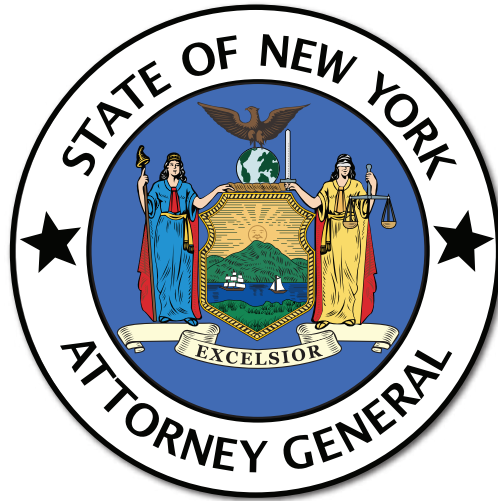


INTERNAL CONTROLS AND FINANCIAL ACCOUNTABILITY FOR NOT-FOR-PROFIT BOARDS



Office of the New York State Attorney General
Charities Bureau
28 Liberty Street
New York, NY 10005

(212) 416-8400

www.charitiesnys.com



INTERNAL CONTROLS AND FINANCIAL ACCOUNTABILITY FOR NOT-FOR-PROFIT BOARDS

**Office of the NYS Attorney General
Charities Bureau
www.charitiesnys.com**

**Guidance Document 2015 - 3, V 1.0
Issue date: April 13, 2015**

The Charities Bureau of the Office of the New York State Attorney General drafted this guidance to assist current and future boards of directors of not-for-profit corporations and trustees of charitable trusts to understand and carry out their fiduciary responsibilities to the organizations they serve. The guidance includes general information concerning internal controls for the protection and oversight of charitable assets. It is not a substitute for advice from a qualified lawyer, independent public accountant or other professional.

The Charities Bureau also publishes *Right from the Start - Responsibilities of Directors of Not-for-Profit Corporations*, which describes basic responsibilities of boards of not-for-profit corporations. That booklet and other publications of interest to directors may be found at <http://www.charitiesnys.com>. The information in this booklet reflects changes to the Not-for-Profit Corporation Law that were included in the [Nonprofit Revitalization Act of 2013](#).

I. INTERNAL CONTROLS

A primary responsibility of a nonprofit's board of directors is to ensure that the organization is accountable for its programs and finances to its contributors, members, the public and government regulators. The development of proper internal controls helps organizations ensure accountability. Accountability requires that the organization comply with all applicable laws and ethical standards; adhere to the organization's mission; create and adhere to conflict of interest, personnel, whistleblower and accounting policies; and protect the rights of members. Each organization must also prepare an annual financial report which must be distributed to all board members. Organizations exempt from taxation must prepare an IRS form 990, 990EZ or 990PF and file it with the Internal Revenue Service. An organization required to register with the

Charities Bureau must file a version of IRS form 990, whether or not it files that form with the IRS. Forms filed with the IRS and/or the Charities Bureau must be made available members of the public who request it.

► **What are Internal Controls?**

Internal controls are policies and procedures that protect the assets of an organization, create reliable financial reporting, promote compliance with laws and regulations and achieve effective and efficient operations. Each organization should adopt internal controls that are appropriate to its particular needs and activities. Internal controls should address accounting and reporting policies and the organization's communication processes, internally and externally, and include procedures for

- √ handling funds received and expended by the organization,
- √ preparing appropriate and timely financial reporting to board members and officers,
- √ conducting the annual audit of the organization's financial statements,
- √ evaluating staff and programs,
- √ maintaining inventory records of real and personal property and their whereabouts, and
- √ implementing personnel, conflicts of interest and whistleblower policies.

II. IMPLEMENTATION AND MONITORING OF INTERNAL FINANCIAL CONTROLS

► **Procedures for Monitoring Assets**

Every organization should have procedures to monitor and keep records of assets received, held and expended. These financial controls should be described in a written document. The procedures should be reviewed with a copy given to directors and officers, trustees, employees and volunteers affected by the policies. It should include procedures for:

- √ preparing an annual income and expense budget and periodic reports - at least quarterly, preferably monthly - comparing actual receipts and expenditures to the budget with timely explanations of variances.
- √ writing and signing checks or vouchers, authorizing use of credit cards and electronic deposits and withdrawals, receiving, recording, securing and depositing cash and other receipts, and authorizing and verifying expenditures. The procedures should ensure that no single individual is responsible for receiving, recording and depositing

funds, and writing and signing checks. Such procedures make embezzlement and misuse of funds more difficult.

- √ ensuring that grants and contributions received are properly recorded, accountings required as a condition of any grant are completed, and restrictions on the use of funds, such as contributions given for a restricted purpose or prohibitions on the use of the principal of an endowment, are obeyed.
- √ accessing, inputting and changing electronic data maintained by the organization.
- √ preserving electronic records, protecting private data, ensuring data compatibility when systems change and creating an appropriate records retention policy.
- √ providing for regular oversight by an audit committee or, if there is no audit committee, by the board of directors itself.¹
- √ preparing for the annual audit process in a timely manner.
- √ reporting to the audit committee or board by employees, contractors and volunteers of allegations of fraud or financial improprieties.
- √ ensuring that timely and appropriate financial reports are distributed to all directors and officers and reviewed by them, as well as the president, chief executive officer, treasurer and chief financial officer.
- √ providing procedures for approving contracts to which the organization is a party, including securing competitive bids from vendors.
- √ making clear the responsibilities of all individuals involved with the organization, including directors, officers, employees, volunteers and consultants, and maintaining an organizational chart and updating such information as necessary.
- √ developing a prudent investment strategy and providing proper oversight of the investment assets.
- √ complying with governmental and other reporting requirements, including watchdog agencies.

¹ Under New York's Not-for-Profit Corporation Law, corporations required to file an audit with the Attorney General's Charities Bureau must have an audit committee made up of independent directors or the board must assume that function with only independent members participating. Independent directors are members of the board who are not paid by the organization and neither they nor their family members have any financial relationship with the organization.

√ complying with obligations to members, employees and the public, including their right to a copy of the organization's annual financial report.

► **Various Roles in the Organization**

A nonprofit should have written job descriptions for its directors, officers, employees, volunteers and consultants. The work of the organization will be more easily accomplished and problems will be avoided if all involved understand what is expected of them and the limits of their authority. A comprehensive description of the chief executive officer's job should make clear that person's responsibilities in the day-to-day activities of the organization and set forth exactly what information is expected by the board and when it must be communicated. For example, if the board expects monthly financial reports and bi-monthly programmatic reports, making those expectations clear from the beginning will avoid ambiguity and will clarify the responsibility for accountability to the board.

Likewise, all other employees should have written job descriptions that advise them of what is expected of them. Volunteers are no exception. They should be given job descriptions that clearly describe what is expected of them. For many organizations, volunteers are the only people who conduct programs and have contact with the public. If they do not understand their responsibilities or do not act professionally, the organization could be at risk.

► **Personnel Policies**

Personnel policies, including vacation and sick leave, health insurance and other benefits, evaluations, ordinary and overtime compensation, conflicts of interest and code of ethics, and grievance procedures (including protections for "whistle blowers") should be in writing and given to all employees prior to hiring, with changes in policies communicated on a regular basis.

► **Training**

Appropriate training should be arranged for all involved. New directors, officers, employees and volunteers should be trained by those who are familiar with the organization and its operations. There are many organizations that provide free or low-cost training for board members and others involved with nonprofits. Also, there are numerous resources that provide guidance and training to nonprofits. Some of those resources are listed on the Attorney General's website – www.charitiesnys.com. For all involved, familiarity with the organization's internal controls is essential. Training is a wise investment!

► **Conflicts of Interest Policies and Code of Ethics**

Directors, officers, trustees, employees and others who serve a nonprofit organization may have personal or business interests that may conflict with their responsibilities to the organization. The Nonprofit Revitalization Act of 2013 enacted a new section 715-a of the Not-for-Profit Corporation Law ("N-PCL") and a new section 8-1.9 of the Estates, Powers and Trusts Law ("EPTL") requiring nonprofits and charitable trusts to adopt and follow a conflicts of

interest policy. Those statutes set forth the procedures to be followed if a board member's personal or financial interests may be advanced by an action of the board.

The conflicts of interest policy must require an individual to disclose any interest the individual and/or the individual's family has in any entity that does business with the organization and that any change in the information concerning potential conflicts should be provided to the organization immediately. The policy should be set forth in the organization's by-laws.

The policy must require that an individual with a conflict may not participate in any decision to approve doing business with the individual or any entity in which the individual or his or her family has an interest, and such decision must be made by a disinterested majority of the board of directors or trustees. Officers, directors and key employees should be provided with the conflict of interest policy and be required to disclose any actual or potential conflicts they may have.

The organization should also have a code of ethics addressing issues such as transparency, disclosure in fundraising solicitations, integrity in governance and diversity.

Additional guidance on the adoption and implementation of conflict of interest policies is posted on the Charities Bureau's web page at www.charitiesnys.com.

► **Auditing a Nonprofit's Finances**

The Nonprofit Revitalization Act of 2013 created a new section 712-a of the N-PCL and a new section 8-1.9 of the EPTL requiring nonprofits and charitable trusts to have the audit overseen by an audit committee made up of independent directors² (or independent members of the entire board must assume that function) if they are required to file an annual audit with the Charities Bureau under Article 7-A of the Executive Law.

Whether or not a nonprofit is required to file an audit with the Charities Bureau, it may be required by other laws or by its funders to have an audit. A nonprofit's board may also decide to have its finances audited as part of the oversight of its assets.

Before commencing an audit, a nonprofit should form an audit committee composed of independent directors and engage an *independent* Certified Public Accountant ("CPA") to conduct the audit. An independent CPA is an individual or company who does not have a financial or other relationship with the nonprofit other than being paid for accounting functions. For example, this means that the CPA can't be a member of the organization's board, a paid employee, a relative of an employee or have other professional or financial dealings with the organization.

Additional information concerning the audit oversight responsibilities of nonprofits is posted on the Charities Bureau's web page at www.charitiesnysnys.com.

² Section 102(a)(21) of the Not-for-Profit Corporation Law sets forth the definition of Independent Director.

► **Review of the Organization’s Governance Structure, Procedures and Programs**

Periodic review of an organization’s structure, procedures and programs will assist board members in determining what is working well and what practices the organization might want to change in order to be more efficient, effective or responsible.

III. MAKE USE OF AVAILABLE RESOURCES

In carrying out their responsibilities, board members should realize that they do not need to it alone. There are many resources available to assist nonprofit organizations in fulfilling their fiduciary duties.

Following are some of those resources:

√ **The Attorney General's Web site** - www.charitiesnys.com - posts all forms and instructions for registration and annual filing with the Charities Bureau and publications of interest to nonprofit organizations, including guidance on the Nonprofit Revitalization Act of 2013.

√ **Contact Us** - If the material on the Attorney General's web site does not answer your particular questions -

For questions about nonprofit organizations, contact:
charities.bureau@ag.ny.gov or (212) 416-8401

For questions about fundraising professionals, contact:
charities.fundraising@ag.ny.gov or (518) 486-9797

√ **Other Helpful Web Sites** - Many more resources are available on the Internet and in communities around the state. Links to some of those resources are posted on the Attorney General's web site – www.charitiesnys.com . Please note that inclusion of any particular entity should not be construed as an endorsement by the Attorney General of that entity or the services it renders.