rigorous)

What it involves: - CPA organizes financial data - Prepares financial statements - NO verification of accuracy - Lowest level of service

Cost: $1,000-$3,000 **Time:** 5-15 hours **Result:** Statement that CPA didn't audit or review

Used for: - Very small organizations - Internal use only - When no formal assurance needed

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AUDIT PROCESS: STEP-BY-STEP

Phase 1: PLANNING (Week 1-2)

Auditor: - Meets with organization - Reviews prior year audit - Understands operations - Identifies risk areas - Plans audit approach

Organization prepares: - Prior year working papers - List of all bank accounts - List of investments - Fixed asset list - Loan agreements - Grant agreements

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Phase 2: INTERIM AUDIT (Week 3-4)

Auditor: - Tests internal controls - Examines transaction documentation - Verifies compliance with policies - Identifies any issues

Auditor tests: - 20-30 transactions to verify properly recorded - Bank reconciliations are accurate - Journal entries are supported - Expense approvals in place

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Phase 3: YEAR-END AUDIT (Week 5-6)

Auditor: - Counts and verifies assets - Observes physical inventory - Confirms bank balances with banks - Confirms receivables with customers - Confirms payables with vendors - Recalculates depreciation - Reviews journal entries

What auditor does: - **Bank confirmation:** Letter sent to bank: "Is this the balance?" Bank replies directly to auditor - **Accounts Receivable confirmation:** Letter to donors: "Do you owe us this amount?" They reply directly - **Physical inspection:** Counts fixed assets; verifies they exist

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Phase 4: TESTING (Week 7-8)

Auditor tests: - Sample of receipts (verify legitimate expenses) - Sample of payroll (verify real employees, correct amounts) - Revenue (verify donations received as recorded) - Grants (verify grant spending properly documented)

Auditor also: - Reviews board minutes (for unusual decisions) - Checks for conflicts of interest disclosures - Verifies compliance with policies - Tests management's estimates

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Phase 5: REPORTING (Week 9)

Auditor prepares: - Audit report (management letter) - Financial statements - Notes to financial statements - Auditor's opinion

Report includes: - Scope of work performed - Any issues found (management letter) - Recommendations - Final audit opinion

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UNDERSTANDING THE AUDIT REPORT

The Audit Opinion (Most Important)

Unqualified Opinion (Clean):

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"In our opinion, the financial statements present fairly,
in all material respects, the financial position of [Org Name]
as of [Date] and the results of its operations for the year
then ended in accordance with generally accepted accounting
principles."

Translation: Everything looks good!
```

Qualified Opinion (Minor Issues):

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"In our opinion, except for [specific issue], the financial
statements present fairly..."

Translation: Mostly good, but this one thing was off
```

Adverse Opinion (Major Issues):

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"In our opinion, the financial statements do not present fairly..."

Translation: Major problems; numbers can't be trusted
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Disclaimer Opinion (Can't Audit):

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"We are unable to express an opinion on the financial statements."

Translation: Too many problems; couldn't complete audit
```

Management Letter (Issues Found)

Low priority: - Minor documentation issues - Suggestions for improvement - No monetary impact

Medium priority: - Compliance issues - Control gaps - Possible errors (but corrected)

High priority: - Fraud indicators - Material errors - Major control failures - Non-compliance with law

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PREPARING FOR AN AUDIT

30 Days Before Audit

Prepare: - Reconcile all bank accounts - Create fixed asset list - Prepare loan/investment agreements - Compile grant awards/reports - Organize board minutes - List all significant transactions

Organize physically: - Create audit folder - Section by area (cash, receivables, payables, etc.) - Put supporting docs in order

Week Before Audit

Have ready: - All reconciliations complete - Bank statements (full year) - Loan amortization schedules - Grant files - Key personnel available - Quiet workspace for auditors

During Audit

Be cooperative: - Provide requested documents promptly - Answer questions accurately - Make staff available - Clarify any issues - Walk auditor through any unusual items

Have answers ready: - Q: "Why is this variance so large?" A: Explain - Q: "Why was this purchase made?" A: Explain - Q: "Did this comply with policy?" A: Explain

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AUDIT COSTS: What to Expect

Size-Based Pricing

Size	Revenue	Audit Cost	Time
Tiny	<$100K	$1,500-$3K	10-15 hrs
Small	$100K-$500K	$3K-$8K	20-40 hrs
Medium	$500K-$2M	$8K-$15K	40-60 hrs
Large	$2M+	$15K-$50K+	60-100+ hrs

Factors Affecting Cost

Cost increases if: - Multiple locations (complexity) - Multiple funding sources (tracking) - Complex accounting (more to verify) - Poor record-keeping (more work) - Issues found (need investigation)

Cost decreases if: - Good record-keeping - Simple structure - All documents organized - No issues - Staff availability

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RED FLAGS AUDITORS LOOK FOR

Financial Red Flags

- Unusual transactions
- Large variances from budget
- Missing documentation
- Unsupported journal entries
- Weak internal controls
- Significant cash balances
- Frequent transfers between accounts
- Unusual vendor relationships

Governance Red Flags

- No board approval for major decisions
- Missing board minutes
- No conflict of interest disclosures
- Lack of segregation of duties
- ED controls all finances
- No independent review

Fraud Red Flags

- Missing receipts
- Round dollar amounts
- Same vendor repeatedly
- Reluctance to provide docs
- Unexplained gaps in records
- Defensive responses

RESPONDING TO AUDIT FINDINGS

If Finding is Minor

Organization response: 1. Acknowledge issue 2. Explain why it happened 3. Describe corrective action 4. Document the fix

Example:

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Finding: Receipt was missing for $500 expense
Response: Staff member found receipt; now on file.
Action: Enhanced receipt storage process to prevent future.
Status: Resolved
```

If Finding is Major

Organization response: 1. Investigate thoroughly 2. Determine root cause 3. Implement fix 4. Board approval of action plan 5. Follow-up audit (may be required)

Example:

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Finding: Cash handling controls inadequate
Response: Audit discovered $2,000 unexplained variance
Action: Implemented segregation of duties; two-person cash handling
Board: Approved new cash procedures
Result: Problem resolved
```

FREQUENCY: HOW OFTEN TO AUDIT?

Minimum Required

Revenue	Requirement
<$50K	None (Form 990-N)
$50K-$200K	Generally not required
$200K-$500K	Varies (some states require audit)
$500K+	Often required (state dependent)
>$1M	Usually required

Best Practice

- **Audit annually:** Organizations >$500,000
- **Review annually:** Organizations $100K-$500K
- **Compilation or self-review:** Organizations <$100K

Grantors

- Always check grant requirements
- Most require audit if grant is significant portion of revenue
- Federal grants: Audit required if total federal funding >$750,000

CHOOSING AN AUDITOR

What to Look For

- **CPA Firm** (Certified Public Accountant)
- **Experience with nonprofits** (important!)
- **Reasonable cost quote**

- **References from similar organizations**
- **Responds to questions clearly**
- **Available on your timeline**

Questions to Ask

1. "How much audit experience do you have with nonprofits?"
2. "What will this audit cost?"
3. "How long will it take?"
4. "Can you provide references?"
5. "Do you use auditors' standards (GAAS)?"
6. "Will we get written report?"
7. "Do you have experience with our funding sources?"

Red Flags When Choosing Auditor

- Very cheap (quality concerns)
- No nonprofit experience
- No references provided
- Can't explain their process
- Promise they'll make problems "disappear"
- Pressure to rush

THE AUDIT REPORT PRESENTATION

Board Meeting Presentation

Auditor typically: - Presents overall findings - Explains the opinion - Discusses management letter items - Answers board questions - Recommends actions

Board should: - Ask questions - Understand all findings - Vote to accept financial statements - Approve corrective actions - Document in minutes

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POST-AUDIT: What Happens Next?

Weeks 1-2 After Audit

☐ Board meeting to discuss findings
☐ Board approves financial statements
☐ Management responds to findings
☐ Plan corrective actions
☐ Assign responsibility for fixes

Months 1-3 After Audit

- ☐ Implement corrective actions
- ☐ Document completion
- ☐ Train staff if applicable
- ☐ Prepare for next audit
- ☐ File Form 990 with IRS (if required)

For Donors/Grantors

- ☐ Share audit report (if requested)
- ☐ Highlight clean opinion
- ☐ Explain any findings and fixes
- ☐ Demonstrate good governance

COMMON AUDIT QUESTIONS ANSWERED

Q: Does an audit guarantee no fraud? A: No. Audit reduces fraud risk but doesn't guarantee detection of all fraud.

Q: Will the auditor find embezzlement? A: If controls are good and auditor tests properly, usually yes. But auditors don't test every transaction.

Q: What if auditor finds nothing? A: That's good news! It means records are accurate and controls are adequate.

Q: Can we use our bookkeeper's review instead of audit? A: No. Must be independent CPA. Bookkeeper has conflict of interest.

Q: What if we don't like the findings? A: You must address them. They're documenting factual issues.

Q: How public is the audit? A: Form 990 (which includes audit info) is public. Actual audit report typically shared only with board, donors, grantors.

SUMMARY

Key Points: Audits verify financial accuracy Required for larger organizations Protect donor trust and funder confidence Identify problems early Should happen annually for most nonprofits Cost is investment in credibility

Next Steps: 1. Determine if audit required (check state law, grantors) 2. Get cost quotes from 2-3 firms 3. Choose experienced nonprofit auditor 4. Prepare documentation 5. Cooperate fully with auditors 6. Address any findings 7. Share results with board/donors

Ethics in Accounting (Simple Version)

Doing the Right Thing with Money

Target Audience: Nonprofit staff, board members, students
Time to Read: 15-20 minutes
Skill Level: Beginner

What is "Ethics in Accounting"?

Ethics = Making the right choice, even when no one is watching

In accounting: Being honest and accurate with money and financial records

Why it matters: - Protects the organization - Protects donors - Keeps stakeholders confident - Required by law - It's the right thing to do

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THE FIVE CORE ETHICAL PRINCIPLES

Principle 1: HONESTY

What it means: Report numbers truthfully

Examples of honesty: - Recording actual expenses, not inflated amounts - Reporting actual participants, not guessed - Disclosing conflicts of interest - Acknowledging mistakes - Not hiding financial problems

Examples of dishonesty: - Recording fake expenses to hide cash - Inflating program numbers to impress donors - Hiding a personal loan to the organization - Not mentioning a major budget shortfall - Falsifying grant reports

The Test: "Would I be comfortable if this was in the newspaper?" - Yes → Probably ethical - No → Probably not ethical

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Principle 2: ACCURACY

What it means: Get the numbers right

Examples of accuracy: - Double-check calculations - Reconcile bank accounts monthly - Use consistent accounting methods - Document all transactions - Correct errors immediately

Examples of inaccuracy: - Rounding to make math easier (cheating) - "Forgetting" to record an expense - Using different methods for different years - Estimating major amounts instead of counting - Leaving errors in records

Why it matters: - Decision-makers rely on accurate numbers - Board makes decisions based on financial reports - Auditors verify accuracy - Inaccuracy = risk of fraud

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Principle 3: OBJECTIVITY

What it means: Don't let personal interests bias your decisions

Examples of objectivity: - Evaluate bids fairly, not from preferred vendor - Record transactions the same way every time - Follow policies even when inconvenient - Disclose if you benefit from a decision - Treat all employees/donors the same

Examples of bias: - Record friend's $500 gift but not stranger's $500 gift differently - Ignore expense from board member but flag expense from staff - Record expense timing to make this year look better - Accept lower bid from person you like (without valid reason) - Hide problem from board because ED is your friend

The Test: "Am I treating this like I would treat it from anyone?" - Yes → Objective - No → Biased

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Principle 4: CONFIDENTIALITY

What it means: Keep sensitive information private

Examples of confidentiality: - Don't share employee salaries with others - Keep donor giving amounts private (unless they want public) - Don't share program participant information - Secure financial documents - Use passwords on financial systems

Examples of breaching confidentiality: - Mention "So-and-so gave us $50,000" to friend - Leave financial statements on desk for visitors to see - Share program details that identify vulnerable participants - Tell staff member another staff member's salary - Post donor names/amounts on social media without permission

Why it matters: - Trust is essential - Donors want privacy - Participants need protection - Legal requirement in many cases - Damages reputation if breached

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Principle 5: ACCOUNTABILITY

What it means: Take responsibility for your actions and decisions

Examples of accountability: - Sign expense reports you approve - Admit mistakes and correct them - Document decisions you make - Report fraud you discover - Stand by policies even if unpopular

Examples of avoiding accountability: - "I didn't know" about fraudulent expense - Blaming system for error you made - Refusing to sign approval document - Knowing fraud but staying silent - Making unauthorized changes without telling anyone

Why it matters: - Prevents chaos and fingerpointing - Ensures problems get fixed - Protects organization - Required for audits - Builds trust

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REAL-WORLD ETHICAL SCENARIOS

Scenario 1: Conflict of Interest

Situation: Finance person's spouse works for vendor bidding for contract

Ethical problem: Personal relationship might bias evaluation

Right thing to do: 1. Disclose the relationship 2. Step out of evaluation 3. Let objective person compare bids 4. Document that conflict was managed

Why this matters: - Fairness to all vendors - Best contract for organization - Maintains integrity

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Scenario 2: Pressure to Bend Numbers

Situation: Board wants to show larger program numbers than actual to impress donor

ED says: "Just round up the numbers; donor will never know"

Ethical problem: Would be fraud/dishonesty

Right thing to do: 1. Say no firmly 2. Explain why accuracy matters 3. Suggest alternatives (emphasize impact per person) 4. Report to audit committee if pressure continues

Why this matters: - Dishonesty compounds (leads to more lies) - Damages reputation if discovered - Violates funder expectations - Illegal in some circumstances

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Scenario 3: Discovering Fraud

Situation: You find that operations manager used program funds for personal expenses

What you discover: - Expense for "office supplies" = Personal car repair - Expense for "program materials" = Personal furniture

Ethical dilemma: Operations manager is nice person; afraid of consequences

Right thing to do: 1. Don't cover it up (makes you culpable) 2. Report to supervisor or board 3. Document what you found 4. Let proper authorities handle 5. Cooperate with investigation

Why this matters: - Fraud is serious (could be criminal) - Covering up is also illegal - Board has right to know - Must be addressed professionally

What happens next: - Investigation by appropriate authority - Recovery of funds - Disciplinary action (could include firing) - Possible police report

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Scenario 4: Questionable Grant Expense

Situation: Grant says "No more than 20% for administrative costs"

Your program spent: - Program: $16,000 (80%) - Admin: $4,000 (20%)

Question: Should you allocate ED time to "program" to make numbers look better?

Ethical analysis: - Misallocating time = Dishonest reporting - Report actual allocation (even if tight) - If truly over, explain to funder

Right thing to do: 1. Report actual allocation 2. If over 20%, discuss with funder 3. Ask if adjustment is acceptable 4. Document funder's response 5. Plan for compliance next year

Why this matters: - Funder trusts you - Misrepresenting violates grant - Could require repayment - Damages future funding

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Scenario 5: Missing Documentation

Situation: Senior staff member was reimbursed $2,000 but has no receipt

Explanation: "I spent it on conference; threw away receipt"

Ethical dilemma: Can't prove the expense happened

Right thing to do: 1. Ask for alternative documentation (credit card, email confirmation) 2. If no documentation, cannot reimburse 3. Explain policy clearly 4. Suggest they use credit card next time (auto-documented) 5. Document this incident

Why this matters: - Auditors require documentation - Without proof, could look like embezzlement - Protects both employee and organization - Prevents future problems

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ETHICAL DECISION-MAKING FRAMEWORK

When facing an ethical dilemma, ask:

1. **Is it legal?**
   - No → Don't do it
   - Yes → Continue
2. **Is it honest?**
   - No → Don't do it
   - Yes → Continue
3. **Would I be embarrassed if public?**
   - Yes → Don't do it
   - No → Continue
4. **Does it violate policy?**
   - Yes → Don't do it
   - No → Continue
5. **Would I do it to my family's organization?**
   - No → Don't do it
   - Yes → Probably okay

If you answer "don't do it" to any question → Don't do it

CONSEQUENCES OF UNETHICAL BEHAVIOR

For the Person

- Criminal charges (if fraud/theft)
- Job loss
- Damage to reputation
- Difficulty finding future employment
- Civil lawsuit
- Guilt and stress

For the Organization

- Loss of nonprofit status (if systemic)
- Loss of donations
- Loss of grants
- Damage to reputation
- Audit findings
- Legal liability
- Staff morale crisis
- Public embarrassment

For Donors/Participants

- Loss of trust
- Questioning if their money was used properly
- Reduced confidence in organization
- Possible financial loss
- Feeling victimized

CREATING AN ETHICAL CULTURE

As an individual: 1. Follow ethical principles personally 2. Speak up when you see problems 3. Refuse to participate in dishonesty 4. Set good example 5. Support others doing the right thing

As a board/leadership: 1. Create code of conduct policy 2. Train staff on ethics 3. Have whistleblower process 4. Investigate complaints promptly 5. Reward ethical behavior 6. Enforce consequences for violations

As an organization: 1. Communicate values clearly 2. Make it safe to report problems 3. Support ethical decisions even if costly 4. Follow through on violations 5. Celebrate integrity

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RED FLAGS FOR UNETHICAL BEHAVIOR

Watch for: - Pressure to "fudge" numbers - Emphasis on hiding problems - Restricted access to information - Lack of documentation - Frequent excuses for missing records - Discouraging questions - Personal expenses mixed with organizational - Unusual transactions - Reluctance to involve board - "Just don't tell anyone"

RESOURCES FOR ETHICAL GUIDANCE

If you face ethical problem:

1. **Talk to supervisor** (if not the problem)
2. **Consult board finance committee**
3. **Use organizational ethics hotline** (if available)
4. **Contact external auditor** (for serious issues)
5. **Seek legal counsel** (if potential crime)
6. **Contact nonprofit resources:**
    - National Council of Nonprofits
    - nonprofit law organizations
    - Ethics hotlines

GLOSSARY

Term	Definition
Ethics	Principles of right and wrong conduct
Fraud	Intentional dishonesty for gain
Embezzlement	Theft of organizational funds
Conflict of Interest	Personal interest conflicts with duty
Confidentiality	Keeping information private
Accountability	Responsibility for actions
Integrity	Being honest and moral
Whistleblower	Person who reports misconduct

BOTTOM LINE

Ethical accounting is simple: - Be honest about what happened - Admit when you're wrong - Don't hide problems - Treat others fairly - Protect confidential information - Take responsibility - Do the right thing even when hard

If you're unsure, ask. Better to check than to make a mistake.

Nonprofit Compliance Reading Guide

Understanding the Rules Your Organization Must Follow

Target Audience: Nonprofit board members, executive directors, new staff
Time to Read: 25-30 minutes
Skill Level: Beginner

What is "Compliance"?

Compliance = Following the laws and rules that govern nonprofits

Why it matters: - Required by law - Protects your 501(c)(3) status - Protects the organization from penalties - Demonstrates good governance - Keeps donors and grantors confident

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THE FOUR MAIN COMPLIANCE AREAS

1. TAX COMPLIANCE

What: The IRS Rules 501(c)(3) Status Requirements: - Must be organized for charitable, educational, religious, scientific, or social purposes - No net earnings can go to individuals (no profit distribution) - Cannot engage in substantial lobbying - Cannot support political candidates or campaigns - Must serve a public or charitable purpose (not private benefit)

Annual Tax Filings Form 990-N (E-Postcard) - Required if: Annual revenue < $50,000 - Filing: Must file online annually - Deadline: May 15 (for calendar year organizations) - What it shows: Just basic info - organization exists and is tax-exempt - Time to file: 15 minutes

Form 990-EZ - Required if: Annual revenue $50,000-$200,000 - Filing: Can file online or by mail - Deadline: May 15 - What it shows: Basic financial info and activities - Time to file: 2-4 hours

Form 990 (Full Return) - Required if: Annual revenue > $200,000 - Filing: Must file online (IRS e-file system) - Deadline: May 15 (or Oct 15 with extension) - What it shows: Complete financial and operational details - Time to file: 40-60 hours (or hire accountant: $3,000-8,000)

Consequences of Non-Filing

- $0 first year: Warning
- $1,000 per year if revenue < $250,000: Penalties
- $10,000 per year if revenue > $250,000: Penalties

- Third year of non-filing: **Automatic loss of 501(c)(3) status**

Key Tax Rules

- **No Individual Benefit:** Salaries must be "reasonable;" cannot benefit insiders
- **Unrelated Business Income:** Side business activities must pay taxes
- **Lobbying Limits:** Can do some lobbying (if <5% of spending)
- **No Political Campaigns:** Absolutely cannot support candidates

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2. FINANCIAL COMPLIANCE

What: Money Rules **Basic Requirements:** - Keep accurate financial records - Separate restricted from unrestricted funds - Track all income and expenses - Maintain receipts and documentation - Follow accounting standards (GAAP) - Have internal controls

Income Documentation

- **Donations:** Keep donor records (not always filed, but required for audit)
- **Grants:** Keep grant agreement, budget, and proof of spending
- **Fees:** Document how much received from programs/services

Expense Documentation

- **All expenses:** Keep receipt or invoice
- **Salaries:** Document with timesheets and contracts
- **Donations:** Document what the money was used for
- **Grants:** Track spending against grant restrictions

Restricted Fund Rules **Critical:** If donor restricts money, you MUST use it for that purpose

Examples: - Donor says "For youth program" → Must use for youth program only - Grant says "By December 31" → Must spend by that date - Grant says "Not for salaries" → Cannot use for salaries

Violation: Using restricted funds for different purpose = Fraud **Consequence:** Return funds to donor; possible legal action; loss of donor trust

Internal Controls **What:** Systems to prevent fraud and errors

Examples: - Two people approve checks over $5,000 - Separate people for approving, paying, and reconciling - Monthly bank reconciliation - Segregation of duties

Why: Reduces risk of theft/fraud

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3. GOVERNANCE COMPLIANCE

What: Board Rules **Board Composition:** - Must have Board of Directors - Board members typically uncompensated (can pay some) - Board must include members independent of staff - Conflict of interest policy required - Board meets at least quarterly (best practice)

Board Duties

1. **Fiduciary Duty:** Act in organization's best interest
2. **Care Duty:** Make informed decisions
3. **Loyalty Duty:** Disclose conflicts of interest

Required Policies

- **Conflict of Interest Policy:** Board/staff disclose conflicts
- **Whistleblower Policy:** How to report misconduct
- **Document Retention Policy:** How long to keep records
- **Code of Conduct:** Ethical standards for board/staff
- **Compensation Policy:** How salaries are set

Board Meetings

- Must hold at least annually (quarterly is best practice)
- Minutes must be kept
- Quorum required (usually majority)
- Major decisions documented

Executive Director/CEO Oversight

- Board approves: Annual salary, significant contracts, major expenditures
- Board receives: Monthly financial reports, program updates
- Board evaluates: ED performance annually

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4. GRANT COMPLIANCE

What: Funder Rules **Every grant has requirements:**

Spending Requirements: - Must spend grant on approved activities - Cannot use grant for different purpose (even if similar) - Must spend within grant period (usually cannot carry over) - No grant crossing to unrestricted funds

Reporting Requirements: - Annual or semi-annual reports to funder - Proof of spending (receipts, documentation) - Outcomes/impact measurement - Financial report showing how money was spent

Record Keeping: - Keep all grant agreements - Keep all receipts and invoices - Document all program activities (timesheets, attendance) - Track outcomes (participants, results, impacts) - Maintain for 3-7 years (funder dependent)

Consequences of Non-Compliance: - Demand for refund of unspent or misused funds - Loss of future grants from that funder - Damage to organization reputation - Possible legal action or fraud investigation - Audit findings; grant status flagged

Common Mistakes: - Spending grant on different activity than approved - Missing deadline for report submission - Not documenting spending (no receipts) - Carrying over unspent funds without approval - Using grant funds to pay administrative overhead (if not approved)

COMPLIANCE CHECKLIST

Annual (Every Year)

Task	Deadline	Who	Consequence
File Form 990-N, -EZ, or -990	May 15	ED + Finance	Loss of 501(c)(3) if 3 years missed
Renew state registration	Varies	ED	Cannot operate legally
Board meets at least once	Year-round	Board	Governance failure
Approve budget	January-Feb	Board	Poor financial planning
Approve ED salary (if applicable)	Annually	Compensation Committee	Governance failure

Quarterly (Every 3 Months)

Task	Deadline	Who	Consequence
Board meeting	Quarterly	Board	Poor governance
Bank reconciliation	Within 30 days	Finance	Undetected fraud
Financial review	Within 30 days	Finance/Audit	Inaccurate reporting

Task	Deadline	Who	Consequence
Grant reports (if due)	Per grant	Program + Finance	Funder enforcement

As Needed

Task	Trigger	Who	Consequence
Update conflict of interest form	Employee hired	New Employee	Unreported conflict
Update whistle-blower hotline	Policy change	ED	Non-compliance
Update bylaws	Board decision	Board	Governance confusion
Approve contracts	Large expense	Board	Improper spending

COMMON COMPLIANCE ISSUES

Issue 1: Conflict of Interest

Problem: Board member's company bid to do work for nonprofit

Compliance Rule: - Board member must disclose conflict - Board member should not vote - Competitive bidding recommended - Decision documented in minutes

Consequence if ignored: - Appearance of impropriety - Possible IRS questions - Donor/staff concerns - Audit findings

Fix: - Have conflict of interest policy - Annual disclosure form from board/staff - Process for handling conflicts

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Issue 2: Missing Documentation

Problem: Cannot find receipt for $5,000 grant expense

Compliance Rule: - All expenses must be documented - Receipts show what was purchased, when, and how much

Consequence if ignored: - Auditor cannot verify spending - Grant funder may demand refund - IRS may question validity of expense

Fix: - Require receipt for all expenses - Scan and store in database - Implement expense submission process

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Issue 3: Restricted Fund Misuse

Problem: Grant restricted to "youth programs" but used for administrative costs

Compliance Rule: - Restricted funds must be used for stated purpose

Consequence if ignored: - Funder may demand repayment - Legal action possible - Organization reputation damaged - Future grants at risk

Fix: - Separate restricted accounts - Document all spending against restrictions - Training for staff on fund restrictions

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Issue 4: Inadequate Record Keeping

Problem: Program staff don't track participant numbers, outcomes

Compliance Rule: - Funders often require outcomes documentation - IRS may ask for proof of program delivery

Consequence if ignored: - Cannot report accurately to grantors - Auditor flags as deficiency - Difficult to renew grants

Fix: - Implement tracking system - Train staff on data collection - Monthly reports on program metrics

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STATE-LEVEL COMPLIANCE

What Varies by State

State Registration: - Most states require annual registration - Fee: $0-$500 typically - Deadline: Often January

State Filing Requirements: - Annual charitable registration renewal - Updated board information - Updated financial information - State-specific forms

State Lobbying Rules: - Some states have stricter lobbying limits - Must register if substantial lobbying - Deadlines and reporting vary

State Audit Requirements: - Some states require audit for organizations over certain size - Some states allow accountant review - Requirements vary by state

What to Do

1. Contact your state's charity regulator (usually Attorney General)
2. Get requirements in writing
3. Put deadlines on organization calendar
4. Assign responsibility

AUDIT PREPARATION

What is an Audit?

Audit = Independent accountant reviews financial records and reports

Frequency: - Required annually for organizations >$500,000 (varies by state/funder) - Common for organizations >$100,000 - Smaller organizations: May do review or compilation

Audit Preparation Checklist

Before the Auditor Arrives: - Bank reconciliation complete and accurate - All journal entries recorded - Financial statements drafted - Supporting documentation organized (receipts, invoices, grant agreements) - Accounts payable list current - Fixed asset list current - Depreciation schedule accurate - Minutes from board meetings available - Conflict of interest disclosures on file - Grant agreements and reports available

---

RED FLAGS FOR COMPLIANCE PROBLEMS

Financial Red Flags

- Cash receipts not documented
- Large expenses without board approval
- Frequent transfers between restricted/unrestricted
- Excess cash not explained
- Inconsistent accounting methods

Governance Red Flags

- Board rarely meets
- Same person controls all finances
- No conflict of interest policy

- No whistleblower policy
- ED salary not approved by board

Grant Compliance Red Flags

- Spending on non-approved activities
- Missing grant reports
- No participant tracking
- Carrying over unspent grants without approval
- Minimal documentation of spending

ACTION ITEMS FOR YOUR ORGANIZATION

1. **Review Current Status**
   - Are you filed with Form 990-N/EZ/990?
   - Is state registration current?
   - Do you have required policies?
2. **Identify Gaps**
   - Missing documentation?
   - Weak internal controls?
   - Unclear fund restrictions?
3. **Create Plan**
   - Assign responsibility for compliance
   - Create compliance calendar
   - Implement missing systems
4. **Train Board/Staff**
   - Explain compliance requirements
   - Clarify roles
   - Answer questions

GLOSSARY

Term	Definition
Form 990	IRS annual tax return for nonprofits
501(c)(3)	Federal tax-exempt status for nonprofits
Conflict of Interest	When personal interest conflicts with organization interest
Restricted Fund	Money that must be used for specific purpose
Whistleblower	Person who reports misconduct
Compliance	Following all required laws and regulations
Audit	Independent review of financial records

Term	Definition
Fiduciary Duty	Legal obligation to act in organization's best interest

Internal Controls Scenario Booklet

Learning to Prevent Fraud and Errors

Target Audience: Finance committee members, nonprofit staff, board directors
Time to Read: 20-25 minutes
Skill Level: Intermediate

What Are Internal Controls?

Internal Controls = Systems and procedures to prevent fraud and errors

Why they matter: - Prevent theft and fraud - Catch honest mistakes - Ensure accuracy of records - Protect assets - Maintain public trust

---

THE THREE MAIN CONTROL PRINCIPLES

Principle 1: SEGREGATION OF DUTIES

Rule: No one person should handle money from start to finish

Example - Wrong Way:

```
Jane handles EVERYTHING:
- Receives invoices
- Approves for payment
- Writes checks
- Reconciles bank account
Risk: Jane could pay fake invoice, change records
```

Example - Right Way:

```
Mary receives invoice → John approves payment → Sarah writes check → Peter reconciles
Risk: Would need 4 people conspiring
```

Key duties to separate: 1. Approver (authorizes spending) 2. Payer (writes/processes payment) 3. Reconciler (verifies what was paid)

Principle 2: DOCUMENTATION

Rule: Keep evidence of every transaction

What to document: - Who approved it? - When was it approved? - For what purpose? - Did we receive what was paid for? - Who verified it?

Paper trail example:

```
Invoice received → Marked "approved" with signature & date →
Receipt matched to invoice → Check written →
Bank reconciliation confirms payment → File stored
```

Principle 3: REVIEW & VERIFICATION

Rule: Someone independent checks the work

What to verify: - Are expenses reasonable? - Is invoice from legitimate vendor? - Was payment actually made? - Do records match reality?

---

10 INTERNAL CONTROL SCENARIOS

Scenario 1: Small Organization ($50,000 budget)

Situation: - Very small staff (ED + admin person) - Limited finance knowledge - Low fraud risk (everyone knows each other) - But: Vulnerable to honest mistakes

Problem: Can't segregate duties (only 2 people)

Controls to implement: - Admin person enters all transactions - ED reviews monthly - Local CPA does quarterly review (catches errors) - Bank statements mailed to ED directly - Two signatures required for checks over $1,000 - Yearly audit or review

Cost: ~$1,000/year (CPA time) **Benefit:** Catches errors; maintains accuracy

---

Scenario 2: Preventing Fictitious Vendors

Situation: - Staff member creates fake vendor - Submits fake invoice for $5,000 - Gets reimbursed - Money goes to personal account

Without controls: Nobody knows

Controls to prevent: 1. **New vendor verification** - Require three bids for new vendors over $500 - New vendors need board approval (or ED + one other) - Check D&B or business license

2. **Invoice verification**
   - Verify vendor phone number independently
   - Call vendor to confirm invoice
   - Check invoice format (legit companies have consistent format)
3. **Segregation**
   - Approver != Payer
   - Bank reconciler != Invoice approver

4. **Unusual transactions flag**
    - Board receives list of new vendors
    - Staff memo explaining each one

Result: Fake vendor attempt caught at new vendor stage

Scenario 3: Preventing Payroll Fraud

Situation: - HR person adds fake employee to payroll - Collects paychecks weekly - Keeps going unnoticed

Without controls: Fraud goes on for months

Controls to prevent: 1. **Segregation** - HR enters employee data - Finance approves payroll - Someone else reconciles timesheets to checks - Payroll processor different from above 3

2. **Timekeeping system**
    - All employees clock in/out (digital system)
    - Timesheets verified by supervisor
    - Only clocked-in time pays
3. **Review**
    - Finance manager reviews new employees before first paycheck
    - Verify address/SSN legit
    - Check if person actually works there
4. **Bank reconciliation**
    - Monthly: Count paychecks issued vs. employees on file
    - Question any variance
5. **Employee list**
    - Distribute employee list quarterly
    - Management signs off: "These are all real employees"

Result: Fake employee caught before first paycheck

Scenario 4: Preventing Credit Card Abuse

Situation: - Organization gives staff members corporate credit cards - One person charges personal expenses - Submits with fake receipt

Without controls: Fraud goes unnoticed

Controls to prevent: 1. **Approval process** - Employee submits receipt + business purpose - Supervisor approves - Approver   Cardholder

2. **Documentation**
    - Receipt required for EVERY charge
    - Personal receipt = Not reimbursable

- Missing receipt = Personal responsibility

3. **Categorization**
    - Cardholder categorizes spend (Program? Admin? Travel?)
    - Finance verifies category is accurate
4. **Review**
    - Manager reviews statements monthly
    - Flag unusual vendors (restaurants, retail)
    - Call cardholder on suspicious charges
5. **Reconciliation**
    - Credit card statement vs. submitted receipts
    - Variance = Investigation
6. **Limit**
    - Spending limit per card ($500/month default)
    - Higher limits need board approval

Result: Personal credit card charges caught immediately

Scenario 5: Preventing Cash Theft

Situation: - Organization collects cash donations - One person handles cash - Some cash goes to personal pocket - Covers by reducing donations recorded

Without controls: Hard to detect

Controls to prevent: 1. **Minimize cash** - Encourage online/check donations - No cash box sitting around - Limit cash on hand

2. **Segregation**
    - Person A receives donation, gives receipt
    - Person B records in system
    - Person C deposits at bank
    - Person D reconciles
3. **Immediate documentation**
    - Every cash donation recorded in receipt book
    - Receipt book = legal document (in order, no blanks)
    - Duplicate copy kept
4. **Daily reconciliation**
    - Cash counted daily
    - Matched to receipts
    - Any variance = Investigation
5. **Banking**
    - Deposit daily (don't hold cash)
    - Bank statement sent to independent person
    - Verify deposited amounts match records
6. **Review**
    - Monthly: Compare donations recorded vs. amounts deposited

- Quarterly: Board reviews donation activity

Result: Cash theft caught within one day

Scenario 6: Preventing Vendor Kickback

Situation: - Procurement person gets “discounts” from vendors - Actually kickbacks for steering business their way - Vendor overcharges; shares surplus with procurement person

Without controls: Difficult to detect

Controls to prevent: 1. **Competitive bidding** - Require 3 bids for expenses over $5,000 - Document all bids received - Choose lowest bid (unless justified) - Document reason for not choosing lowest

2. **Rotation**
    - Different person handles vendor relationships each year
    - No single person has long-term vendor relationship
3. **Conflict of interest**
    - Procurement person declares if they know vendor
    - Steps out of decision if conflict exists
    - Policy enforced
4. **Price comparison**
    - Verify vendor prices are market rate
    - Compare to other vendors’ quotes
    - Flag if significantly higher than competitors
5. **Review**
    - Board reviews vendor spending quarterly
    - Questions unusual relationships
    - Asks: “Are we getting best value?”
6. **Auditor focus**
    - External auditor specifically reviews vendor relationships
    - Tests for unusual pricing patterns

Result: Kickback scheme discovered during audit

Scenario 7: Preventing Duplicate Payments

Situation: - Invoice received; approved for payment - File not organized; same invoice processed again - Organization pays same bill twice - Money lost

Without controls: Easy to miss

Controls to prevent: 1. **Invoice numbering** - Stamp each invoice with: Date received, invoice number - Mark “PAID” when processed - File paid invoices separately

2. **Tracking log**
    - Keep log of all invoices processed
    - Include: Date, vendor, invoice #, amount, check #
    - Chronological order
3. **Payment verification**
    - Before processing, check: "Have we paid this before?"
    - Match invoice number to log
    - If duplicate number: Stop; ask vendor
4. **Segregation**
    - Person processing payment   Person reconciling
    - Reconciler catches duplicates
5. **Bank reconciliation**
    - Monthly: Match checks to invoices
    - Any check without matching invoice = Investigation
    - Any invoice without matching check = Investigation
6. **Vendor follow-up**
    - If vendor demands payment twice, call them
    - Verify invoice legitimacy

Result: Duplicate payment caught before sending

Scenario 8: Preventing Budget Overspending

Situation: - Department manager overspends budget - Approves expenses that exceed allocation - Budget becomes meaningless - Year ends with $50,000 overage

Without controls: Budget ignored

Controls to prevent: 1. **Budget allocation** - Clear budget per department - Board-approved - Documented

2. **Monthly reporting**
    - Budget vs. actual each month
    - Show YTD spending
    - Show remaining budget
    - Flag if trending over
3. **Approval limits**
    - Manager can approve up to $5,000
    - Director can approve up to $25,000
    - Board must approve over $25,000
    - If spending approaching limit, higher approval required
4. **Variance investigation**
    - If spending 10% over budget: Department explains
    - If spending 20% over budget: Board meeting
    - If spending 30% over budget: Freeze spending pending review

5. **Forecasting**
    - Monthly: Manager forecasts what they'll spend
    - Finance matches against budget
    - Alerts if projected overage
6. **Review**
    - Monthly finance report to board
    - Highlight budgets on track vs. over/under
    - Board questions variances

Result: Overspending caught early; can be corrected mid-year

Scenario 9: Preventing Unauthorized Commitments

Situation: - Program director agrees to $20,000 expense - Never got board approval - Finance discovers when bill arrives - Organization didn't budget for it - Difficult to refuse

Without controls: Commitments made without approval

Controls to prevent: 1. **Approval hierarchy** - Expenses under $5,000: ED approval - Expenses $5,000-$25,000: Board finance committee - Expenses over $25,000: Full board - Clear policy in writing

2. **Procurement process**
    - All major purchases go through formal process
    - Requisition → Approval → Bidding → Purchase order
    - No purchase without approval
3. **Purchase order system**
    - Organization issues purchase order
    - Vendor understands commitment only when PO issued
    - PO must be pre-approved
4. **Commitment tracking**
    - List of all pending commitments
    - Board reviews monthly
    - Prevents surprises
5. **Vendor communication**
    - Clear written approval before committing
    - Email from authorized person confirms
    - Vendor confirms no commitment until approval

Result: Unauthorized commitment caught before commitment made

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Scenario 10: Detecting Accounting Errors

Situation: - Journal entry was recorded wrong - Asset recorded as expense - Financial statements are now inaccurate - Auditor questions discrepancy

Without controls: Errors go undetected

Controls to prevent: 1. **Segregation** - Person recording   Person reviewing - Independent review catches errors

2. **Verification**
   - For every entry, document: Why? Who? When? Source?
   - Entry reviewer checks source documentation
   - Matches to entry
3. **Trial balance**
   - Monthly: Generate trial balance (all accounts)
   - Compare to prior month
   - Investigate unusual changes
4. **Reconciliation**
   - Monthly: Reconcile bank statement to GL
   - Monthly: Reconcile fixed assets to GL
   - Monthly: Reconcile AR/AP to detail listings
5. **Bank reconciliation detail**
   - List each check: Date, check #, amount
   - Verify matched to GL
   - Any variance = Investigation
6. **Quarterly review**
   - Draft financial statements
   - Review for unusual items
   - Ratio analysis (expenses as % of revenue)
   - Flag anything unusual

Result: Accounting errors caught during monthly reconciliation

---

SMALL ORGANIZATION SAMPLE POLICY

Expense Approval: - Under $500: ED approval - $500-$2,000: ED approval + Board Treasurer review - Over $2,000: Board meeting vote

Cash Handling: - 2 people must count cash - Record in receipt book immediately - Deposit daily - Bank statement sent to Board Treasurer

Payroll: - Timesheets must be signed by supervisor - Finance reviews before processing - Bank reconciliation verifies all checks cleared

Credit Cards: - Monthly review by Treasurer - Receipt required for every charge - Spending limit: $500/month per person

Vendor Changes: - New vendors must be on board meeting agenda - Discussion of why selected - Pricing verification

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ACTION STEPS

1. **Assess current controls** (Week 1)
    - What controls do you have?
    - What gaps exist?
2. **Identify high-risk areas** (Week 2)
    - Where could fraud happen?
    - Where are errors likely?
3. **Design controls** (Weeks 3-4)
    - For each risk, what control helps?
    - Keep realistic for your size
4. **Implement** (Weeks 5-6)
    - Train people on new procedures
    - Get feedback
    - Adjust as needed
5. **Monitor** (Ongoing)
    - Board finance committee reviews monthly
    - Make sure controls are actually followed
    - Update as needed

Internal Controls 101 Guide – Easy, Practical Safeguards for Small Nonprofits

Organization: ______________________________
Your Name: ______________________________
Date: ______________________________

What Are Internal Controls?

Internal Controls = Rules and processes to prevent money problems and fraud

Simple Definition: Internal controls are the safeguards that make sure: - Money isn't stolen - Mistakes are caught - Rules are followed - Records are correct - Donors' money is used properly

Why They Matter: Prevent fraud Catch mistakes early Protect the organization Build donor trust Show you're responsible Make audits easier

---

The Control Environment (Culture)

What It Is:

The attitude of leadership about doing things right

Key Elements:

Leadership Integrity - Board and staff model honesty - Donors' money treated with respect - "We do the right thing even when no one's watching"

Clear Policies - Written procedures everyone knows - "Here's how we handle money" - Everyone follows same rules

Accountability - People responsible for their area - Regular checks and balances - Problems reported and fixed

Competent Staff - People trained to do their jobs - Regular professional development - Right people in right positions

---

THE FIVE KEY INTERNAL CONTROLS

CONTROL 1: Segregation of Duties

What It Is:

No ONE person controls the whole money process

The Problem (Bad):

```
Jane does EVERYTHING with donations:
- Receives donation
- Records it
- Deposits it
- Reconciles it
- No one checks Jane's work

Risk: Jane could steal and no one would know
```

The Solution (Good):

```
STEP 1 - John receives donation
        ↓
STEP 2 - Mary records it in system
        ↓
STEP 3 - Peter deposits it in bank
        ↓
STEP 4 - Sarah reconciles to bank statement
        ↓
STEP 5 - Board reviews report

Result: Fraud very hard (would need 5 people to agree)
```

For Small Nonprofits:

Minimum (2 people): - One person handles money - Different person checks/records

Better (3 people): - Person A: Receives/deposits money - Person B: Records transactions - Person C: Reviews/approves

Best (4+ people): - Checks and balances throughout - Multiple approvals needed

Simple Example: Paying a Bill

Wrong Way (1 person):

```
John gets invoice → John approves → John writes check → John mails
(John could approve fake invoices, no one checks)
```

Right Way (2 people):

```
Mary gets invoice → John approves (checks is real) → Mary writes check (with approval) → Son
(Mary can't approve, John can't write check, creates oversight)
```

CONTROL 2: Authorization & Approval

What It Is:

Rules about who can approve what, based on amount

Why It Matters:

- Not everyone should approve everything
- Bigger purchases need more approval
- Clear spending authority prevents overspending

Sample Approval Matrix:

Amount	Approval Required	Signature
Under $500	Director approval	________________
$500-$2,000	Director + Board Treasurer	________________
$2,000-$10,000	Board Treasurer	________________
Over $10,000	Full Board vote	________________

Real Example:

Situation 1: Buy office supplies ($300) - Authorization needed: Executive Director - Process: Submit receipt, sign off - Time: 1 day

Situation 2: Buy new computer ($2,500) - Authorization needed: Director + Board Treasurer - Process: Request approval, get two signatures - Time: 3-5 days

Situation 3: Hire new staff ($50,000/year) - Authorization needed: Full Board vote - Process: Present at board meeting, vote - Time: 1 month

---

CONTROL 3: Documentation & Records

What It Is:

Written proof of every transaction

Why It Matters:

- "If it's not written down, it didn't happen"
- Audit trail if questions arise
- Proof you followed rules
- IRS requirement

Required Documents:

Transaction	Required Proof
Receipt of Donation	Donation letter/receipt
Grant Award	Grant agreement
Payment Made	Invoice + check copy
Reimbursement	Receipt + form
Employee Pay	Timesheet + pay stub
Bank Deposit	Deposit slip

Simple System:

```
Folder for Each Month:

    Donations (all receipts)
    Grants (agreements, reports)
    Invoices (bills to pay)
    Payments (copies of checks)
    Receipts (proof of spending)
    Bank Statements (monthly)

At Year End:
  Everything in chronological order
  All matched to general ledger
  Ready for auditor
```

Key Rule:

NO CASH PAYMENTS WITHOUT RECEIPT

CONTROL 4: Bank Reconciliation

What It Is:

Proving that your records match the bank's records

Why It Matters:

- Catches theft immediately
- Finds mistakes
- Shows you're in control
- IRS expects this

How to Do It (Monthly):

Step 1: Get bank statement

```
Opening Balance: $10,000
Deposits: +$5,000
Checks cleared: -$3,000
Closing Balance: $12,000
```

Step 2: Compare to your records

```
Your books show: $12,000 cash
Bank statement shows: $12,000 cash
Difference: $0
```

Step 3: Investigate differences

```
Your books show: $12,000
Bank statement shows: $11,900
Difference: $100

Investigation:
- Check shows $100 but not cleared
- That's normal (pending)
- You record $12,000 (you wrote it)
- Bank shows $11,900 (not cleared yet)
- Next month will match
```

Red Flags:

- Difference > $100
- Same difference month after month
- Bank won't reconcile
- Extra deposits you didn't record

CONTROL 5: Regular Reviews & Audits

What It Is:

Someone independent checking the books

Why It Matters:

- Catches problems early
- Shows everything's correct
- Builds donor confidence
- Required by some grants

Who Should Review:

Monthly: - Executive Director reviews bank reconciliation - Someone checks expenses against budget

Quarterly: - Board Finance Committee reviews statements - Compare to budget

Annually: - Full Board reviews financial statements - Discuss any variances - CPA audit (if required)

Every Few Years: - Independent audit - CPA reviews everything - Public report issued

What Auditors Look For:

Item	What They Check
Revenue	Are donations real? Properly recorded?
Expenses	Are bills real? Properly approved?
Cash	Does it match bank?
Assets	Do we really own this equipment?
Compliance	Did we follow grant requirements?

THE FRAUD TRIANGLE (Why People Steal)

Element 1: PRESSURE

- "I need money for rent"
- "My salary isn't enough"
- "Organization is struggling"

Element 2: OPPORTUNITY

- No checks on money
- One person controls everything
- No one audits
- Bad controls

Element 3: RATIONALIZATION

- "I'll pay it back"
- "The organization owes me"
- "It's not that much"
- "No one will notice"

How Controls Help:

Reduce Pressure: - Fair salaries - Good benefits - Clear communication

Eliminate Opportunity: - Segregation of duties - Authorization requirements - Regular audits - Documentation

Address Rationalization: - Clear ethics policy - Consequences explained - Leadership models integrity

---

Red Flags of Fraud

Red Flag	Meaning	Action
Missing receipts	Where's proof?	Ask for receipt
No bank reconciliation	How do we know the truth?	Demand reconciliation
One person controls money	Too much power	Reassign duties
No approvals recorded	How was it authorized?	Implement approval process
Large round numbers	Suspicious	Question appropriateness
Missing invoices	What was this for?	Investigate
Pressure from staff	"Don't audit, trust me"	That's a red flag!
Friends/family payments	Potential conflict	Review closely

Building Controls for Your Organization

Small Nonprofit (Budget <$500K)

MINIMUM CONTROLS:

1. **Two People on Money**
    - One receives/deposits
    - One records/approves
2. **Written Policies**
    - Approval amounts
    - Donation handling

    - Expense procedures
3. **Monthly Reconciliation**
    - Bank reconciliation (1 hour)
    - Verify deposits match records
4. **Quarterly Review**
    - Board looks at statements
    - Compare to budget
5. **Annual Audit (if required by grant)**
    - Professional CPA
    - Full review

Medium Nonprofit (Budget $500K - $5M)

RECOMMENDED CONTROLS:

1. **Clear Segregation of Duties**
    - At least 3 people on money
    - Clear job descriptions
2. **Policies & Procedures Manual**
    - Written everything
    - Everyone signs they read it
3. **Internal Control Assessment**
    - Annual review of controls
    - Update as needed
4. **Monthly Accounting**
    - Bank reconciliation
    - Budget comparison
    - Executive Director review
5. **Quarterly Financial Review**
    - Board Finance Committee
    - Detailed discussion
6. **Annual Audit**
    - CPA audit
    - Management letter
    - Corrective action plan

Setting Up a Simple Control System

STEP 1: Write Policies

```
Create document:
"Financial Procedures Manual"

Include:
- Who approves what amounts
```

- How to receive donations
- How to handle cash
- Check writing process
- Grant tracking
- Expense reimbursement
- Bank reconciliation process

STEP 2: Assign Duties

Create chart:
Position → Responsibilities → Authority

Example:
Bookkeeper → Records transactions → Approve <$500
Treasurer → Reviews financials → Approve <$5,000
Director → Manages operations → Approve <$10,000
Board → Strategic decisions → Approve >$10,000

STEP 3: Create Forms

Create templates:
- Donation receipt form
- Check request form
- Expense reimbursement form
- Approval form
- Bank reconciliation template

STEP 4: Document Everything

Create filing system:
- All receipts
- All invoices
- All bank statements
- All approvals
- All reports

STEP 5: Train Staff

Make sure everyone knows:
- Their responsibilities
- Approval limits
- Required documentation
- What to do with money
- Who to ask questions

STEP 6: Review Regularly

```
Schedule reviews:
- Monthly: Bank reconciliation
- Quarterly: Board review
- Annually: Full assessment
- Every 3 years: External audit
```

Common Control Mistakes

Mistake 1: Only one person with access to money **Solution:** Always have at least 2 people

Mistake 2: No written approval authority **Solution:** Create approval matrix

Mistake 3: Keeping cash without receipts **Solution:** Require receipt for every transaction

Mistake 4: No bank reconciliation **Solution:** Monthly reconciliation

Mistake 5: Mixing personal and organizational money **Solution:** Separate accounts, never mix

Mistake 6: No board oversight **Solution:** Monthly board finance reports

---

What You Now Understand

- What internal controls are and why they matter
- The five key types of controls
- How segregation of duties prevents fraud
- Why documentation is critical
- How bank reconciliation works
- The fraud triangle
- Red flags of fraud
- How to set up controls for your organization

Your Control Checklist

Basic Controls in Place: - [ ] At least 2 people handle money - [ ] Written approval policies - [ ] Monthly bank reconciliation - [ ] All transactions documented - [ ] Board reviews financials - [ ] Annual audit (if applicable)

Advanced Controls: - [ ] Segregation of duties matrix - [ ] Written policies manual - [ ] Conflict of interest policy - [ ] Whistleblower policy - [ ] Internal control assessment - [ ] Regular staff training

Ready for Success: - [ ] No fraud red flags - [ ] All documents organized - [ ] Board confident in controls - [ ] Donors trust the organization - [ ] Audits pass without issues

---

Implementation Date: ______________________________
Review Date: ______________________________
Confidence Level: Learning Ready to implement Implemented Expert