NONPROFIT FINANCIAL ACCOUNTABLITY

You have surely read about them. In our local area a well-loved, trusted, long-time church secretary stole from the church that employed her to pay for her son's drug addiction treatment. Or the town clerk that used the town credit card for personal purchases. Or the Texas mom who stole almost $300,000 from a nonprofit youth sports league.

All small nonprofits depend on their Treasurers to handle the bank account and pay the bills. That individual is the only one in most cases, that even sees the monthly checking account statement. Rarely does the Board of the nonprofit actually ensure accountability for the funds by performing a review of the books. Some feel that it gives the appearance that the Treasurer is not trusted. And some Treasurers take that as a sign that they are not trusted and take offence if a review is even mentioned. A good Treasurer will not only welcome the review, but he or she will insist on it.

Small nonprofits can't afford the cost of an audit performed by an accounting firm. They can run $5,000 or more. A review of the financial statements by a CPA will cost about half that. The amount that the group has in all its various accounts (checking, savings, investment) should determine this decision along with any federal or state requirements for a formal audit—mostly driven by the amount received in Federal or State grant funds. Small nonprofits rarely reach these thresholds.

Federal nonprofit audit requirement:
Currently, as a result of the Uniform Guidance, all non-federal government agencies and nonprofit organizations that expend $750,000 or more in federal awards in a given fiscal year are required to obtain a Single Audit.

North Carolina nonprofit audit requirement:
Audit Required: Yes, in certain circumstances, if receiving state funds. Statute and Description: N.C.G.S. 159-40 | A non-governmental entity that receives $500,000 or more annually in state funds, must submit a "Yellow Book" Audit done by CPA that includes a Schedule of Federal and State Awards. The complete report to the funding agency and to the Office of the State Auditor is due within 9 months of organization's year end. Note: An A-133 audit may be substituted for the yellow book audit. Additionally, the State Auditor may conduct an investigation of any nonprofit that receives $1,000 or more in state grant funds and in

connection with that review counties and municipalities may require nonprofits receiving at least $1,000 in local grants to conduct an independent audit.

Absent the Audit: How small nonprofits can demonstrate accountability without one

The following material was taken from an article produced by Nonprofit Quarterly in 2007, but is still relevant today. The material has been modified to reflect a small nonprofit that does not have paid staff.

In the ongoing debate at the state and federal levels about how best to regulate public charities, a recurring question has been, "At what annual budget size should nonprofits obtain an audit of their year-end financial statements?" In 2005, Independent Sector's Panel on the Nonprofit Sector recommended to Congress that federal law be changed to require exempt organizations with annual revenues exceeding $1 million to have their financial statements audited by an independent CPA, and further, that organizations with annual revenues of $250,000 to $1 million have their statements reviewed by an independent accountant. Meanwhile, watchdog groups and standards-setting entities continue to vary in their answers to the audit question. The Wise Giving Alliance has a $250,000 annual revenue threshold, while the Standards of Excellence Institute's threshold is $300,000.

With such diversity of opinion among experts and regulators alike, it is no wonder that board members of community-based nonprofits are confused about when to begin having their statements audited. Moreover, with the audit proving to be a ubiquitous element of accountability legislation and recommended self-regulation, how should those community-based organizations that don't get an annual audit otherwise demonstrate their fiscal responsibility?

First, board leadership must recognize pragmatically what an audit does—and does not do—for a small nonprofit. An audit is an outside CPA's professional opinion on the material accuracy of an organization's year-end financial statements. An audit has nothing to do with financial strategy or organizational sustainability—a fact that too many nonprofit staff and board members overlook. An organization's own financial statements, which minimally include a balance sheet and an income statement, are first and foremost internal management tools. Even small organizations of $50,000 to $250,000 should produce internal financial statements for staff and board on a quarterly basis; larger groups should do so monthly. With the complexity and unpredictability of nonprofit income and the small margin upon which most community-based groups survive, timely analysis of accurate financial statements is both essential and totally independent of the audit issue.

The benefits to a community-based nonprofit of purchasing an annual audit of its year-end financial statements fall into three categories:

Generate Donor and Constituent Confidence. From a pure return on investment perspective, perhaps the greatest benefit to a nonprofit of purchasing an annual audit is the ability to provide copies of it to prospective major donors and institutional funders. An unqualified audit is a universal indicator (though hardly a guarantee) that an organization is investing in its financial management and that the financial statements it is including with its proposal are likely to be accurate. Beyond donors, the audit is a symbol (though, again, hardly a guarantee) of an organization's broad constituency, including the media and watchdog groups, that the organization is committed to fiscal accountability.

Ensure Compliance with Accounting Standards. Board leadership benefit from an audit done by a CPA who has current knowledge of nonprofit accounting standards in that such CPAs can help move an organization towards best financial management practices. The Board leadership, knowing that they will have to defend accounting judgments to an auditor at year-end sustains a kind of accounting discipline, or rigor, throughout the year.

Prevent or Catch Fraud. This benefit is perhaps the most commonly overstated. In fact, an annual audit is only a small potential element of a sound system of internal controls. One need only reflect on the major corporate (or state agency) scandals that continue to make the news to recognize that the audit process does not always prevent or catch fraudulent activity. Certainly, the prospect of an audit may play a deterrent function, but a determined volunteer can find ways to steal from a nonprofit that an auditor, who may be onsite testing for two days each year, will not detect.

If these are the primary benefits of purchasing an annual audit, how does a nonprofit that elects not to purchase one meet these same objectives? Let's assume this is a small nonprofit with a budget of $20,000 and a savings account of $50,000. The board definitely wants to generate donor and constituent confidence, ensure compliance with nonprofit accounting standards, and prevent fraud.

Generating Donor and Constituent Confidence without an Audit. There are six things a small nonprofit can do to inspire financial confidence among donors and constituents.

First, it can establish and maintain an active board finance committee with a strong treasurer who can speak fluently about the financial condition of the organization. When the Treasurer includes board members in responses to constituent inquiry, it sends a message of financial oversight and transparency to the community.

Second, the treasurer ensures that the organization's IRS Form 990 is done well and submitted on time each year. Without an audit, many funders and constituents will rely on the Form 990 to assess the organization's financial status. The Form 990 is due four and a half months after the close of an organization's fiscal year. To demonstrate transparency, the nonprofit can put PDFs of its last three Form 990s on its Web site. Most small nonprofits complete the 990-N Electronic Notice (e-postcard) for tax-exempt organizations not required to file Form 990 or Form 990-EZ. There is no paper form.

Third, the nonprofit can produce an inexpensive annual report to the community summarizing the impacts it had over the previous year as well as the sources and uses of its funds. If thoughtfully written and presented, the annual report need not be a fancy production to effectively communicate the organization's sense of mission and financial accountability to its constituents. In demonstrating impact and accountability, an annual report is an effective marketing and donor cultivation vehicle, even though these are not its explicit intents.

Fourth, Treasurer and Board can be fanatical about tracking restricted contributions. In the end, most major donors and funders want to be assured that their funds are used as they intended them to be. Before organization takes a penny of restricted money, it should set up adequate systems for identifying expenses as satisfying those agreements. At a minimum, a well-structured and maintained Excel workbook that keeps a running balance on each restricted funding source is essential. (Example of a restricted fund: Mr. and Ms. A give $5,000 to the Friends of the XYZ Library to purchase children's books for the Little Free Libraries maintained by the Friends.)

Fifth, Board can develop a summarized version of the organization's approved annual budget for public consumption. Many donors and funders ask for an annual budget before they commit funds. The Board can consolidate its income and expense categories for a clean, high-level look at its financial plan for the year. With reduced line items, there will be room on the page for a short narrative about the budget's assumptions and desired programmatic outcomes. Such a document demonstrates that the nonprofit understands the nature of outside constituents' financial questions—as opposed to board's—and is responsive with an informative, digestible presentation.

Finally, the organization may elect to engage an outside CPA in a financial statement review, rather than a full-blown audit. Less expensive and time-intensive, a review does not include onsite testing and therefore does not conclude with an auditor's "opinion"—a technical term for the CPA's expert judgment as to whether the financial statements prepared by the organization were prepared in accordance with accepted accounting principles. Instead, based on limited document review and communications with the board, the review report's objective is to give limited assurance that no significant modifications to the financial statements are needed to make them conform to accepted accounting principles. For roughly half the price of an audit, the organization would have a CPA-prepared document to share with constituents, albeit one with less "bite." Only organizations with larger funds would consider this type of audit.

Preventing or Catching Fraud Without an Audit. **The primary ways that organizations prevent fraud, regardless of budget size, are in segregating financial duties and creating a culture of financial ethics and transparency.** The only difference for small nonprofits is that having enough people among whom to segregate financial duties is a greater challenge. In smaller nonprofits, the Treasurer dispenses funds (check or credit card use) as approved by the board President or his/her designee. This puts two persons in the segregation of duties loop. Policies and procedures should be developed for handling of cash (at book sales), credit card use, and issuance of checks over a certain amount (second signature). Generally, the officers are on the bank signatory card. Having the bank statements sent to the President instead of the Treasurer is another example of segregation of duties. In today's electronic world it is also possible to for the President to have online access to the organization's bank accounts (checking and savings) so she or he can periodically check activity. However, credit card purchases will only show up as an amount, so some method of review of credit card purchases will help ensure legitimacy of those purchases.

It is the job of the organization's leaders to establish and maintain a culture of financial transparency. At its essence, this is about how carefully we collect and share financial information with a broad array of internal and external stakeholders. A fundamental assumption of the auditing process is that the organization has the capacity to produce its own year-end financial statements in accordance with generally accepted accounting principles. Small and emerging organizations have to work up to this capacity, just as they have to work up to the financial capacity to afford an audit. (**Those that intend to be all volunteer or very small indefinitely may never reach audit-readiness**.) The strategies outlined above will not only position an organization as serious about financial accountability and transparency, they are also necessary steps in the journey towards sufficient financial capacity to warrant an annual audit.

https://nonprofitquarterly.org/absent-the-audit-how-small-nonprofits-can-demonstrate-accountability-without-one/

And one other caution, **small loose-knit nonprofits are prime targets for spammers.** Officers may receive an email from the President asking them to purchase gift cards for some bogus immediate need or the Treasurer might receive instructions from the President to pay a bogus invoice. These will be very real—using the names of individuals. The first thing to do is to look closely at the email address from which the email came. This is generally a dead give-away as it will be different from the supposed-sender's real email address. Secondly, do not hit reply to inquire about the request. Call, text or email the sender directly to verify the request. These two actions will prevent something you might regret later.

Establishing fiscal controls in a small nonprofit

1. Clear definition of duties of officers related, especially the Treasurer.
2. Conflict of Interest statement—all officers and directors.
3. Ensuring all corporate papers are in order and being safeguarded (e.g., Articles of Incorporation, Bylaws, IRS 501 (c)3 designation, FEIN, NC Incorporation as a nonprofit)
4. Record retention and destruction
5. Financial policy and procedure manual that addresses the basics:
    a. Segregation of Duties
    b. Annual authorization of bank account signers
    c. Bank account online access authorizations
    d. Cash receipts—handling cash for sales at fundraisers
    e. Accounts receivable/billing
    f. Disbursement of cash/accounts payable
    g. Chart of Accounts with narrative
    h. Procurement
    i. Budget and process for approving and documenting expenditures or amounts not approved in the budget
    j. Travel Expenses
    k. Credit card purchases
    l. Contributions received (regular and restricted)

m. Financial reporting—internal
n. Financial reporting—external (IRS, state, members, public, funders)
o. In-kind contributions (non-monetary goods or services)
p. Financial Statement review
q. Inventory and property records
r. Grants received
s. Grants awarded
t. NC sales tax recoverable
u. NC sales tax payable
v. NC Charitable Solicitation License

These policies and procedures should be reviewed and updated periodically.

Methods to conduct a financial review of a nonprofit:

1. Can be done by a small (2 or 3 member) audit committee
2. Can be done by the Treasurer of another small nonprofit (reciprocation). The organization's treasurer should not be included in selecting the other nonprofit.
3. Process:
    a. Have copies of or access to the pertinent:
        i. Documentation of IRS 990 filing for most recent fiscal year.
        ii. NC tax refund filing for most recent period.
        iii. NC taxable sales payment for most recent period.
        iv. financial policies and procedures (to ensure compliance with)
        v. Chart of accounts (if one exists)
        vi. Budget approved for the current year
        vii. Board minutes or emails approving expenditures not in the budget
        viii. Bank statements for 1 to 3 months--Include one period at least where a fundraiser was held that month
        ix. Credit card statements for the same 1 to 3 months as bank statements
        x. Receipts for expenditures
        xi. Any forms used to document income, disbursals, or bank deposits
        xii. Documentation of member dues for those same periods
        xiii. Any online PayPal, credit card or other electronic transfer of funds documentation (e.g., payment of dues, payment for a workshop, payment for a meal, online book sales)
        xiv. Documentation of contributions (regular and restricted) for those same periods.

xv. If restricted funds were spent during the periods in question, documentation that restrictions were followed.

b. Examine documentation of 990 filing for most recent fiscal year.
c. Examine tax refund filing for most recent period.
d. Examine taxable sales payment for most recent period.
e. Whoever is doing the "audit" should familiarize themselves with the policies and procedures. Review compliance as part of the audit—especially with the segregation of duties, handling of cash, and use of restricted funds.
f. Compare entries on the bank statement and ensure that there are receipts for every income and expenditure. Compare the expenditure to the budget. If the expense is not on the budget is there a corresponding approval noted in either the Board minutes or on an email? Note any discrepancies.
g. Take the credit card statement. Compare the total to the total listed on the bank statement. Compare the credit card receipts for each purchase to the credit card statement. Compare these expenses to the approved budget. Note any discrepancies.
h. Review cash receipts (e.g., book sales) against deposit slip against the bank account entry.
i. Make notes of discrepancies as you go along.
j. Write a brief report summarizing the process and noting discrepancies. Make pertinent recommendations for improvement if needed.

While this is not an "official audit" it goes a long way toward ensuring the organization's constituents at the organization appropriately manages its finances when the cost of an "official audit" cannot be justified.