

What Religious Organizations Should Know About Internal Controls



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- A professional services firm with three distinct business lines
 - Accounting and Consulting
 - Outsourcing
 - Wealth Advisory
- 3,600 employees
- Offices coast to coast
- Nonprofit group serves 6,000 clients across the country



Speaker Introductions

- **Harold Parsons, CPA**

Harold is the Principal-in-Charge of religious organizations in our Nonprofit practice at CLA. He has over 30 years serving nonprofit clients of all sizes, and he has led the firm's efforts surrounding health care tax credits for this industry.

- **Tim Murphy, CPA**

Tim has focused on outsourcing and consulting to nonprofits for over 20 years. In that time, Tim has concentrated on serving faith based organizations, social service agencies, and organizations that receive federal and state funding.

- **Jeff Roberts, CPA**

Jeffrey is an outsourced CFO with CLA. For over 20 years he has been helping nonprofits achieve financial excellence through improved monthly reporting, cashflow management, strategic planning, and systems design.

Learning Objectives

At the end of this session, you will be able to:

- Understand the risks associated with a weak internal control environment
- Apply tools and best practices to enhance your internal controls
- Better safeguard your organization's assets, personnel, and membership

Recent Developments

- **Washington Post Investigation** — Published October 26, 2013
 - Essentially data mining Form 990 Part VI, Question 5 – “Did the Organization become aware of a significant diversion of assets?”
 - More than 1,000 NPO’s checked the box; not all disclosed on Schedule O
 - The 10 largest disclosures cited combined losses that potentially totaled more than a half-billion dollars
 - Approximately 50% examined did not appear to reveal the full amount lost
 - Created searchable database wapo.st/diversionsdatabase

Recent Developments

- **Washington Post Investigation – continued**
 - Multiple religious organizations listed in the WaPo database
 - Regulators in 7 states, Washington DC, and Congress launch investigations
 - CLA’s John Langan posted a “Letter to the Editor” on November 17, 2013
 - ◇ Incidence of fraud no greater in NPO sector than in for-profit (per ACFE study)
 - ◇ Catch-22: public expectation that overhead should be low can discourage more spending on sound financial controls

Recent Developments

- **Estimated \$37 billion in church-related financial fraud in 2013**
 - More than the estimated amount churches plan to spend on worldwide mission
 - Approximately 80% of all cases of church fraud go unreported
 - Source: Status of Global Mission Report (Gordon Conwell)

\$850,000 Fraud Example

- **CFO stole \$850,000 from church funds**
 - Source: Church Finance Today, September 2013 issue
 - Had control of church bank accounts, credit cards and checks
 - Had access to digital signatures of church officers
 - Paid home mortgage and personal credit cards with church funds
 - Luxury purchases and sporting events paid with church funds
- **The Verdict (for the church)**
 - Just **basic** internal controls could have prohibited or significantly limited his ability to embezzle from the church
 - ◇ Require 2 signatures for all checks above a nominal amount
 - ◇ Have monthly bank statements and reconciliations reviewed by an independent church official

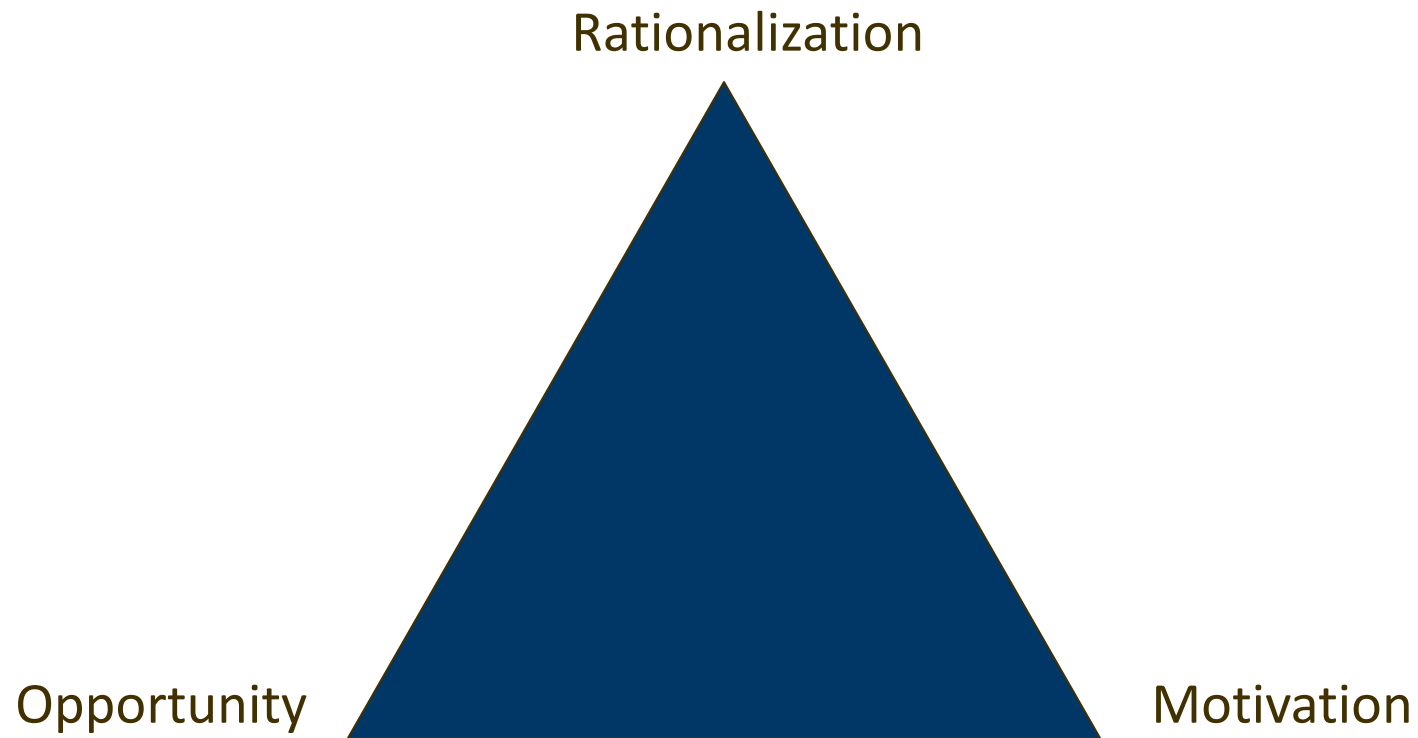
Internal Controls – why should we care?

- Lack of internal controls can not only make you more vulnerable to fraud, it can lead to incorrectly reported financial information (omissions, errors, misstatements)
- Internal controls can help your organization run more efficiently and effectively
- Internal controls can help reduce risk in your organization

Internal Controls – why should we care?

- Nonprofits are often more susceptible to fraud
 - Limited resources for accounting and oversight
 - Use of volunteers who may have access to confidential information
 - Volunteer boards with little or no financial oversight experience
 - Smaller organizations typically suffer the largest median losses (ACFE 2012 report)

Fraud Triangle



Types of Fraud

- **Collusion**

- The collusive activities of two or more individuals can result in control failures. Individuals acting collectively to perpetrate and conceal an action from detection can alter financial data or other management information in a manner that cannot be identified by the control system.

- **Lapping**

- Lapping is one of the most common types of employee fraud. It is the postponement of entries for the collection of receivables to conceal an existing cash shortage. The fraud is perpetrated by a person who records cash in both the cash receipts journal and subsidiary accounts receivable journal. The employee records the recording of cash receipts from one source and covers the shortage with receipts from another source. The employee must continue to cover the shortage through repeated lapping, replace the stolen money, or find another way to conceal the shortage.

Types of Fraud

- **Accounts Payable Fraud**

- An employee may falsify payments to real vendors or create phony vendor addresses to which checks are sent. Alternatively, an employee may intentionally overpay an invoice, take the refund from the supplier, and pocket it.

- **Payroll ghosts and unauthorized pay changes**

- Padding the payroll is another common form of fraud. With this, an employee might either keep paying checks for employees after their employment has terminated or add nonexistent employees to the payroll. Unauthorized pay changes and the non-recording of vacations used are frequent occurrences when there are not ongoing monitoring mechanisms or procedures in place.

The Purpose of Internal Controls

- To safeguard assets
- To produce accurate accounting data
- To contribute to efficient operations
- To promote compliance with board policy and donor restrictions
 - **BONUS:** *An employee working under a good system of internal controls is more easily protected from suspicion should any shortages or discrepancies occur.*

Internal controls help to limit the **opportunity** to commit fraud.

Controls According to COSO

- Policies, procedures, and practices that ensure management objectives are achieved and risk mitigation strategies are carried out. Control activities can be both preventive and detective.
- Provides REASONABLE assurance not absolute assurance.
- It is a process – a means to an end not an end in itself.

Benefits of strengthening internal controls

- Safeguard organization assets
- Protect organization's personnel
- Provide reliable/accurate financial information to the Board and Constituents
- Operate effectively and efficiently
- Comply with relevant laws
- To be a hero to your friendly auditor (requirements of SAS 104 – 111)

Set Your Course

- Evaluate Control Environment, or “Tone at the Top”, which serves as the foundation of the control system by providing oversight and structure. [COSO Volume 1 - Executive Summary.pdf](#)
- Identify and Assess (Financial) Risks
- Document Control Activities
- Inform and Communicate
- Monitor your system

Control Environment - Examples

- Clear lines of authority and accountability that emphasize the importance of internal controls
- A documented code of conduct/ethical standards
- A formal budget process and prompt variance analysis

A plan to attract and retain competent personnel

- An effective audit/finance committee and internal audit functions (yes, even in a small organization)

Risk Assessment - Examples

- Clear objectives regarding operating, financial reporting, and law compliance functions
- An entity-wide review to assess and evaluate risk
- Use a risk matrix

		<i>Sample Risk Graph</i>		
	High			Priority Risk
Impact				
	Low	No Action Risk		
		Low	Occurrence	High

Ask:

- What could happen?
- How likely is it?
- What would the damage be?

Types of Threats You should evaluate

- Internal or external fraud – how could it happen in your organization?
- Misuse of assets
- Incomplete, unreliable or improperly reported information
- Damage to reputation by various factors
- Violation of legal requirements
- Risk of programmatic failure

Control Activities - Examples

- Segregation of duties – collections of cash contributions counted by two or more people
- Controlled access to electronic data processing operations and adequate back-up (disaster recovery) in place
- Document control activities of each significant process (cash receipts, cash disbursements, payroll, etc.)

Information & Communication - Examples

- Management support for developing and maintaining effective financial management information systems
- The sharing of information on emerging risk issues with other religious organizations

Channels of communication for employees and church workers to report suspected irregularities or illegal acts (whistleblower policy)

Monitoring - Examples

- Regular receipt and prompt acting on reports of problems in internal controls (from external/internal auditors, etc.)
- Prompt follow-up on unusual variances from budget
- Periodic comparison of physical inventories, fixed assets, and donor system to GL
- Independent review of monthly closing checklists and bank reconciliations
- Periodic review of source documents for adherence to design

Evaluate Control Design – IMPORTANT!

- *Control design will achieve desired goal if implemented correctly*
 - *Example 1 - Cash receipts are counted by two individuals who do not have recording or authorization duties. Properly Designed*
 - *Example 2 - Cash receipts are counted by one individual who has been faithful to the ministry for more than 10 years. Improperly Designed*

Notes On Monitoring

- *Monitor for system, staff and organizational changes (regularly test for effectiveness using controls documentation as a checklist)*
- *Review for open or undiscovered issues*
- *Review trends (donation levels, employee behavior, etc.)*
- *Use internal audit function, or outsource qualified volunteer(s) or professional(s)*
- *Ongoing*

Best Practices

- **Cash Receipts**

- *Written Policies/Procedures*
- *Dual Control until counted*
- *Rotating count teams*
- *Tamper evident bags*
- *Regular constituent statements (with concerns directed to objective party)*
- *Review budget to actual performance and investigate material differences*
- *Reconciliation of donor system to accounting system*
- *Regular (monthly) bank reconciliations by objective party, who does not have recording function*
- *Banking solutions (Remote Deposit Capture, etc.)*
- *Other: Church/Event specific – Security Personnel*

Best Practices

• Cash Disbursements

- *Written Policies/Procedures*
- *Proper thresholds/limits for payment (Petty Cash, Checks (dual signature), Wires/ACHs (dual approval))*
- *Authorized Check Signer (or wire/ACH approver) should not have recording function, and vice versa*
- *Custody of check stock, bank cards/tokens and passwords should be properly restricted*
- *Voided and canceled checks should be properly noted*
- *Use of banking controls such as Positive Pay, Wire/ACH email confirmation, and approved vendors*
- *Regular (monthly) bank reconciliations by objective party, who does not have recording function*
- *Corporate Card Usage Policies and Spending Limits*
- *Adequate review of all expense reports (e.g. Independent board member reviews CEO expense reports)*
- *Monthly review of budget to actual performance with investigation of material differences*
- *Timely review of all journal entries*

Best Practices

- **Payroll**

- *CEO Compensation Set and Approved by Board*
- *Use of Industry Compensation Data for all positions*
- *Potential Outsourcing of Payroll Processing, Benefit Administration and Tax Filings*
- *Timely tax reporting and payment*
- *Inclusion of taxable benefits and exclusion of non-taxable benefits (e.g. Spousal Travel)*
- *Objective review/approval of payroll records for each pay period (e.g. HR Director)*
- *Monthly review of budget to actual performance with investigation of material differences*

Feeling Overwhelmed? Start here...

- 1. Tone at Top** – Executive team, ministers and board should set the tone for sufficient controls and policies...and be willing to follow the rules themselves! (*Treadway Commission found this was the most important factor!*)
- 2. Cash Receipts** – Implement dual control on all incoming deposits. Two people should open the mail, count the deposit, and sign the deposit log together. Use tamper evident bags if someone makes the deposit on their own.
- 3. Cash Disbursements** – Immediately secure blank check stock, require approvals, and have someone independently reconcile the bank statement.

Feeling Overwhelmed? Start here...

- 4. Payroll** – ensure that the CEO’s compensation is reviewed and approved by the board using comparable industry data. Consider the advantages of outsourcing payroll.
- 5. Risk Assessment** – Consider having an annual risk brainstorming session where staff can comment freely on risks they observe. Rate the risks and discuss what can be done to mitigate those risks.
- 6. Consider outsourcing** options for internal controls design, implementation, and testing.

Questions?

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