

Nonprofit Resource Center



Development of Policies and Procedures

Gerry Zack, CPA, CFE, CCEP

Nonprofit Resource Center

Zack, P.C.

www.nonprofitresource.com

www.zackpc.com



GERARD M. ZACK, MBA, CFE, CPA, CCEP
President – Zack, P.C.
Founder – Nonprofit Resource Center, Inc.
Rockville, MD

Gerard Zack is the president of Zack, P.C., which specializes in providing internal control, internal audit, fraud prevention consulting, fraud investigation, and governance consulting for nonprofit organizations, businesses and government agencies throughout the U.S. and Europe. Gerry is based in Rockville, Maryland and has provided audit and anti-fraud services for clients of all types and sizes since 1981. For more information about Gerry and Zack, P.C., go to www.zackpc.com.

Gerry also is the founder of the Nonprofit Resource Center, through which he provides training and online financial management tools specifically geared towards the unique internal control and financial management needs of nonprofit organizations. For more information about NRC, go to www.nonprofitresource.com.

Mr. Zack is a Certified Fraud Examiner and CPA and has focused most of his career on audit and fraud-related services. Gerry is recognized as one of only nine Fellows in the 50,000-member Association of Certified Fraud Examiners based on his contributions to the anti-fraud field. Gerry is also a Certified Compliance and Ethics Professional.

Gerry is the author of *Fair Value Accounting Fraud: New Global Risks and Detection Techniques* (August 2009 by John Wiley & Sons) and *Fraud and Abuse in Nonprofit Organizations: A Guide to Prevention and Detection* (published in 2003 by John Wiley & Sons). He is also the author of numerous articles on fraud and teaches seminars on fraud prevention and detection for businesses, government agencies, and nonprofit organizations. He has been brought in by more than 50 CPA firms to provide customized internal staff training on specialized auditing issues, including SAS 99 and fraud detection in audits, and has trained chief financial officers of all types of nonprofit organizations. He is a frequent speaker at national conferences, including the Annual Conference of the ACFE, the AICPA Not-for-Profit Industry Conference, National Association of Counties, and many more.

Mr. Zack earned his M.B.A at Loyola College in Maryland and B.S.B.A at Shippensburg University of Pennsylvania. He can be contacted at (301) 987-0287 or by email at Gerry@zackpc.com.

Development of Policies and Procedures

DEVELOPMENT OF
POLICIES & PROCEDURES

by
Gerard M. Zack, CPA, CFE, CCEP
President – Zack, P.C.
Founder – Nonprofit Resource Center
www.nonprofitresource.com

Agenda

- Discussion of format and content of policies and procedures
- Overview of a model of strong internal controls
- Discussion of specific policies and procedures
- Explanation of tax-related policies and procedures

Policy

- A statement of an organization's approach to a particular issue
- It is a guide or governing principle
- Rules that govern either the organization taken as a whole or individual departments/functions

Development of Policies and Procedures

Procedure

- Each procedure should be linked to a policy
- Describes the implementation of a policy
- Describes the steps that are expected to be taken in order to properly implement and comply with the policy
- Procedures may also identify the forms used in connection with a procedure and policy

Why do we need policies and procedures?

Purposes of P&P

- Facilitates training of staff
 - New staff
 - Fill-ins while staff away on vacation
 - Job rotation
 - Temporary workers
- Demonstrates commitment to sound internal controls
- Reduces organizational risk in the event of harm to third parties or noncompliance with laws, regulations, or grant provisions

Development of Policies and Procedures

Purposes of P&P

- Provides a clearer audit trail for purposes of audits, investigations, etc.
- Demonstrates compliance with IRS expectations on the revised Form 990

Policies and Procedures vs. Internal Controls

Internal Control - Defined

- A process – effected by those charged with governance, management, and other personnel – designed to provide reasonable assurance about the achievement of an entity's objectives.
- Framework developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), which issued *Internal Control – Integrated Framework* (1992)

Development of Policies and Procedures

Three Objectives of I.C.

- 1) Effectiveness and efficiency of operations
- 2) Reliability of financial reporting
- 3) Compliance with applicable laws and regulations

Safeguarding of Assets

- Is a subset of each of these 3 objectives
- Internal control should provide assurance
- that assets are safeguarded from:
 - Ineffective or inefficient use
 - Unauthorized acquisition, use, disposal, or theft (fraud)
 - Illegal use

Components of Internal Control

- 1) Control environment
- 2) Risk assessment
- 3) Control activities
- 4) Information and communication
- 5) Monitoring

Development of Policies and Procedures

1. Control Environment

- Integrity & ethical values of management
- Commitment to competence
- Board oversight & interaction w/auditors
- Management philosophy regarding risk
- Organizational structure
- Assignment of authority & responsibility
- Human resource policies

2. Risk Assessment

- Organization's identification & analysis of relevant risks in relation to achievement of objectives, such as:
 - ▣ Changes in regulatory environment
 - ▣ New personnel
 - ▣ New systems or technology
 - ▣ Rapid growth or downsizing
 - ▣ New programs, grants, services

3. Control Activities

- Policies & procedures to help ensure that management directives are carried out:
 - ▣ Physical controls (facilities)
 - ▣ Information processing (e.g. those that check accuracy, completeness & authorization of transactions)
 - ▣ Performance reviews (e.g. budget to actual)
 - ▣ Segregation of duties

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4. Information & Communication

- Methods & records used to record, process, summarize, & report transactions & to maintain accountability over assets, liabilities, & net assets:
 - Accounting records
 - Accounting processing
 - Financial reporting process
 - Communication of employee duties and responsibilities
 - Disaster recovery

5. Monitoring

- Assessing the quality of internal control performance over time, including taking corrective action, using:
 - Internal audit
 - External audit
 - Special assessments of internal controls
 - Input from personnel
 - Input from third parties (e.g. donors, grantors, vendors, etc.)

Application of Internal Controls

- Each of the five inter-related components have application to each of the three objectives of internal control:
 - Operations
 - Financial reporting
 - Compliance
- Each of the five components may apply on an organization-wide basis or may differ by:
 - Location
 - Function
 - Department, division or program (unit)

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Deficiencies in Internal Control

- Deficiency in the design of internal control
- Deficiency in the application of internal control
 - A subset of this may also include deficiencies in the documentation of internal controls
- Intentional over-ride of an internal control

4 Types of Internal Controls

- Preventive
 - Designed to prevent errors, fraud, or illegal acts from being committed
 - Distinguish preventive policies from preventive controls (e.g. requiring two signatures on checks)
- Detective
 - Designed to detect errors, frauds, or illegal acts and allow for corrective action
 - Example: bank account reconciliation

4 Types of Internal Controls

- Directive
 - Proactive controls that cause or encourage a desirable event to occur
 - Examples: incentive programs, training, etc.
- Mitigating (Compensating)
 - Controls that compensate for the lack of an expected control
 - Lessen the severity of a weakness in controls

Development of Policies and Procedures

Characteristics of Policies & Procedures

- Don't create without intending to implement and enforce
- Be specific
- Use clear language (avoid legalese)
- Identify who is responsible
- Keep updated
- State effective dates (and retain prior policies and procedures for audit purposes)
- Determine and state who they apply to

Elements of an Organizational System of Internal Control

1. Financial Controls
 - a. Preventive controls
 - b. Detective controls
2. Non-Financial Controls and Systems

Key Elements of Internal Controls

- Financial Controls
- Specific internal controls regarding specific transactions (e.g. cash receipts, payroll, check writing, purchasing, etc.)
- Nonfinancial Controls
- Human resources
 - Information technology
 - Grants management
 - Insurance and risk management
 - Management oversight
 - Board and audit committee oversight

Development of Policies and Procedures

Specific Policies and Procedures
Designed to Achieve Strong
Internal Controls

Segregation of Duties

- Separate Incompatible Duties
- For Example, If One Person Makes a Mistake, Another Person Identifies and Corrects the Mistake
- One Important Goal: Make it Impossible to Commit and Conceal a Fraud or to Make a Mistake Without Anyone Catching it (i.e. Detective Controls)
- Example: Separate Functions Involved in Handling Funds From Those Involved With Recording Them in the Accounting Records

Segregation of Duties in Small NPOs

- Segregate the Most Essential Detective Duties
- May Need to Involve a Board Member
 - e.g. Have bank statements mailed directly to a board member for his/her review prior to returning them to the bookkeeper

Development of Policies and Procedures

Purchasing Controls - General

- Purchase Order System
- Procurement Authorization Policies
- Policies and Processes for Solicitation and Evaluation of Bids from Vendors
- Contract Review
- Conflict of Interest Policies
- Controls Over Establishment of Vendors in Accounts Payable Master Files
- Use of Separate Accounts to Track Refunds

The RFP Process

- Involve Multiple Personnel in Preparing the RFP
- Develop Comprehensive RFP With Specific Criteria
- Develop Scoring Sheet (Assign Percentage Weighting to Each Criterion) and Include in the RFP to Ensure Objectivity in Evaluating Vendors
- Strict Adherence to Deadlines, Procedures
- Multiple People Involved in Grading the Proposals

Payment Approval

- Require Original Invoices (no copies or statements accepted)
- Match With Receiving Reports
- Match With Purchase Order
- Match With Vendor Bid/Proposal
- Review of Invoice
 - Mathematical accuracy
 - Description of goods or services
 - Quantities and prices
 - Vendor information
- Documented Approval by Purchasing Agent
- Cancellation of Invoice

Development of Policies and Procedures

Detective Controls

- Budget to Actual Expense Analysis
- Trend Analysis
- Ratio Analysis
- Periodic Review of Vendor Histories
 - Patterns, duplicate payments, etc.
- Review of Data in Vendor Master Files
 - Completeness
 - Match addresses and other data

Expense Report Controls

- Travel Authorizations in Anticipation of all Trips
- Limit Travel Advances and Have Employee Authorize Deduction From Pay if not Accounted for
- Timely Preparation and Submission of Expense Report
- Appropriate Supporting Documentation
- Establish and Monitor Travel Budgets
- Per Diems or Specific Documentation Requirements

Supporting Documentation

- Itemized Hotel Bills for Lodging
 - Do not accept credit card receipts
- Receipts for Meals, Entertainment
- Boarding Passes and Receipts for Airfare
 - Proof that trip was taken – itineraries only show that a reservation was made

Development of Policies and Procedures

Expense Report Review

- Mathematical Accuracy
- Match Authorized Dates of Travel With Supporting Documentation
 - ▣ Watch for extra nights of lodging, etc.
- Original Supporting Documentation
 - ▣ Vendor invoices (hotels, etc.), not just credit card receipts
- Documentation of Business Purpose, etc. per IRS Requirements
- Compare all Information on Receipts

Expense Report Review

- For Airfare, Match Ticket Numbers, Passenger Names and Dates of Travel
- Cross-Check Meals and Entertainment With Expense Reports of Co-Workers Also in Attendance
- For Asset Purchases, Verify Organization Receipt (Examine Delivery Address, etc.)

Revenue & Cash Receipts Controls

- Segregation of Duties
 - ▣ Billing
 - ▣ Recording revenue
 - ▣ Opening mail
 - ▣ Bank deposits
 - ▣ Posting receipts
 - ▣ Bank reconciliations

Development of Policies and Procedures

Cash Receipts Processing

- Immediate Restrictive Endorsements of Checks
- Dual Control or Lockbox System
- Preparation of Permanent Record
- Timely Deposits
- Matching Permanent Record With Deposits
- Matching Deposits with A/R Postings

Processing of Credit Card Payments

- Security over credit card numbers
- Controls over processing of payments received

Additional Controls for Contributions

- Use and Reconciliation of Business Reply Mail for Solicitations
- Publication of Donor Names
- Controls Over Acknowledgement Letters and/or Receipts (not very reliable as a control)
- Periodic/Annual Donor Statements
- Rotation of Duties and Analysis of Recorded Contributions

Development of Policies and Procedures

Accounts Receivable

- Billing of Grants Tied to Underlying Costs or Level of Effort Reporting and Documentation
 - And segregate billing from record-keeping associated with providing of services
- Proper Levels of Authorization and Approval (Segregated from Receipt of Payments) for:
 - Discounts
 - Refunds and credits
 - Price adjustments
 - Bad debt write-offs

Detective Controls for Revenue

- Comparing Recorded Revenue With Budgets and Prior Years (trend analysis)
- Reasonableness Testing of Specific Accounts
 - Use of independent data to calculate expected revenue, then compare to actual
- Periodic Reviews of Customer Activity Reports (and/or customer statements)
- Monitor Aging of Receivables
- Review all A/R Credits, Write-offs
- Review Non-Cash JE's to Cash Accounts

Check Preparation

- Secure Storage of Check Stock
- Pre-Numbered Checks (reconciled)
- No Pre-Signed Checks
- Two Signatures
- Use Checks that are Difficult to Alter
- Appropriate Voiding of Checks
- Use of "Positive Pay" System

Development of Policies and Procedures

Bank Reconciliation Procedures

- Consider Having Treasurer/Board Member Receive Bank Statement or Prepare Bank Rec. if Lack of Segregation of Duties
- Review Statement for Duplicate Checks or Un-Numbered Checks
- Investigate Gaps in Check Numbers
- Review Statement for Other Debits
- Examine Returned Checks
 - Signs of alteration or forged signatures
 - Review endorsements for consistency
- Compare Payees With Check Register or Disbursements Journal
- Verify Lists of Voided Checks

Payroll Controls

- Segregation of Duties
 - New Hire Set Up & Deletion of Terminated Employees
 - Authorization of Pay Rates & Adjustments
 - Entering Timesheet Information
 - Calculation of Payroll
 - Authorization of Payroll
 - Check Preparation (and signing, if applicable)
 - Distribution of Payroll to Employees
 - Reconciliation of Payroll Account

Payroll Controls

- Documentation
 - Pay rates and adjustments
 - Withholdings and deductions
- Timekeeping Policies
 - Preparation by employee only
 - Authorization of hours worked by supervisor
- Access Controls Over Payroll Database
- Use of Separate Payroll Account Using Pre-Numbered Checks
 - Restrict access to checks

Development of Policies and Procedures

Payroll Controls

- Compare Number of Paychecks to Number of Employees
- Analyze Employee Deductions and Withholdings
 - ▣ Follow up on employees with no deductions and limited tax withholdings
- Cross-Check Bank Accounts Into Which Direct Deposits are Deposited
- Cross-Check Addresses, SSNs, etc.
- Review Patterns of Overtime Hours

Fundraising Issues

- Deductibility of Gift Received From Donor
 - ▣ Beware of agency relationship; Agent's actions are attributable to the NPO
- What Portion of Proceeds Will be Used in Organization's Programs
 - ▣ Beware of agency relationship
- What Gifts to Accept
- Compliance With Donor Restrictions

Compliance With Donor Restrictions

- Clarity in Fundraising Solicitations
- Offsetting Proceeds Against Cost of Raising the Funds
- Charging of Indirect Costs to the Purpose/Program
- Use of Funds Received in Excess of Stated Goal
- Inability to Use all Funds for Stated Purpose

Development of Policies and Procedures

Tax-Related Policies and Procedures

Form 990 and Tax P&Ps

- Private inurement – prohibited
- Political intervention – prohibited
- Lobbying – limited, but allowable (but cannot charge to government awards)
- Audit committees
- Conflicts of interest
- Approval of compensation
- Donor advised funds

Form 990 and Tax P&Ps

- Review and approval of Form 990
- Independence
- Whistleblower policy
- Record retention/destruction
- State registrations and filings
- Fundraising issues and controls
- Involvement in joint ventures with taxable entities
- Many others.....

Development of Policies and Procedures

**Non-Financial Controls
Policies and Procedures**

Non-Financial Systems

- Several Non-Financial Systems Are Important to Internal Control and Fraud Protection
- Among the Most Important:
 - Human Resources Systems
 - Physical Security
 - Information Technology Systems
 - Communications Systems/Whistleblower Policies
 - Insurance Protection
 - Management Behavior and Oversight
 - Board Oversight
 - Audit Functions

Human Resources Systems

- Hiring Policies and Practices
- New Employee Orientation
- Code of Ethics and Related Policies
- Performance Evaluation Systems
- Compensation Adjustment Practices
- Grievance Policies
- Counseling of Troubled Employees
- Exit Interviews

Development of Policies and Procedures

Hiring Practices (1)

- Identity Verification
 - ▣ Cross-checks historical data to verify social security number
- Background Checks
 - ▣ Criminal convictions (felonies and misdemeanors)
 - ▣ Driving records
 - ▣ Other public records searches (civil suits, bankruptcy, etc.)
- FCRA Implications
 - ▣ Disclosures and written authorization

Hiring Practices (2)

- Consider State Laws and Cases
 - ▣ Relevance of background data searched in relation to position applied for
 - ▣ How far back to consider background data
- Qualifications Verification
 - ▣ Credentials fraud (degrees, certifications, positions held)
- Honesty/Integrity Testing
 - ▣ Professionally designed and validated tests only
 - ▣ Assess overall honesty and integrity of applicant

Employee Orientation

- Set the Tone for Ethical Behavior
- Review all Employee Conduct Policies
- Emphasis by Senior Management
 - ▣ Great time for an appearance by senior management
- Signatures Representing Acceptance of Policies (e.g. Code of Ethics, etc.)

Development of Policies and Procedures

Codes of Ethics

- Two Approaches to Drafting
 - ▣ Detailed – identifying specific acts
 - ▣ Broad – conduct in general terms
- If Broad, Cross-Reference Other Written Policies, Such as Personnel Manual, etc.
- Have Employees Sign, Acknowledging They Understand it and Agree to Comply With it
- Training and Periodic Re-certification

Ethics Training Topics

- Code of Ethics
- Conflicts of Interest
- Ethical Issues
- Kickbacks
- Hotline Usage & Other Methods of Reporting
- Protection from Retaliation
- Each Person's Role in Maintaining an Ethical Workplace

The Value of Ethics Training

- With Fraud Awareness or Ethics Training:
 - ▣ Median Loss = \$100,000
 - ▣ Median Months to Detection = 15
- Without:
 - ▣ Median Loss = \$200,000
 - ▣ Median Months to Detection = 24

Development of Policies and Procedures

Policy on Suspected Misconduct

- Functions in Conjunction With Code of Ethics
- Identifies How to Report Suspected Activities
- Incorporates Whistleblower Protection Provisions
- States Employer's Rights
 - ▣ Including right to inspect and search employee files, lockers, desks, etc. that are provided as an employee convenience by the employer
- Explains Disciplinary Actions That May Result, Including Termination

Conflict of Interest Policies

- Duty of loyalty – cannot serve two masters
- Require disclosure of conflicts with persons/entities with a direct or indirect financial interest
 - ▣ Entities in which ownership interest is held
 - ▣ Certain family members (specify)
- Should require two actions:
 - ▣ Disclosure by the conflicted person
 - ▣ Resolution in accordance with NPO policy, including nonparticipation by the conflicted person in making any decisions

Components of a Conflict of Interest Policy

- Who is covered
 - ▣ Board, employees, family members, and entities under the control of these individuals
- Scope of activities and relationships covered – define what a conflict is
- Standards and procedures for
 - ▣ Disclosure
 - ▣ Resolution
 - ▣ Documentation
 - ▣ Disciplinary action for failure to disclose

Development of Policies and Procedures

Performance Evaluation & Compensation

- Fairness
 - Involve multiple people in processes
 - Clear communication of expectations and criteria for evaluation
- Consistency
 - Application of policies
 - Forms and formats
 - Methods of delivery
- Perceived Inequities are Common Motive for Fraud

Grievances and Counseling

- Open-Door Policy for Communication of Grievances
- Formal Policies for Addressing Grievances Involving Direct Supervisors and Co-Workers
- Confidential Counseling for Troubled Employees (Reduces Risks Associated With External Motives)

Exit Interviews

- Last Chance to Obtain Valuable Information
- May be Willing to Disclose Information That They Were Previously Uncomfortable With
- Separate Meetings With Supervisor and H.R. Representative
- Inquire About:
 - Organization's systems of fraud protection
 - Awareness of fraud and abuse

Development of Policies and Procedures

Physical Security

- Who has access?
- During what times?
- Using what method of restricting access?
- Updated how frequently?

Controls

- Restrict Access to Data
 - ▣ Limit and screen personnel with access
 - ▣ Keep under lock and key (and never leave out while away from work station)
 - ▣ Restrict use of photocopier (most common method of stealing this information)
- Document and Data Destruction Policies

IT Controls

1. Governance
 - a) Policies
2. Management
 - a) Standards
 - b) Organization and management
 - c) Physical and environmental controls
3. Technical
 - a) Systems software controls
 - b) Systems development controls
 - c) Application-based controls

Development of Policies and Procedures

3.a. Systems Software Controls

- 1) Access rights allocated and controlled according to stated policy
- 2) Division of duties enforced via software and configuration controls
- 3) Intrusion and vulnerability assessment, prevention, and detection in place and monitored
- 4) Intrusion testing on a regular basis
- 5) Encryption services applied where necessary
- 6) Change management processes in place (patches, changes to software, etc.)

3.b. Systems Dev. & Acq. Controls

- 1) User requirements documented and achievement measured
- 2) Systems design and development follows formal process to ensure that needed requirements and controls are designed into the system
- 3) Testing should ensure the individual system elements work as required, system interfaces operate as expected, users are involved in testing, and intended functionality is achieved
- 4) Application maintenance, including change management, follows consistent and structured pattern

3.c. Application-Based Controls

- Objectives:
 - 1) Input data is accurate, complete, authorized and correct
 - 2) Data is processed as intended
 - 3) Data stored is accurate and complete
 - 4) All output is accurate and complete
 - 5) A record is maintained to track the process of data from input to storage, and to the eventual output

3.c. Application-Based Controls

- 1) Input controls – integrity of data entered
- 2) Processing controls – processing is complete, accurate, and authorized
- 3) Output controls – compare results with intended result and check against input
- 4) Integrity controls – monitor data in process and/or in storage to ensure it remains consistent and correct
- 5) Management trail – audit trail enables the tracking of transactions from source to result

Examples of Application Controls

- Sign Checks
- Data Matching
- Validity Checks
- Range and Limit Checks
- Field Checks & Required Field Checks
- Document Cancellation
- Pre-Number Sequence Testing
- Batch Totals
- Password protection – “read-only” rights
- Auto log-off features

Protection of Hardware

- Inventory & Physical Security
- Special Considerations for Laptops:
 - Make Boot up Impossible Without Passwords
 - Auto Log-off
 - Establish Policies Regarding What Data and Software May be Taken Off-Site
 - Data Encryption Software if Data Will be Transmitted to/from Off-site
 - Security Software

Development of Policies and Procedures

Communications

- Organization Chart
 - Clear understanding of lines of communication
- Access to Audit Committee
 - Or equivalent board-level representatives
- Hotlines
 - Anonymous reporting of suspected fraud and abuse, or any other misconduct, by employees
- External
 - Crisis management

Hotlines

- Allows for Anonymous Reporting of Suspected Wrongdoing
- Utilize Third-Party Services (EthicsLine of Association of CFE's; The Network; Pinkerton Security; Other Services)
- FraudNet, a Service of GAO to Report Wrongdoing Involving Federal Funds
 - fraudnet@gao.gov or
 - (202) 512-3086

Detection of Fraud

Methods of Fraud Detection:	NPO	Overall
□ Tips	48.8%	46.2%
□ Internal Controls	24.8%	23.3%
□ By Accident	10.7%	20.0%
□ Internal Audit	13.2%	19.4%
□ External Audit	14.9%	9.1%
□ Notified by Police	1.7%	3.2%

Source: 2008 ACFE Report to the Nation on Occupational Fraud and Abuse

Development of Policies and Procedures

Tips Came From:

- Employee – 57.7%
- Customer – 17.6%
- Vendor – 12.3%
- Shareholder/Owner – 9.2%
- Anonymous – 8.9%
- Competitor – 1.0%

Source: 2008 ACFE Report to the Nation on Occupational Fraud and Abuse

The Value of Hotlines

- Nonprofits With Hotlines
 - Median Loss = \$50,000
 - Months Prior to Detection = 12
- Nonprofits Without Hotlines
 - Median Loss = \$124,000
 - Months Prior to Detection = 30

Source: 2008 ACFE Report to the Nation on Occupational Fraud and Abuse

Hotlines

- Consider Method of Reporting:
 - Telephone interview
 - Voicemail service
 - Web-based format
- Consider Protocol for Dissemination of Information:
 - Direct to audit committee
 - Compliance officer
 - Human resources
 - Internal audit

Development of Policies and Procedures

Hotlines

- Consider Method of Reporting:
 - Telephone interview
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Promote the Hotline

- Personnel Manual and Other Policy Manuals
- Staff Meetings
- Memos/Newsletters
- Postings in Break Rooms
- Intranet

Day-to-Day Management

- Understanding Responsibilities and Risks
- Setting an Example – Follow all Policies
 - "Tone at the top"
 - Communicate seriousness of internal control
- All Supervisors and Managers Have Responsibilities
 - "Tone at the middle"
 - Awareness of red flags of problems
- Enforcement of Policies
 - And reward ethical behavior
- Responding to Fraud and Deficiencies in I.C.
- Open-Door Policies – Receive Communications Regarding Allegations of Wrongdoing
- Corrective Actions

Development of Policies and Procedures

Building an Ethical Culture

- Responsibility of management
- Critical in minimizing organizational liability for harm done to third parties based on actions of employees and volunteers
- Consider U.S. Sentencing Guidelines as basis for developing a program
 - Having these elements in place can be used to reduce penalties assessed to corporations

Audit Committee Functions

- Oversee All Audit Functions
 - Selection, Planning, etc.
- Review and Approve Audit Reports
- Oversee Corrective Actions in Response to Auditor Findings
- Monitor Adequacy of Internal Controls
- Receive Communications
- Investigate Allegations of Fraud

Audit Committee Functions (2)

- Monitor Compliance With Code of Conduct
- Manage Conflicts of Interest
- Monitor Adequacy of Insurance Protection
- Assess Financial Risks Due to Current Operating Environment

Financial Oversight

- Budgeting
 - ▣ Establishing budgets
 - ▣ Variance analysis
- Financial Analysis
 - ▣ Analysis of financial statements
 - ▣ Trend analysis
 - ▣ Ratio analysis
 - ▣ Benchmarking

For More on Fraud and Internal Controls, See:

Fraud and Abuse in Nonprofit Organizations: A Guide to Prevention and Detection

by Gerard M. Zack, CFE, CPA, MBA

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CONTACT INFORMATION

Gerard M. Zack, CPA, CFE, CCEP
Nonprofit Resource Center, Inc.
Zack, P.C.
1700 Rockville Pike, Suite 400
Rockville, MD 20852
Tel: (301) 987-0287
E-Mail: gerry@zackpc.com

POLICY ON STANDARDS FOR FINANCIAL MANAGEMENT SYSTEMS

In accordance with OMB Circular A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*, Example NPO maintains a financial management system that provides for the following. Specific procedures to carry out these standards are detailed in the appropriate sections of this manual.

1. Accurate, current, and complete disclosure of the financial results of each Federally-sponsored project or program in accordance with the reporting requirements of A-110 and/or the award.
2. Records that identify adequately the source and application of funds for Federally-sponsored activities. These records shall contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, outlays, income, and interest.
3. Effective control over and accountability for all funds, property, and other assets. Example NPO shall adequately safeguard all such assets and assure they are used solely for authorized purposes.
4. Comparison of outlays with budget amounts for each award. Whenever possible, financial information shall be related to performance and unit cost data.
5. Written procedures to minimize the time elapsing between the transfer of funds to Example NPO from the U.S. Treasury and the issuance or redemption of checks, warrants, or payments by other means for program purposes by the recipient.
6. Written procedures for determining the reasonableness, allocability and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award.
7. Accounting records including cost accounting records that are supported by source documentation.

CONFLICTS OF INTEREST

Introduction

In the course of business, situations may arise in which an Organization decision-maker has a conflict of interest, or in which the process of making a decision may create an appearance of a conflict of interest.

All directors and employees have an obligation to:

1. Avoid conflicts of interest, or the appearance of conflicts, between their personal interests and those of the Organization in dealing with outside entities or individuals,
2. Disclose real and apparent conflicts of interest to the Board of Directors, and
3. Refrain from participation in any decisions on matters that involve a real conflict of interest or the appearance of a conflict.

What Constitutes a Conflict of Interest?

All employees and directors of Example NPO owe a duty of loyalty to the Organization. This duty necessitates that in serving the Organization they act solely in the interests of the Organization, not in their personal interests or in the interests of others.

The persons covered under this policy shall hereinafter be referred to as “interested persons.” Interested persons include all members of the board of directors and all employees, as well as persons with the following relationships to directors or employees:

1. Spouses or domestic partners
2. Brothers and sisters
3. Children, grandchildren, and great grandchildren
4. Spouses of individuals listed in 2 and 3
5. Corporations, partnerships, LLCs, and other forms of businesses in which an employee or director, either individually or in combination with individuals listed in 1, 2, 3, or 4, collectively possess a [35%] or more ownership or beneficial interest

Conflicts of interest arise when the interests of an interested party may be seen as competing with those of the Organization. Conflicts of interest may be financial (where an interested party benefits financially directly or indirectly) or nonfinancial (e.g. seeking preferential treatment, using confidential information).

Examples of conflicts of interest include, but are not limited to, situations in which a director or employee:

1. Negotiates or approves a contract, purchase, or lease on behalf of the Organization and has a direct or indirect interest in, or receives personal benefit from, the entity or individual providing the goods or services;

2. Negotiates or approves a contract, sale, or lease on behalf of the Organization and has a direct or indirect interest in, or receives personal benefit from, the entity or individual receiving the goods or services;
3. Employs or approves the employment of, or supervises a person who is an immediate family member of the director or employee;
4. Sells products or services in competition with the Organization;
5. Uses the Organization's facilities, other assets, employees, or other resources for personal gain;
6. Receives a substantial gift from a vendor, if the director or employee is responsible for initiating or approving purchases from that vendor.

Disclosure Requirements

A director or employee who believes that he/she may be perceived as having a conflict of interest in a discussion or decision must disclose that conflict to the group making the decision. Most concerns about conflicts of interest may be resolved and appropriately addressed through prompt and complete disclosure.

Therefore, Example NPO requires the following:

1. On an annual basis, all members of the Board of Directors, the [Executive Director], members of senior management, and employees with purchasing and/or hiring responsibilities or authority shall inform, in writing, the [Executive Director] and the chair of the [Audit {Finance} Committee], of all reportable conflicts or confirm that there are no conflicts to report.
2. Prior to the preparation of the disclosure statements, the accounting department shall distribute a list of all vendors with whom the Organization has transacted business at any time during the preceding year, along with a copy of the disclosure statement;
3. The [Executive Director] shall review all forms completed by employees, and the [Audit {Finance} Committee] shall review all forms completed by directors and the [Executive Director], and determine appropriate resolution in accordance with the next section of this policy.
4. If a conflict arises during the year, the employee or board member will immediately notify the [Executive Director] who will determine appropriate resolution.

Resolution of Conflicts of Interest

All real or apparent conflicts of interest shall be disclosed to the [Audit {Finance} Committee] and the [Executive Director] of the Organization. Conflicts shall be resolved as follows:

- The [Audit {Finance} Committee] shall be responsible for making all decisions concerning resolutions of conflicts involving directors, the [Executive Director], and other members of senior management.

- The chair of the committee shall be responsible for making all decisions concerning resolutions of conflicts involving [Audit {Finance} Committee] members.
- The chair of the board shall be responsible for making all decisions concerning resolutions of the conflict involving the chair of the [Audit {Finance} Committee].
- The [Executive Director] shall be responsible for making all decisions concerning resolutions of conflicts involving employees below the senior management level, subject to the approval of the [Audit {Finance} Committee].

An employee or director may appeal the decision that a conflict (or appearance of conflict) exists as follows:

- An appeal must be directed to the chair of the board.
- Appeals must be made within 30 days of the initial determination.
- Resolution of the appeal shall be made by vote of the full Board of Directors.
- Board members who are the subject of the appeal, or who have a conflict of interest with respect to the subject of the appeal, shall abstain from participating in, discussing, or voting on the resolution, unless their discussion is requested by the remaining members of the board.

Disciplinary Action for Violations of this Policy

Failure to comply with the standards contained in this policy will result in disciplinary action that may include termination, referral for criminal prosecution, and reimbursement to the Organization or to the government, for any loss or damage resulting from the violation. As with all matters involving disciplinary action, principles of fairness will apply. Any employee charged with a violation of this policy will be afforded an opportunity to explain her/his actions before disciplinary action is taken.

Disciplinary action will be taken:

1. Against any employee who authorizes or participates directly in actions that are a violation of this policy.
2. Against any employee who has deliberately failed to report a violation or deliberately withheld relevant and material information concerning a violation of this policy.
3. Against any director, manager or supervisor who attempts to retaliate, directly or indirectly, or encourages others to do so, against any employee who reports a violation of this policy.

A board member who violates this policy will be removed from the board.

Editor's Note: Disciplinary procedures listed here should agree with any procedures included in Example NPO's Personnel Policies.

POLICY ON SUSPECTED MISCONDUCT

Introduction

This policy communicates the actions to be taken for suspected misconduct committed, encountered, or observed by employees and volunteers.

Like all organizations, Example NPO faces many risks associated with fraud, abuse, and other forms of misconduct. The impact of these acts, collectively referred to as misconduct throughout this policy, may include, but not be limited to:

- Financial losses and liabilities
- Loss of current and future revenue and customers
- Negative publicity and damage to the Organization's good public image
- Loss of employees and difficulty in attracting new personnel
- Deterioration of employee morale
- Harm to relationships with clients, vendors, bankers, and subcontractors
- Litigation and related costs of investigations, etc.

Our Organization is committed to establishing and maintaining a work environment of the highest ethical standards. Achievement of this goal requires the cooperation and assistance of every employee and volunteer at all levels of the Organization.

Definitions

For purposes of this policy, misconduct includes, but is not limited to:

1. Actions that violate the Organization's Code of Conduct (and any underlying policies) or any of the accounting and financial policies included in this manual
2. Fraud (see below)
3. Forgery or alteration of checks, bank drafts, documents or other records (including electronic records)
4. Destruction, alteration, mutilation, or concealment of any document or record with the intent to obstruct or influence an investigation, or potential investigation, carried out by a department or agency of the Federal government or by the Organization in connection with this policy
5. Disclosure to any external party of proprietary information or confidential personal information obtained in connection with employment with or service to the Organization
6. Unauthorized personal or other inappropriate (non-business) use of equipment, assets, services, personnel or other resources
7. Acts that violate Federal, state, or local laws or regulations
8. Accepting or seeking anything of material value from contractors, vendors, or persons providing goods or services to Example NPO. Exception: gifts less than a nominal value.

Editor's note: Organizations should quantify the term "nominal," such as by establishing a \$50 or some other threshold.

9. Impropriety of the handling or reporting of money in financial transactions.
10. Failure to report known instances of misconduct in accordance with the reporting responsibilities described herein (including tolerance by supervisory employees of misconduct of subordinates).

Fraud is further defined to include, but not be limited to:

- Theft, embezzlement, or other misappropriation of assets (including assets of or intended for the Organization, as well as those of our clients, subcontractors, vendors, contractors, suppliers, and others with whom the Organization has a business relationship)
- Intentional misstatements in the Organization's records, including intentional misstatements of accounting records or financial statements
- Authorizing or receiving payment for goods not received or services not performed
- Authorizing or receiving payments for hours not worked
- Forgery or alteration of documents, including but not limited to checks, timesheets, contracts, purchase orders, receiving reports

Example NPO prohibits each of the preceding acts of misconduct on the part of employees, officers, executives, volunteers and others responsible for carrying out the Organization's activities.

Reporting Responsibilities

Every employee, officer, and volunteer is responsible for immediately reporting suspected misconduct to their supervisor, Internal Audit, [Director of Finance], or the Chair of the [Audit {Finance} Committee]. When supervisors have received a report of suspected misconduct, they must immediately report such acts to their manager, Internal Audit, the [Director of Finance] or the [Audit {Finance} Committee].

Whistleblower Protection

The Organization will consider any reprisal against a reporting individual an act of misconduct subject to disciplinary procedures. A "reporting individual" is one who, in good faith, reported a suspected act of misconduct in accordance with this policy, or provided to a law enforcement officer any truthful information relating to the commission or possible commission of a Federal offense or any other possible violation of the Organization's Code of Conduct.

Investigative Responsibilities

Due to the sensitive nature of suspected misconduct, supervisors and managers should not, under any circumstances, perform any investigative procedures.

The [Director of Finance] or [Internal Audit Department] has the primary responsibility for investigating suspected misconduct involving employees below the [Executive Director] and executive management level. The [Director of Finance] [Internal Audit Department] shall provide a summary of all investigative work to the [Audit {Finance} Committee].

The [Audit {Finance} Committee] has the primary responsibility for investigating suspected misconduct involving [Executive Director] and executive level positions, as well as board members and officers. However, the Audit Committee may request the assistance of the [Director of Finance] [Internal Audit Department] in any such investigation.

Investigation into suspected misconduct will be performed without regard to the suspected individual's position, length of service, or relationship with the Organization.

In fulfilling its investigative responsibilities, the [Audit {Finance} Committee] shall have the authority to seek the advice and/or contract for the services of outside firms, including but not limited to law firms, CPA firms, forensic accountants and investigators, etc.

Members of the investigative team (as authorized by the [Audit {Finance} Committee]) shall have free and unrestricted access to all Organization records and premises, whether owned or rented, at all times. They shall also have the authority to examine, copy and remove all or any portion of the contents (in paper or electronic form) of filing cabinets, storage facilities, desks, credenzas and computers without prior knowledge or consent of any individual who might use or have custody of any such items or facilities when it is within the scope of an investigation into suspected misconduct or related follow-up procedures.

The existence, the status or results of investigations into suspected misconduct shall not be disclosed or discussed with any individual other than those with a legitimate need to know in order to perform their duties and fulfill their responsibilities effectively.

Protection of Records – Federal Matters

Example NPO prohibits the knowing destruction, alteration, mutilation, or concealment of any record, document, or tangible object with the intent to obstruct or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States government, or in relation to or contemplation of any such matter or case.

Violations of this policy will be considered violations of the Organization's Code of Ethics and subject to the investigative, reporting, and disclosure procedures described earlier in this Policy on Suspected Misconduct.

Disciplinary Action

Based on the results of investigations into allegations of misconduct, disciplinary action may be taken against violators. Disciplinary action shall be coordinated with appropriate representatives from the Human Resources Department. The seriousness of misconduct will be considered in determining appropriate disciplinary action, which may include:

- Reprimand
- Probation
- Suspension
- Demotion
- Termination
- Reimbursement of losses or damages
- Referral for criminal prosecution or civil action

This listing of possible disciplinary actions is for information purposes only and does not bind the Organization to follow any particular policy or procedure.

Confidentiality

The [Audit {Finance} Committee] and the [Director of Finance] treat all information received confidentially. Any employee who suspects dishonest or fraudulent activity will notify the [Director of Finance] or the [Audit {Finance} Committee] Chair immediately, and should not attempt to personally

conduct investigations or interviews/interrogations related to any suspected fraudulent act (see **Reporting Procedures** section above).

Great care must be taken in the investigation of suspected improprieties or irregularities so as to avoid mistaken accusations or alerting suspected individuals that an investigation is under way. Investigation results will not be disclosed or discussed with anyone other than those who have a legitimate need to know. This is important in order to avoid damaging the reputations of persons suspected but subsequently found innocent of wrongful conduct and to protect Example NPO from potential civil liability.

An employee who discovers or suspects fraudulent activity may remain anonymous. All inquiries concerning the activity under investigation from the suspected individual(s), his or her attorney or representative(s), or any other inquirer should be directed to the [Audit {Finance} Committee] or legal counsel. No information concerning the status of an investigation will be given out. The proper response to any inquiry is "I am not at liberty to discuss this matter." Under no circumstances should any reference be made to "the allegation," "the crime," "the fraud," "the forgery," "the misappropriation," or any other specific reference.

The reporting individual should be informed of the following:

1. Do not contact the suspected individual in an effort to determine facts or demand restitution.
2. Do not discuss the case, facts, suspicions, or allegations with anyone unless specifically asked to do so by the Example NPO legal counsel or the [Audit {Finance} Committee].

Disclosure to Outside Parties

Allegations of and information related to allegations of suspected misconduct shall not be disclosed to third parties except under the provisions described in this policy (such as disclosure to outside investigators hired by the Organization to aid in an investigation).

However, all known frauds involving the [Executive Director], senior management, or members of the Board of Directors, as well as all material frauds involving employees below the senior management level, shall be disclosed by the [Audit {Finance} Committee] to the Organization's external auditors.

GIFT ACCEPTANCE

Overview of Gift Acceptance Policies

A gift/contribution is consideration given to the Organization for which the donor receives no direct benefit and requires nothing in exchange (it is nonreciprocal) other than assurance that the intent of the contribution will be honored by Example NPO. Two broad principles apply to all gifts given to the Organization:

1. A gift shall not be accepted that is not in the charitable interest of the donor, considering the donor's financial situation and philanthropic interests, as well as tax, legal, and other relevant factors.
2. A gift shall not be accepted unless there is a reasonable expectation that acceptance of the gift shall ultimately benefit Example NPO

Categories of Gifts

Gifts to the Organization are classified into two categories, based on the level of risk associated with acceptance of the gift.

Gifts of **marginal risk** include the following:

- Cash and cash equivalents (e.g. certificates of deposit)
- Gifts of securities actively traded on a U.S. public market (e.g. publicly-traded stocks, mutual funds, corporate and government bonds, etc.)
- Personal property with a fair value of less than [\$5,000] (new or used)

Gifts of the preceding three categories shall be considered to be of marginal risk only if they are either unrestricted or restricted to one specific, existing Example NPO program

Gifts of **great-than-marginal risk** include the following:

- Any gift requiring the acceptance of a restriction that (a) is not clearly identifiable with an existing program of Example NPO, (b) would require the addition or modification of an Example NPO program, (c) would not be consistent with the mission of Example NPO, (d) would not be consistent with Example NPO's tax-exempt purpose under IRC section 5901(c)(3), (e) would violate any federal, state or local law or regulation, or (f) would result in excessive control to the donor, or anyone designated by the donor, over the subsequent use of the contributed asset
- Any gift from a donor involved in businesses or activities that may be deemed to be inconsistent with the mission of Example NPO
- Personal property with a fair value of [\$5,000] or more (new or used)
- Real property (either an outright gift of property or the donated use of such property)
- Non-publicly-traded securities (e.g. ownership interests in privately-held businesses, partnerships, etc.)
- Charitable remainder trusts

- Charitable lead trusts
- Conditional promises to give/pledges
- Unusual items or items of questionable value (including works of art, animals, historic artifacts, memorabilia, etc.)
- Life insurance
- Notification of the intent to give non-cash assets through a bequest

Editor's Note: The purpose of these gift acceptance policies is to provide clear guidance regarding which types of gifts may be accepted without further consideration (in the example policy below, this is the director of development, but it may also include other staff), versus gifts that must be reviewed by senior management prior to being accepted or rejected. In some cases, it may be appropriate to include a review of riskier gifts by either a gift acceptance committee or the board of directors.

Gift Acceptance Procedures

Gifts of marginal risk may be accepted by the [Director of Development] without any further review and approval. Gifts of greater-than-marginal risk may be accepted only after review and approval of both the [Director of Finance] and [Executive Director]. This review and approval shall be documented on a Gift Acceptance form.

It is also the policy of Example NPO to liquidate all gifts of public-traded securities within ten days of receipt unless it is determined by the [Director of Finance] that holding the securities as an investment of the organization would be fiscally prudent, appropriate and consistent with the Organization's investment policies.

ADMINISTRATION OF FEDERAL AWARDS

Preparation and Review of Proposals

Individual departments are responsible for preparing proposals for projects that the department intends to pursue. However, all proposals shall be reviewed by the [Director of Finance] prior to submission to government agencies or other funding sources. Final proposals shall be reviewed and approved in writing by the Board of Directors and the [Executive Director].

Editor's Note: We recommend the Board adopt the following procedures for grant proposals:

- 1. Grant applications greater than \$_____ will be approved by the Board.***
- 2. The full Board (or appropriate Board committee) will approve acceptance of all grants.***
- 3. The full Board will be involved in all decisions concerning new funding sources.***

In addition, the Organization may refuse to consider all grants under a certain dollar amount based on the cost/benefit of administering such awards.

Post-Award Procedures

After an award has been made, the following steps shall be taken:

1. Verify the specifications of the grant or contract. The Accounting Department shall review the terms, time periods, award amounts and expected expenditures associated with the award. A Catalog of Federal Domestic Assistance (CFDA) number shall be determined for each award. All reporting requirements under the contract or award shall be summarized.
2. Create new general ledger account numbers (or segments). New accounts shall be established for the receipt and expenditure categories in line with the grant or contract budget.
3. Gather documentation. A file is established for each grant or contract. The file contains the proposal, all correspondence regarding the grant or contract, the final signed award document and all reports submitted to the funding sources.

Compliance with Laws, Regulations and Provisions of Awards

Example NPO recognizes that as a recipient of Federal funds, the Organization is responsible for compliance with all applicable laws, regulations, and provisions of contracts and grants. To ensure that the Organization meets this responsibility, the following policies apply with respect to every grant or contract received directly or indirectly from a Federal agency:

1. For each Federal award, an employee within the department responsible for administering the award will be designated as "grant manager."
2. Each grant manager shall attend a training on grant management prior to beginning his/her role as a grant manager (or as early in their functioning as a grant manager as practical). Thereafter,

all grant managers shall attend refresher/update courses on grant management every two years.

3. The grant manager shall take the following steps to identify all applicable laws, regulations, and provisions of each grant and contract:
 - a. Read each award and prepare a summary of key compliance requirements and references to specific laws and regulations.
 - b. Review the "OMB Circular A-133 Compliance Supplement" (updated annually) published by the Office of Management and Budget (OMB) for compliance requirements unique to the award and for compliance requirements common to all Federal awards.
 - c. Review the section of the Catalog of Federal Domestic Assistance (CFDA) applicable to the award.
 - d. The grants manager will communicate grant requirements to those who will be responsible for carrying them out, or impacted by them.
4. The Accounting Department shall forward copies of applicable laws regulations to the grant manager (such as OMB Circulars, pertinent sections of compliance supplements, and other regulations).
5. The grant manager and/or the Accounting Department shall identify and communicate any special changes in policies and procedures necessitated by Federal awards as a result of the review of each award.
6. The grant manager shall take all reasonable steps necessary to identify applicable changes in laws, regulations, and provisions of contracts and grants. Steps taken in this regard shall include, but not be limited to, reviewing subsequent grant and contract renewals, reviewing annual revisions to the "OMB Circular A-133 Compliance Supplement," and communications with Federal awarding agency personnel.
7. The grant manager shall inform the independent auditors of applicable laws, regulations, and provisions of contracts and grants. The grant manager shall also communicate known instances of noncompliance with laws, regulations, and provisions of contracts and grants to the auditors.

Document Administration

Editor's Note: Each organization receiving government funds should maintain a well-organized and secure file of all pertinent grant-related documents. This facilitates compliance with requirements of the award, retention of documents required, and the audit. The policies in this section are designed to establish such a system.

For each grant/award received by Example NPO from a federal, state, or local government agency, a master file of documents applicable to the award shall be prepared and maintained. The responsibility for assembling each master file shall be assigned to the [Program Manager] assigned to administer the program.

The master file assembled for each government award shall include all of the following documents (including originals of all documents received from the awarding agency):

1. Copy of the initial application for the award and corresponding budget
2. All correspondence to and from the awarding agency post-application, leading up to the award
3. The final, approved budget and program plan, after making any modifications
4. The grant agreement and any other documents associated with the initial making of the award
5. Copies of pertinent laws and regulations, including awarding agency guidelines, associated with the award
6. Subsequent grant modifications (financial and programmatic)
7. Subsequent correspondence to/from the awarding agency
8. Results of any monitoring visits conducted by the awarding agency, including resolution by Example NPO of any findings arising from such visits
9. Correspondence and other documents resulting from the closeout process of the award

The preceding grant document file shall be organized into four sections as follows:

1. Pre-award documents
2. Post-award documents
3. Laws, regulations, and agency guidelines
4. Audit/monitoring-related documents

On the inside front cover of the grant document file shall be a Summary of Critical Award Provisions, prepared by the [Program Manager]. This summary shall include, at a minimum, the following:

1. Key compliance requirements, including citations of applicable laws and regulations
2. Important deadlines
3. Correspondence contact information at the awarding agency

The original grant document file shall remain in the office of the [Program Manager] in a locked filing cabinet. The [Program Manager] shall maintain a separate file of frequently requested documents that shall consist of photocopies of the documents included in the secure grant document file. The purpose of this file of copied documents is to limit the potential for loss of valuable documents. Any other Example NPO employee making a valid request for access to grant documents shall be provided with the file of copied documents and shall be asked to sign this file out of the [Program Manager's] office.

SEGREGATION OF DUTIES

Control Grid - Revenue and Cash Receipts

Example NPO strives to maintain adequate segregation of duties in its income and cash receipts functions. The following table illustrates how responsibilities have been assigned. In this table, personnel are identified as follows:

- A. [Director of Finance]
- B. [Senior Accountant]
- C. [Accounts Payable Technician]
- D.
- E.

	A	B	C	D	E
Produce invoice to bill customer					
Enter invoice into A/R system					
Initial receipt of funds (cash or checks)					
Restrictively endorse checks					
Initial receipt of credit card payments					
Prepares initial record of funds collected					
Preparation of deposit slip					
Take deposit slip to bank					
Process credit card payments					
Enter payments into A/R system					
Reconcile log of collections w/ A/R posting					
Authorizes credits or other adjustments					
Posts credits/adjustments to A/R system					
Authorizes write-off of bad debts					
Posts bad debt write-offs to A/R system					
Prepares periodic customer statements					
Reconciles A/R with general ledger					
Reconciles bank statement					
Reviews A/R aging					
Performs follow-up calls on old A/R					

POLICIES ASSOCIATED WITH EXPENDITURES AND DISBURSEMENTS

PURCHASING POLICIES AND PROCEDURES

Overview

Example NPO requires the practice of ethical, responsible, and reasonable procedures related to purchasing, agreements and contracts, and related forms of commitment. The policies in this section describe the principles and procedures that all staff shall adhere to in the completion of their designated responsibilities.

The goal of these procurement policies is to ensure that materials and services are obtained in an effective manner and in compliance with the provisions of applicable Federal statutes and executive orders.

Responsibility for Purchasing

All department heads or their designees shall have the authority to initiate purchases on behalf of their department, within the guidelines described here. Department directors shall inform the Accounting Department of all individuals that may initiate purchases or prepare purchase orders. The Accounting Department shall maintain a current list of all authorized purchasers.

The Accounting Department shall be responsible for processing purchase orders. The [Director of Finance] has approval authority over all purchases and contractual commitments, and shall make the final determination on any proposed purchases where budgetary or other conditions may result in denial.

Code of Conduct in Purchasing

Ethical conduct in managing the Organization's purchasing activities is absolutely essential. Staff must always be mindful that they represent the Board of Directors and share a professional trust with other staff and the general membership.

- Staff shall discourage the offer of, and decline, individual gifts or gratuities of value in any way that might influence the purchase of supplies, equipment, and/or services.
- Staff shall notify their immediate supervisor if they are offered such gifts.
- No officer, board member, employee, or agent shall participate in the selection or administration of a vendor if a real or apparent conflict of interest would be involved. Such a conflict would arise if an officer, board member, employee or agent, or any member of his/her immediate family, his/her spouse/partner, or an organization that employs or is about to employ any of the parties indicated herein, has a financial or other interest in the vendor selected.
- Officers, board members, employees, and agents shall neither solicit nor accept gratuities, favors, or anything of monetary value from vendors or parties to sub-agreements.
- Unsolicited gifts of a nominal value [establish an appropriate dollar threshold, such as \$25 or less] may be accepted with the approval of the [Executive Director].

Competition (Government Grants, per OMB Circ. A-110 43)

In order to promote open and free competition, the Organization will:

- Be alert to any internal potential conflicts of interest.
- Be alert to any noncompetitive practices among contractors that may restrict, eliminate or restrain trade.
- Not permit contractors who develop specifications, requirements or proposals to bid on such procurements.
- Award contracts to bidders whose product/service is most advantageous in terms of price, quality and other factors.
- Issue solicitations that clearly set forth all requirements to be evaluated.
- Reserve the right to reject any and all bids when it is in the Organization's best interest.

Non-Discrimination Policy

All vendors/contractors who are the recipients of Organization funds, or who propose to perform any work or furnish any goods under agreements with Example NPO, shall agree to these important principles:

1. Vendors/contractors will not discriminate against any employee or applicant for employment because of race, religion, color, sexual orientation or national origin, except where religion, sex, or national origin is a bona fide occupational qualification reasonably necessary to the normal operation of the vendors/contractors.
2. Vendors/contractors agree to post in conspicuous places, available to employees and applicants for employment, notices setting forth the provisions of this nondiscrimination clause. Notices, advertisement and solicitations placed in accordance with Federal law, rule, or regulation shall be deemed sufficient for meeting the intent of this section.

Procurement Procedures (Government Grants)

The following are Example NPO's procurement procedures:

1. Example NPO shall avoid purchasing items that are not necessary for the performance of the activities required by a Federal award. (A-110_44(1))
2. Where appropriate, an analysis shall be made of lease and purchase alternatives to determine which would be the most economical and practical procurement for the Federal government. (A-110_44(2)) This analysis should only be made when both lease and purchase alternatives are available to the program.
3. Some form of cost or price analysis shall be made for every procurement. Price analysis may be made in various ways, including comparison of price quotations submitted or market prices. Cost analysis is the review and evaluation of each element of cost to determine reasonableness, allocability, and allowability. (A-110_45)

Editor's Note: OMB has explained this requirement by providing for "considerable latitude in determining the appropriate form of the cost or price analysis, depending on the nature and size of the procurement." Therefore, organizations are encouraged to implement efficient and reasonable comparison procedures.

Cost/price analysis for routine supplies may be performed at the beginning of the year to identify a vendor to be used for the entire year. We recommend you price such items in total, not by individual item.

4. Documentation of the cost and price analysis associated with each procurement decision shall be retained in the procurement files pertaining to each Federal award. (A-110_46)
5. For all procurements in excess of the small purchase acquisition threshold (\$100,000 in 2005), procurement records and files shall be maintained the include all of the following:
 - a. The basis for contractor selection.
 - b. Justification for lack of competition when competitive bids or offers are not obtained.
 - c. The basis for award cost or price.
6. Example NPO shall make all procurement files available for inspection upon request by a Federal awarding agency.
7. All contracts with vendors shall require the vendor to certify in writing that it has not been suspended or disbarred from doing business with any Federal agency. (Alternatively, the Organization may research potential vendors on the Excluded Parties List at the GSA\ website.)
8. Example NPO shall not utilize the "cost-plus-a-percentage-of-costs method of contracting. (A-110_44(3)(c))

All staff members with the authority to approve purchases will receive a copy of and be familiar with A-110, federal cost principles.

Use of Purchase Orders

Example NPO utilizes a purchase order system. A properly completed purchase order shall be required for each purchase decision (i.e., total amount of goods and services purchased, not unit cost) in excess of [\$500 or some other threshold established by the Organization], with the exception of travel advances and expense reimbursements, which require the preparation of a separate form described elsewhere in this manual. A properly completed purchase order shall contain the following information, at a minimum:

1. Specifications or statement of services required
2. Vendor name, address, point of contact and phone number
3. Source of funding (if applicable)
4. Delivery or performance schedules
5. Delivery, packing and transportation requirements

6. Special conditions (if applicable)
7. Catalog number, page number, etc. (if applicable)
8. Net price per unit, less discount, if any
9. Total amount of order
10. Authorized signature
11. Date purchase order was prepared

Purchase orders shall be pre-numbered, kept in a secure area in the Accounting Department, and issued upon request from an authorized purchaser.

All purchase orders shall be recorded in a purchase order log. At the end of each accounting period, an aged outstanding purchase order report shall be prepared and distributed to each purchasing representative and the [Director of Finance].

Authorizations and Purchasing Limits

All completed purchase orders must be signed by the preparer and approved by the [Department Director]. The following table displays required approvals and solicitations:

Amount of Purchase	Required Approvals	Required Solicitation
< \$5,000	Dept. Director	2 oral bids
\$5,000 ≤ \$25,000	Dept. Director Dir. of Finance	2 oral or written bids
\$25,001 ≤ \$100,000	Dept. Director Dir. of Finance Executive Dir.	3 written bids
> \$100,000	Dept. Director Dir. of Finance Executive Dir. Board of Directors	3 written bids

The [Executive Director] is authorized to enter into any contract on behalf of Example NPO. Contracts of \$5,000 or less must be reviewed and approved by the [Department Director] and the [Director of Finance], but do not require approval from the [Executive Director]. These policies shall also apply to renewals of existing contracts.

Required Solicitation of Quotations from Vendors (Government Grants)

Solicitations for goods and services (requests for proposals or RFPs) should provide for all of the following:

1. A clear and accurate description of the technical requirements for the material, product or service to be procured. Descriptions shall not contain features which unduly restrict competition. *(A-110_44(a)(3)(i))*
2. Requirements which the bidder/offeror must fulfill and all other factors to be used in evaluating bids or proposals (see the next section entitled "Evaluation of Alternative Vendors" for required criteria) *(A-110_44(a)(3)(ii))*
3. Technical requirements in terms of functions to be performed or performance required, including the range of acceptable characteristics or minimum acceptable standards. *(A-110_44(a)(3)(iii))*
4. The specific features of "brand name or equal" descriptions that bidders are required to meet when appropriate. *(A-110_44(a)(3)(iv))*
5. The acceptance, to the extent practical, of products and services dimensioned in the metric system of measurement. *(A-110_44(a)(3)(v))*
6. Preference, to the extent practical, for products and services that conserve natural resources and protect the environment and are energy efficient. *(A-110_44(a)(3)(vi))*
7. Preference for recycled products pursuant to EPA guidelines. *(A-110_16)*
8. A description of the format, if any, in which proposals must be submitted, including the name of the person to whom proposals should be sent.
9. The date by which proposals are due.
10. Required delivery or performance dates/schedules.
11. Clear indications of the quantity(ies) requested and unit(s) of measure.

Extensions of Due Dates and Receipt of Late Proposals

Solicitations should provide for sufficient time to permit the preparation and submission of offers before the specified due date. However, an extension may be granted if a prospective offeror so requests.

Vendor proposals are considered late if received after the due date and time specified in the solicitation. Late proposals shall be so marked on the outside of the envelope and retained, unopened, in the procurement folder. Vendors that submit late proposals shall be sent a letter notifying them that their proposal was late and could not be considered for award.

Evaluation of Alternative Vendors

Vendors shall be evaluated on a weighted scale that considers the following criteria:

1. Adequacy of the proposed methodology
2. Skill and experience of key personnel
3. Demonstrated experience
4. Other technical specifications designated by department requesting proposals
5. Compliance with administrative requirements of the request for proposal (format, due date, etc.)
6. Vendor's financial stability
7. Vendor's demonstrated commitment to the nonprofit sector
8. Results of communications with references supplied by vendor
9. Ability/commitment to meeting time deadlines
10. Cost
11. Minority- or women-owned business status of vendor
12. Other criteria (to be specified by department requesting proposal)

Not all of the preceding criteria may apply in each purchasing scenario. However, the department responsible for the purchase shall establish the relative importance of the appropriate criteria prior to requesting proposals and shall evaluate each proposal on the basis of the criteria and weighting that have been determined.

After a vendor has been selected and approved by the [Department Director], the final selection shall be approved by the [Executive Director] prior to entering into a contract.

Affirmative Consideration of Minority, Small & Women-Owned Businesses (Government Grants per OMB Circ. A-110 44(3)(b))

Positive efforts shall be made by Example NPO to utilize small businesses, minority-owned firms, and women's-owned business enterprises, whenever possible. Therefore, the following steps shall be taken:

1. Ensure that small business, minority-owned firms, and women's business enterprises are used to the fullest extent practicable. (A-110_44(3)(b)(1))
2. Make information on forthcoming opportunities available and arrange time frames for purchases and contracts to encourage and facilitate participation by small business, minority-owned firms and women's business enterprises. (A-110_44(3)(b)(2))
3. Consider in the contract process whether firms competing for larger contracts tend to subcontract with small businesses, minority-owned firms and women's business enterprises. (A-110_44(3)(b)(3))
4. Encourage contracting with consortiums of small businesses, minority owned firms and women's business enterprises when a contract is too large for one of these firms to handle individually. (A-110_44(3)(b)(4))

5. Use the services and assistance, as appropriate, of such organizations as the Small Business Administration and the Department of Commerce's Minority Business Development Agency in the minority-owned firms and women's business enterprises. (A-110_44(3)(b)(5))

Availability of Procurement Records - Government Grants per OMB Circ. (A-110 44(3)(e))

Example NPO shall, on request, make available for the Federal awarding agency, pre-award review and procurement documents, such as requests for proposals, when any of the following conditions apply:

- The process does not comply with the Example NPO's procurement standards (A-110_44(3)(e)(1))
- The procurement is expected to exceed the small purchase threshold (\$100,000 in 2005) and is to be awarded without competition or only one bid is received (A-110_44(3)(e)(2))
- The procurement exceeds the small purchase threshold and specifies a "name brand" product (A-110_44(3)(e)(3))
- The proposed award exceeds the small purchase threshold and is to be awarded to other than the apparent low bidder under a sealed bid procurement. (A-110_44(3)(e)(4))
- A proposed contract modification changes the scope of a contract or increases the contract amount by more than the amount of the small purchase threshold. (A-110_44(3)(e)(5))

Right to Audit Clause

Example NPO requires a "Right to Audit" clause in all contracts between the Organizations and vendors that either:

1. Take any form of temporary possession of assets (including payments) directed for the Organization, or
2. Process data that will be used in any financial function of the Organization.

This Right to Audit clause shall permit access to and review of all documentation and processes relating to the vendor's operations that apply to Example NPO, as well as all documents maintained or processed on behalf of Example NPO, for a period of three years. The clause shall state that such audit procedures may be performed by Example NPO employees or any outside auditor or contractor designated by the Organization.

Vendor Files and Required Documentation

The Accounting Department shall create a vendor folder for each new vendor from whom Example NPO purchases goods or services.

The Accounting Department shall mail a blank Form W-9 to new vendors and request that the vendor complete and sign the W-9 (or provide equivalent, substitute information) and return it in the postage-paid envelope provided. Completed, signed Forms W-9 or substitute documentation shall be filed in each vendor's folder. Vendors who do not comply with this request shall be issued a Form 1099 at the end of each calendar year in accordance with the policies described in the section of this manual on "Government Returns." See the section on "Payroll and Related Policies" for guidance on determining whether a vendor should be treated as an employee.

SEGREGATION OF DUTIES

Control Grid – Purchasing and Disbursements

Example NPO strives to maintain adequate segregation of duties in its purchasing and disbursements functions. The following table illustrates how responsibilities have been assigned. In this table personnel are identified as follows:

- A. [Department Directors]
- B. [Department Managers]
- C. [Director of Finance]
- D. [Senior Accountant]
- E. [Accounts Payable Technician]

Duty	A	B	C	D	E
Inputs data into vendor master file					
Obtains Form W-9 from new vendors					
Initiates purchases					
Authorizes purchases					
Prepares purchase order/requisition					
Prepares request for proposal					
Administers collection of proposals					
Evaluates proposals					
Selects vendor					
Receives vendor invoice					
Approves vendor invoice					
Assigns general ledger coding					
Inputs invoice into A/P system					
Selects A/P to be paid					
Runs A/P checks					
Reviews checks					
Signs checks					
Mails checks					
Maintains custody of unused checks					
Reconciles A/P to general ledger					
Performs bank reconciliation					
Review cancelled checks					
Reviews bank reconciliations					

SEGREGATION OF DUTIES

Control Grid – Payroll and Human Resources

Example NPO strives to maintain adequate segregation of duties in its payroll and human resources functions. The following table illustrates how responsibilities have been assigned. In this table, personnel are identified as follows:

- A. [Human Resources Manager]
- B. [Director of Finance]
- C. [Senior Accountant]
- D. [Payroll Technician]
- E.

Duty	A	B	C	D	E
Authorize new hires					
Authorize salary adjustments					
Authorize terminations					
Sets up new employee in P/R system					
Enters salary adjustments to P/R/ system					
Enters direct deposit info. in P/R system					
Deletes terminated employees from P/R					
Review changes to payroll master file					
Approves timesheets					
Enters timesheets					
Reviews input of timesheet data					
Reviews distribution of time					
Reviews payroll register					
Prints checks (or paystubs)					
Signs payroll checks					
Distributes checks (paystubs)					
Has access to unused payroll checks					
Prints annual W-2 forms					
Reviews annual W-2 forms					
Distributes annual W-2 forms					

NET ASSETS

Classification of Net Assets

Net assets of the Organization shall be classified based upon the existence or absence of donor-imposed restrictions as follows:

Unrestricted Net Assets - Net assets that are not subject to donor imposed stipulations.

Temporarily Restricted Net Assets - Net assets subject to donor imposed stipulations that may or will be satisfied through the actions of the Organization and/or the passage of time.

Permanently Restricted Net Assets - Net assets subject to donor imposed stipulations that the Organization permanently maintain certain contributed assets. Generally, donors of such assets permit the Organization to use all or part of the income earned from permanently restricted net assets for general operations or for specific purposes. Permanent restrictions do not pass with the expiration of time, nor can they be removed through the Organization's actions.

Net assets accumulated that are not subject to donor imposed restrictions, but which the Board of Directors of the Organization has earmarked for specific uses, shall be segregated in the accounting records as "board-designated" funds within the unrestricted category of net assets.

Restrictions may be associated with either a time period (e.g. a particular future time period) or a purpose (e.g. specific programs). A purpose stipulation will be considered a restriction only if it is more specific than the broad limits resulting from the nature of the Organization, the environment in which it operates, and the purposes specified in Example NPO's Articles of Incorporation and Bylaws.

Reclassifications from Restricted to Unrestricted Net Assets

The Organization shall report in its statement of activities a reclassification from restricted to unrestricted net assets if any of the following events occur:

1. Fulfillment of the purpose for which the net assets were restricted (e.g. spending restricted funds for the stipulated purpose)
2. Expiration of time restrictions imposed by donors
3. Death of an annuity beneficiary
4. Withdrawal by the donor (or by a court) of a time or purpose restriction

If a donor stipulates multiple restrictions (such as a purpose and a time restriction), reclassifications from temporarily restricted to unrestricted net assets shall be reported only upon the satisfaction of the final remaining restriction.

Reclassifications from Unrestricted to Restricted Net Assets

If the Organization receives a restricted contribution from a donor who further stipulates that the Organization set aside a portion of its unrestricted net assets for that same purpose, the Organization shall report in its statement of activities a reclassification of net assets from unrestricted to temporarily or permanently restricted, based on the specific nature of the restriction.

Disclosures

The Organization discloses in a footnote to the financial statements the different types of temporary and permanent restrictions associated with the Organization's net assets as of the end of each fiscal year.

ANNUAL AUDIT

Role of the Independent Auditor

Example NPO will arrange for an annual audit of the Organization's financial statements to be conducted by an independent accounting firm. The independent accounting firm selected by the Board of Directors will be required to communicate directly with the Organization's [Audit {Finance} Committee] upon the completion of their audit. In addition, members of the [Audit {Finance} Committee] and [Executive Committee] are authorized to initiate communication directly with the independent accounting firm.

Audited financial statements, including the auditor's opinion thereon, will be submitted and presented to the Board of Directors by the independent accounting firm at the Organization's Annual Meeting, after the financial statements have been reviewed and approved by the [Audit {Finance} Committee].

Auditor Independence

Example NPO may from time to time request the independent auditor to provide services outside the scope of the annual audit and Form 990 preparation. In connection with these nonaudit services, it is imperative that the independent auditor remain independent in fact and in appearance in order to continue serving the Organization as its auditor.

Generally, in order to remain independent with respect to the audit, the Organization's auditors should not provide non-audit services that involve performing management functions or making management decisions nor should they provide non-audit services in situations where the non-audit services are significant/material to the subject matter of the audits (or where they would be auditing their own work in connection with the annual audit).

Therefore, it is the organization's policy to evaluate any non-audit service requested from the independent auditor for possible impairments to the firm's independence, and to not permit the performance of any services that would impair independence. This evaluation shall be performed by the [Director of Finance], who may consult the independent auditor or other external sources in making this determination.

In addition, for each non-audit service that is to be provided by the Organization's independent auditor, the Organization shall:

1. Designate a management level individual to be responsible and accountable for overseeing the non-audit service (to be determined by the [Executive Director]);
2. Establish and monitor performance of the non-audit service to ensure that it meets management's objectives (to be performed by the person designated in step 1);
3. Make any decisions that involve management functions related to the non-audit service and accept full responsibility for such decisions; and

4. Evaluate the adequacy of the services performed and findings that result.

How Often to Review the Selection of the Auditor

Example NPO shall review the selection of its independent auditor in the following circumstances:

1. Anytime there is dissatisfaction with the service of the current firm
2. When a fresh perspective and new ideas are desired
3. Every [5 years] to ensure competitive pricing and a high quality of service (this is not a requirement to change auditors every five years; simply to re-evaluate the selection)

Selecting an Auditor

The selection of an accounting firm to conduct the annual audit is a task that should be taken very seriously. The following factors shall be considered by Example NPO in selecting an accounting firm:

1. The firm's reputation in the nonprofit community
2. The depth of the firm's understanding of and experience with not-for-profit organizations and Federal reporting requirements under OMB Circular A-133
3. The firm's demonstrated ability to provide the services requested in a timely manner
4. The ability of firm personnel to communicate with Organization personnel in a professional and congenial manner

If Example NPO decides to prepare and issue a written Request for Proposal (RFP) to be sent to prospective audit firms, the following information shall be included:

1. Period of services required
2. Type of contract to be awarded (fixed fee, cost basis, etc.)
3. Complete description of the services requested (audit, management letter, tax returns, etc.)
4. Identification of meetings requiring their attendance, such as staff or Board of Director meetings
5. Organization chart of Example NPO
6. Chart of account information
7. Financial information about the Organization
8. Copy of prior year reports (financial statements, management letters, etc.)
9. Identification of need to perform audit in accordance with OMB Circular A-133
10. Other information considered appropriate
11. Description of proposal and format requirements
12. Due date of proposals
13. Overview of selection process (i.e., whether finalists will be interviewed, when a decision shall be made, etc.)
14. Identification of criteria for selection

Minimum Proposal Requirements from prospective CPA firms shall be:

1. Firm background
2. Biographical information (resumes) of key firm member who will serve Example NPO

3. Client references
4. Information about the firm's capabilities
5. Firm's approach to performing an audit
6. Copy of the firm's most recent quality/peer review report, including any accompanying letter of findings
7. Other resources available with the firm
8. Expected timing and completion of the audit
9. Expected delivery of reports
10. Cost estimate including estimated number of hours per staff member
11. Rate per hour for each auditor
12. Other information as appropriate

In order to narrow down the proposals to the top selections, the [Director of Finance] shall meet with the prospective engagement teams from each proposing firm to discuss their proposal. Copies of all proposals shall be forwarded to each member of the [Audit {Finance} Committee]. After the [Director of Finance] narrows down the field of prospective auditors to [three] firms, final interviews of each firm are conducted by the [Audit {Finance} Committee], who makes the final recommendation to the Board of Directors for approval.

Preparation for the Annual Audit

Example NPO shall be actively involved in planning for and assisting with the Organization's independent accounting firm in order to ensure a smooth and timely audit of its financial statements. In that regard, the Accounting Department shall provide assistance to the independent auditors in the following areas:

Planning - The [Director of Finance] is responsible for delegating the assignments and responsibilities to accounting staff in preparation for the audit. The [Director of Finance] shall review the list of information requested by the auditors and assign responsibility for each item to the appropriate staff of Example NPO. The [Director of Finance] shall then schedule and direct status meetings in the weeks leading up to the audit in order to review the progress of staff in preparing for the audit.

The [Director of Finance] shall arrange and coordinate any and all meetings, interviews, telephone discussions, and conference calls requested by the auditor with Example NPO board members, audit or finance committee members, or employees of NPO to facilitate the auditor's work. Prior to any such meetings or discussions, the [Director of Finance] shall inform each Organization participant of the nature of the discussion or meeting and what, if any, preparations they should do prior to the meeting. The [Director of Finance] shall communicate to each Example NPO participant in such meetings or discussions the importance of being open, honest and frank with the auditors with respect to any and all questions posed by the auditors.

Involvement - Organization staff will do as much work as possible in order to assist the auditors and, therefore, reduce the cost of the audit.

Interim Procedures - To facilitate the timely completion of the annual audit, the independent auditors may perform selected audit procedures prior to the Organization's year-end. By performing significant portions of audit work as of an interim date, the work required subsequent to year-end is reduced.

Organization staff will provide requested schedules and documents to assist the auditors during any interim audit fieldwork.

Throughout the audit process, Example NPO will make every effort to provide schedules, documents and information requested by the auditors in a timely manner.

Concluding the Audit

Upon receipt of a draft of the audited financial statements of Example NPO from its independent auditor, the [Director of Finance] shall perform a detailed review of the draft, consisting of the following procedures:

1. Carefully read the entire report for typographical errors
2. Trace and agree each number in the financial statements and accompanying footnotes to the accounting records and/or internal financial statements of Example NPO
3. Review each footnote for accuracy and completeness

Any questions or errors noted as part of this review shall be communicated to the independent auditor in a timely manner and resolved to the satisfaction of the [Director of Finance].

It shall also be the responsibility of the [Director of Finance] to review and respond in writing to all management letter or other internal control and compliance report findings and recommendations made by the independent auditor.

In addition, the Single Audit Clearinghouse form shall be completed and a copy submitted to the [Audit {Finance} Committee].

Audit Adjustments

It is the policy of Example NPO to record all adjustments prepared by the independent auditor in connection with the annual audit, in order for the internal financial statements of the Organization to agree with the final audited financial statements for the year.

The Organization may also receive a list of unadjusted differences (or passed audit adjustments) from the independent auditor in connection with the audit. If the Organization receives such a list, it shall be the responsibility of the [Director of Finance] to make any necessary adjusting journal entries in the accounting records of the fiscal year subsequent to the audited year in order to correct any uncorrected misstatements that carry forward from the audited period.

Internal Control Deficiencies Noted in the Audit

In accordance with generally accepted auditing standards, at the conclusion of the audit the Organization's independent auditors may provide a written communication of internal control deficiencies noted in connection with their audit. Not all deficiencies in internal control are required to be reported by the auditor. Only the following two types of deficiencies are required to be communicated:

1. **Material weakness** – A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis.
2. **Significant deficiency** – A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

The Organization’s independent auditors are required to provide written communication to the audit committee of all significant deficiencies and material weaknesses (i.e. only those deficiencies that rise to the level of materiality at which they qualify under the definitions provided above, in the opinion of the auditor).

It is the Organization’s policy that all internal control deficiencies that are communicated by the auditor in writing shall be formally addressed by the audit committee, the [Executive Director] and the [Director of Finance]. The [Executive Director] and the [Director of Finance] shall prepare a written response, which shall include a corrective action plan, to each internal control finding and such response shall be presented to the audit committee for its review and approval.

Audit Committee Responsibilities

In accordance with the Example NPO by-laws, there shall be an Audit Committee consisting of [three] members. The term of office shall be for [three] years, with one member being elected by the Example NPO Board of Directors each year.

See the “Board Governance” section of this manual, as well as the Audit Committee Charter, for a detailed description of the Audit Committee’s responsibilities and its authority.

Audit Committee Communications With the Auditors

In accordance with generally accepted auditing standards, in connection with and at the conclusion of each annual audit, the auditors are required to make certain communications directly to the audit committee. The [Director of Finance] shall facilitate all of these communications, arranging for face-to-face meetings, telephone or conference calls, or delivery of electronic or paper documents between auditor and audit committee members.

Some of the communications that Example NPO’s auditors may have with the Organization’s audit committee include:

1. Planning discussions prior to commencing the audit, such as by inquiring of audit committee members their perception of where the risk of material misstatements in the Organization’s financial statements may be greatest, the various risks of fraud, and other inquiries.
2. Planning stage communications informing the audit committee of the planned scope and nature of certain audit procedures that the auditors plan to perform, to aid in the audit committee members having a thorough understanding of the audit

3. Internal control deficiencies noted during the audit, communicated in writing at the conclusion of the audit
4. Any material fraud detected by the auditor, or any fraud, regardless of materiality, involving senior management, noted at any time during the audit
5. Significant problems or other issues that arose during the audit (e.g. disagreements with management and certain other items that the auditors may be required to report to the audit committee)
6. Audit adjustments made by the auditors as a result of their audit
7. Certain audit differences noted by the auditors that they deemed not material enough to warrant making an adjustment for.

Audit committee members should be aware of these communications and engage in active discussions with the auditors whenever it is considered appropriate in the fulfillment of these or their other duties.

BOARD GOVERNANCE

AUDIT COMMITTEE

Purpose

The primary responsibility for the Organization's financial reporting and internal controls rests with senior operating management, as overseen by the Organization's Board of Directors (the "Board"). The purpose of the Audit Committee (the "Committee") is to assist the Board in fulfilling this responsibility by providing oversight of the Organization's audit functions (external and internal), as well as other investigations (external and internal).

Authority

The Audit Committee has authority to:

- Retain the Organization's external [and internal] auditors.
- Investigate any matter brought to its attention with complete and unrestricted access to all books, records, documents, facilities, and personnel of the Organization.
- Retain outside counsel, auditors, investigators, or other experts in the fulfillment of its responsibilities, including the sole authority to approve the firms' fees and other retention terms.

The Committee shall be provided with the resources necessary to discharge its responsibilities. The Board shall review the adequacy of this Charter on an annual basis. The Committee may form and delegate authority to subcommittees and may delegate authority to one or more members of the Committee.

Membership

The Audit Committee shall be a standing committee of the Board of Directors, comprised of not less than three members of the Board. Members of the Committee shall:

1. Have no relationship to the Organization that may interfere with the exercise of their independence from management and the Organization;
2. Not be members of the Organization's Finance Committee, a separate committee of the Board of Directors;
3. Be financially literate regarding the specialized matters of Organization or shall acquire such financial literacy within a reasonable time period after appointment to the Committee.

In addition, at least one member of the Committee shall be a financial expert possessing the following characteristics:

1. An understanding of generally accepted accounting principles applicable to the Organization and financial statements;

2. The ability to assess the application of generally accepted accounting principles in connection with accounting for estimates, accruals, and reserves of the Organization;
3. Experience preparing, auditing, analyzing, or evaluating financial statements of comparable complexity to those of the Organization;
4. Understanding of internal controls and procedures for financial reporting; and
5. Understanding of audit committee functions.

Appointments to the Audit Committee shall be for two-year terms and eligible for consecutive appointments of no more than one additional two-year term.

Responsibilities

The Committee's role is one of oversight, recognizing that the Organization's management is responsible for preparing the Organization's financial statements and that the external auditors are responsible for auditing those financial statements. The Committee recognizes that the Organization's internal financial management team, as well as the external auditors, have more time and detailed information about the Organization than do Committee members. Consequently, in discharging its oversight responsibilities, the Committee is not providing expert advice or any assurances as to the Organization's financial statements or any professional certification as to the external auditor's services.

The Committee shall have certain responsibilities in the areas of financial reporting, internal control, and organizational governance.

In the areas of financial **reporting and internal control**, the Committee shall:

- Oversee the external audit process, including nomination of the external audit firm, auditor engagement letters and fees, timing and coordination of audit fieldwork visits, monitoring of audit results, review of auditor's performance, and review of non-audit services provided by the external audit firm for compliance with professional independence standards;
- Review accounting policies;
- Review the Organization's financial statements, including year-end and interim financial statements, other reports requiring approval by the Board before submission to government agencies, and auditor opinions and management letters;
- Determine that all required tax and information return filings with Federal, state and local government agencies are current and in compliance with reporting requirements;
- Receive and review any other communications from the external auditors that the external auditors are required to submit to the Board or Committee under currently applicable professional auditing standards;
- Review and discuss with management the findings and recommendations communicated by the external auditor;
- Inquire about the existence and nature of significant audit adjustments proposed by the external auditors and significant estimates made by management;
- Meet privately with the external auditors to discuss the quality of management, financial, accounting, information technology and internal audit personnel, and to determine whether any restrictions have been placed by management on the scope of their external audit or if there are any other matters that should be discussed with the Committee;

- Review the letter of management representations provided to the external auditors as part of the annual audit and inquire as to whether any difficulties were encountered in obtaining the representation letter;
- Prepare a report, signed by the chair of the Committee, for presentation to the full Board of Directors, describing the activities and responsibilities of the Committee.
- Direct special investigations into significant matters brought to its attention within the scope of its duties;
- Review this Charter on an annual basis and propose any recommended changes to the Board.

In the area of Organizational **governance**, the Committee shall:

- Review Organization policies regarding compliance with laws and regulations, ethics, employee conduct, conflicts of interest, and the investigation of misconduct or fraud;
- Review current and pending litigation or regulatory proceedings impacting Organizational governance in which the Organization is a party;
- Establish and monitor Organization procedures for receiving and handling complaints about accounting and auditing matters;
- Review significant cases of employee or director conflict of interest, misconduct or fraud;
- Review and approve the internal audit charter, which explains the framework for providing internal audit services to management and the Committee;
- Review and approve management's appointment and termination of the Organization's Director of Internal Audit;
- Review plans and budgets associated with the internal audit function to determine that audit objectives, plans, financial budgets, and schedules provide for adequate support of the Audit Committee's goals and objectives;
- Require the Director of Internal Audit to prepare a written report on an annual basis describing the scope and results of internal audit procedures;
- Discuss with the Director of Internal Audit and the external audit firm the reliability of the Organization's information technology system and any specific security measures in protecting the Organization against fraud and abuse;
- Meet regularly with the Organization's general counsel to discuss legal matters that may have a significant impact on the Organization.

The Committee shall meet on a regular basis and call special meetings as deemed necessary in fulfilling the responsibilities described in this Charter.

Part VI Governance, Management, and Disclosure (Sections A, B, and C request information about policies not required by the Internal Revenue Code.)

Section A. Governing Body and Management

		Yes	No
For each "Yes" response to lines 2–7b below, and for a "No" response to lines 8 or 9b below, describe the circumstances, processes, or changes in Schedule O. See instructions.			
1a	Enter the number of voting members of the governing body	1a	
b	Enter the number of voting members that are independent	1b	
2	Did any officer, director, trustee, or key employee have a family relationship or a business relationship with any other officer, director, trustee, or key employee?	2	
3	Did the organization delegate control over management duties customarily performed by or under the direct supervision of officers, directors or trustees, or key employees to a management company or other person?	3	
4	Did the organization make any significant changes to its organizational documents since the prior Form 990 was filed?	4	
5	Did the organization become aware during the year of a material diversion of the organization's assets?	5	
6	Does the organization have members or stockholders?	6	
7a	Does the organization have members, stockholders, or other persons who may elect one or more members of the governing body?	7a	
b	Are any decisions of the governing body subject to approval by members, stockholders, or other persons?	7b	
8	Did the organization contemporaneously document the meetings held or written actions undertaken during the year by the following:		
a	The governing body?	8a	
b	Each committee with authority to act on behalf of the governing body?	8b	
9a	Does the organization have local chapters, branches, or affiliates?	9a	
b	If "Yes," does the organization have written policies and procedures governing the activities of such chapters, affiliates, and branches to ensure their operations are consistent with those of the organization?	9b	
10	Was a copy of the Form 990 provided to the organization's governing body before it was filed? All organizations must describe in Schedule O the process, if any, the organization uses to review the Form 990	10	
11	Is there any officer, director or trustee, or key employee listed in Part VII, Section A, who cannot be reached at the organization's mailing address? If "Yes," provide the names and addresses in Schedule O	11	

Section B. Policies

		Yes	No
12a	Does the organization have a written conflict of interest policy? If "No," go to line 13	12a	
b	Are officers, directors or trustees, and key employees required to disclose annually interests that could give rise to conflicts?	12b	
c	Does the organization regularly and consistently monitor and enforce compliance with the policy? If "Yes," describe in Schedule O how this is done	12c	
13	Does the organization have a written whistleblower policy?	13	
14	Does the organization have a written document retention and destruction policy?	14	
15	Did the process for determining compensation of the following persons include a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision:		
a	The organization's CEO, Executive Director, or top management official?	15a	
b	Other officers or key employees of the organization? Describe the process in Schedule O. (see instructions)	15b	
16a	Did the organization invest in, contribute assets to, or participate in a joint venture or similar arrangement with a taxable entity during the year?	16a	
b	If "Yes," has the organization adopted a written policy or procedure requiring the organization to evaluate its participation in joint venture arrangements under applicable federal tax law, and taken steps to safeguard the organization's exempt status with respect to such arrangements?	16b	

Section C. Disclosure

- 17** List the states with which a copy of this Form 990 is required to be filed ▶
- 18** Section 6104 requires an organization to make its Forms 1023 (or 1024 if applicable), 990, and 990-T (501(c)(3)s only) available for public inspection. Indicate how you make these available. Check all that apply.
 Own website Another's website Upon request
- 19** Describe in Schedule O whether (and if so, how), the organization makes its governing documents, conflict of interest policy, and financial statements available to the public.
- 20** State the name, physical address, and telephone number of the person who possesses the books and records of the organization: ▶

Supplemental Financial Statements

2008

Open to Public Inspection

Department of the Treasury Internal Revenue Service

Attach to Form 990. To be completed by organizations that answered "Yes," to Form 990, Part IV, line 6, 7, 8, 9, 10, 11, or 12.

Name of the organization Employer identification number

Part I Organizations Maintaining Donor Advised Funds or Other Similar Funds or Accounts. Complete if the organization answered "Yes" to Form 990, Part IV, line 6.

Table with columns (a) Donor advised funds and (b) Funds and other accounts. Rows include Total number at end of year, Aggregate contributions, Aggregate grants, Aggregate value, and Yes/No questions about donor advisement.

Part II Conservation Easements. Complete if the organization answered "Yes" to Form 990, Part IV, line 7.

Conservation Easements section including checkboxes for purposes (public use, natural habitat, open space, historic structure), a table for held easements at end of year (2a-2d), and questions about monitoring and reporting.

Part III Organizations Maintaining Collections of Art, Historical Treasures, or Other Similar Assets. Complete if the organization answered "Yes" to Form 990, Part IV, line 8.

Part III questions regarding reporting of art and historical treasures, including revenue and asset amounts for public exhibition or financial gain.

Part II Fundraising Events. Complete if the organization answered "Yes" to Form 990, Part IV, line 18, or reported more than \$15,000 on Form 990-EZ, line 6a. List events with gross receipts greater than \$5,000.

		(a) Event #1	(b) Event #2	(c) Other Events	(d) Total Events (Add col. (a) through col. (c))
		(event type)	(event type)	(total number)	
Revenue	1 Gross receipts				
	2 Less: Charitable contributions				
	3 Gross revenue (line 1 minus line 2)				
Direct Expenses	4 Cash prizes				
	5 Non-cash prizes				
	6 Rent/facility costs				
	7 Other direct expenses				
	8 Direct expense summary. Add lines 4 through 7 in column (d) ▶				
9 Net income summary. Combine lines 3 and 8 in column (d) ▶					

Part III Gaming. Complete if the organization answered "Yes" to Form 990, Part IV, line 19, or reported more than \$15,000 on Form 990-EZ, line 6a.

		(a) Bingo	(b) Pull tabs/Instant bingo/progressive bingo	(c) Other gaming	(d) Total gaming (Add col. (a) through col. (c))	
Revenue	1 Gross revenue					
Direct Expenses	2 Cash prizes					
	3 Non-cash prizes					
	4 Rent/facility costs					
	5 Other direct expenses					
	6 Volunteer labor	<input type="checkbox"/> Yes _____% <input type="checkbox"/> No	<input type="checkbox"/> Yes _____% <input type="checkbox"/> No	<input type="checkbox"/> Yes _____% <input type="checkbox"/> No		
	7 Direct expense summary. Add lines 2 through 5 in column (d) ▶					()
	8 Net gaming income summary. Combine lines 1 and 7 in column (d) ▶					

	Yes	No
9 Enter the state(s) in which the organization operates gaming activities: _____		
a Is the organization licensed to operate gaming activities in each of these states?	9a	
b If "No," Explain: _____ _____		
10a Were any of the organization's gaming licenses revoked, suspended or terminated during the tax year?	10a	
b If "Yes," Explain: _____ _____		
11 Does the organization operate gaming activities with nonmembers?	11	
12 Is the organization a grantor, beneficiary or trustee of a trust or a member of a partnership or other entity formed to administer charitable gaming?	12	

			Yes	No
13 Indicate the percentage of gaming activity operated in:	a The organization's facility	13a	%	
	b An outside facility	13b	%	
14 Provide the name and address of the person who prepares the organization's gaming/special events books and records:				
Name ▶				
Address ▶				
15a Does the organization have a contract with a third party from whom the organization receives gaming revenue?				15a
b If "Yes," enter the amount of gaming revenue received by the organization ▶ \$, and the amount of gaming revenue retained by the third party ▶ \$				
c If "Yes," enter name and address:				
Name ▶				
Address ▶				
16 Gaming manager information:				
Name ▶				
Gaming manager compensation ▶ \$				
Description of services provided ▶				
<input type="checkbox"/> Director/officer <input type="checkbox"/> Employee <input type="checkbox"/> Independent contractor				
17 Mandatory distributions:				
a Is the organization required under state law to make charitable distributions from the gaming proceeds to retain the state gaming license?				17a
b Enter the amount of distributions required under state law distributed to other exempt organizations or spent in the organization's own exempt activities during the tax year ▶ \$				

**SCHEDULE J
(Form 990)**

Compensation Information

OMB No. 1545-0047

2008

For certain Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees

▶ Attach to Form 990. To be completed by organizations that answered "Yes" to Form 990, Part IV, line 23.

Open to Public Inspection

Department of the Treasury
Internal Revenue Service

Name of the organization	Employer identification number
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Part I Questions Regarding Compensation

	Yes	No
1a Check the appropriate box(es) if the organization provided any of the following to or for a person listed in Form 990, Part VII, Section A, line 1a. Complete Part III to provide any relevant information regarding these items.		
<input type="checkbox"/> First-class or charter travel <input type="checkbox"/> Housing allowance or residence for personal use <input type="checkbox"/> Travel for companions <input type="checkbox"/> Payments for business use of personal residence <input type="checkbox"/> Tax indemnification and gross-up payments <input type="checkbox"/> Health or social club dues or initiation fees <input type="checkbox"/> Discretionary spending account <input type="checkbox"/> Personal services (e.g., maid, chauffeur, chef)		
b If line 1a is checked, did the organization follow a written policy regarding payment or reimbursement or provision of all of the expenses described above? If "No," complete Part III to explain	1b	
2 Did the organization require substantiation prior to reimbursing or allowing expenses incurred by all officers, directors, trustees, and the CEO/Executive Director, regarding the items checked in line 1a?	2	
3 Indicate which, if any, of the following the organization uses to establish the compensation of the organization's CEO/Executive Director. Check all that apply.		
<input type="checkbox"/> Compensation committee <input type="checkbox"/> Written employment contract <input type="checkbox"/> Independent compensation consultant <input type="checkbox"/> Compensation survey or study <input type="checkbox"/> Form 990 of other organizations <input type="checkbox"/> Approval by the board or compensation committee		
4 During the year, did any person listed in Form 990, Part VII, Section A, line 1a:		
a Receive a severance payment or change of control payment?	4a	
b Participate in, or receive payment from, a supplemental nonqualified retirement plan?	4b	
c Participate in, or receive payment from, an equity-based compensation arrangement?	4c	
If "Yes" to any of lines 4a–c, list the persons and provide the applicable amounts for each item in Part III.		
Only 501(c)(3) and 501(c)(4) organizations must complete lines 5–8.		
5 For persons listed in Form 990, Part VII, Section A, line 1a, did the organization pay or accrue any compensation contingent on the revenues of:		
a The organization?	5a	
b Any related organization?	5b	
If "Yes" to line 5a or 5b, describe in Part III.		
6 For persons listed in Form 990, Part VII, Section A, line 1a, did the organization pay or accrue any compensation contingent on the net earnings of:		
a The organization?	6a	
b Any related organization?	6b	
If "Yes" to line 6a or 6b, describe in Part III.		
7 For persons listed in Form 990, Part VII, Section A, line 1a, did the organization provide any non-fixed payments not described in lines 5 and 6? If "Yes," describe in Part III	7	
8 Were any amounts reported in Form 990, Part VII, paid or accrued pursuant to a contract that was subject to the initial contract exception described in Regs. section 53.4958-4(a)(3)? If "Yes," describe in Part III	8	