NOT-FOR-PROFIT AND EDUCATION

RAISING THE BAR ON FINANCIAL GOVERNANCE

Best practices for not-for-profit boards of directors in Ontario

THE ENVIRONMENT IN WHICH NOT-FOR-PROFIT ORGANIZATIONS OPERATE IS RAPIDLY CHANGING: ACCELERATING TECHNOLOGY, COMPLEX OPERATING ENVIRONMENTS AND GREATER STAKEHOLDER EXPECTATIONS FOR ACCOUNTABILITY AND TRANSPARENCY. AT THE SAME TIME, THE CANADA NOT-FOR-PROFIT CORPORATIONS ACT (CNCA), WHICH CAME INTO FORCE IN 2011, AND THE ONTARIO NOT-FOR-PROFIT CORPORATIONS ACT (ONCA), WHICH IS EXPECTED TO COME INTO FORCE IN 2016, HAVE ESTABLISHED NEW LEGISLATIVE AND GOVERNANCE FRAMEWORKS.

More than ever before, board members are held to a higher degree of accountability. Anyone who joins the board of a not-for-profit or charitable organization should be prepared to govern with a clear understanding of their responsibilities and a strong focus on best practices. These Acts establish higher standards of oversight in a number of areas — including financial accountability. For example, the duties, powers, liabilities, protections and standards of care for directors are clarified. Not-for-profit corporations must now make their financial statements available to members. They will also be categorized according to whether they solicit public donations or government funding, with requirements for financial audit or review engagements based on these categories and on gross annual revenue.

Financial oversight represents only one area of director responsibility and this issue should not detract attention from other important governance responsibilities such as vision, mission, strategic direction, programs, personnel and advocacy. By building a strong foundation for financial governance, directors can be assured that effective policies and controls are in place, and can focus their attention on priorities.

The following are important areas that will help to establish a reliable foundation:

- Financial management
- Finance committee
- Audit committee
- Budgeting
- Financial resources
- Internal controls
- Fraud risk management
- Reporting and filing obligations
- Compliance with by laws (ONCA)

Financial Management

All members of the board of directors share responsibility for properly managing and protecting the assets of the organization they serve by developing appropriate policies and procedures. While these will vary according to an organization's particular characteristics, common components include: accounting procedures, internal controls, budgeting, financial record keeping and reporting, and asset protection.

About Us

BDO's Not-For-Profit and Education Practice team provides a full range of tailored services to help organizations like yours address their changing needs and identify new opportunities. Our strength and depth of expertise with organizations operating at the local, provincial and/or national levels means that our professionals are able to apply practical knowledge and insight to assist you in addressing the various challenges you face. As a member firm of the international BDO network, we also have access to advisors around the globe with over 1,300 offices in more than 150 countries.

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Best practices

- All board members should be sufficiently financially literate to understand terminology, read financial statements and ask appropriate questions
- Develop financial management policies that encompass all critical financial areas of the operation
- Establish a finance and/or audit committee to contribute additional financial oversight

Finance Committee

Depending on the size and complexity of an organization, a board may establish a finance committee to provide assurance that finances are being handled appropriately. This committee should meet on a regular basis to review, in advance of the board, the treasurer's reports, the budget and financial statements. The committee then makes recommendations to the Board regarding its findings.

Best practices

- A minimum of three members on the committee should be financially literate (understand budgets, statements of financial position, statements of operations and fund balance, and cash flow statements)
- In the absence of an audit committee, this committee should review all policies related to financial management
- In small organizations, the finance committee often also assumes the responsibilities of an audit committee (see below)

Audit Committee

For not-for-profit organizations that are required to have an annual audit of financial records by an independent accounting firm, the audit committee provides oversight regarding the integrity of financial reporting. Since the external auditor is accountable to the Board and not to management, this committee is responsible for recommending the appointment of the external auditor, ensuring the audit is conducted efficiently and cost-effectively, and recommending to the Board approval of the annual audited financial statements. This committee also recommends to the Board appropriate compensation for the auditor, provides guidance regarding the specific areas to be addressed during the audit, oversees the work of the auditor and thoroughly reviews draft financial statements and auditor recommendations.

If current board members don't possess the requisite skills to serve on the finance committee or the audit committee, the board should be prepared to recruit new directors from outside the organization.

Best practices

- A minimum of three members on the committee should understand the organization's financial reporting system and have knowledge of operations, internal controls and risks
- At least one member on the committee should have specific accounting expertise
- The terms of reference should clearly outline the committee's responsibilities and specific duties
- The committee should provide oversight of ethical and compliance commitments of management and employees
- The committee should establish an annual agenda, schedule regular meetings with set agendas and maintain minutes of each meeting

Budgeting

Annual budgeting is integral to protecting assets, ensuring that funds are used appropriately and for properly managing income and investments. Thus all members of the board — not just the finance committee — have certain responsibilities for the budget. These include developing policies that outline responsibilities for budget preparation, approval and monitoring. Policies should also address major expenditure decisions such as capital item purchases, staff hires and wage increases. Every board member should carefully review the annual operating budget before approving it.

Best practices

- Have a clear understanding of the organization's financial situation prior to approving the budget
- Regularly monitor the budget by comparing it with actual results to ensure that revenue, expenses and investments are meeting expectations and question variances
- Hold staff accountable for providing timely and accurate monthly reports including explanations of any significant issues
- Review the statements of financial position, statements of operations and fund balance, and cash flow statements every quarter to identify trends

Financial Resources

The Board must ensure that an organization has sufficient financial resources to achieve its mission. This requires certain due diligence; for example, directors should carefully review audited financial statements for any significant changes in financial assets. As well, when an organization relies on fundraising activities to finance services and programs, the Board should ensure donor contributions and endowments are used as they were intended, monitor how well funds are managed and ensure the cost of raising funds is reasonable.

Best practices

- Review terms of reference for restricted funds
- Provide financial literacy training for directors
- Review reports on the organization's fundraising practices
- Review funding agreements to ensure the organization is in compliance
- Ensure that sufficient controls are in place for fundraising and other revenue-generating activities
- Carefully review monthly or quarterly financial reports

Internal Controls

Internal controls ensure that assets are safeguarded and that transactions are properly authorized, recorded and reported. The Board's responsibilities include developing policies that encompass transactions, communication, implementation, monitoring and review. As well, directors should seek regular assurance from management that controls are functioning effectively.

Best practices

- Regularly review management reports on internal controls
- Inquire about significant risks and how they have been addressed
- Question how weaknesses have been addressed
- Ensure that fraud detection practices are included in internal control policies
- Question whether the current monitoring process is sufficient

Fraud Risk Management

Should fraud occur within a not-for-profit or charitable organization, Board members could be held liable for missing funds, even if they were unaware that fraud occurred. Thus the Board must oversee and evaluate an organization's fraud risk management policies in order to protect the public, the organization and themselves. Directors should also be aware of potential fraud threats and acquire a full understanding of the steps management has taken to prevent and detect fraud.

Best Practices

- Institute policies for codes of conduct, conflicts of interest, management reviews and whistleblowing
- Question how management's audit strategies and internal controls address fraud risk
- Appoint an auditor to assess the effectiveness of the organization's anti-fraud controls
- Include a risk management review as a regular Board agenda item
- Ensure that each Board member has sufficient director's liability insurance

Reporting and Filing Obligations

The Board is responsible for ensuring the organization meets its tax obligations and reporting requirements. The consequences of failing to do so can be serious, including fines and even revocation of charity status. As well, more than 100 federal and provincial statutes can impose personal liability on directors if a not-for-profit fails to pay wages to employees or taxes to the government.

While obligations vary depending upon the complexity of the organization and whether it is incorporated or a registered charity, these may include filing remittances (e.g. Employment Insurance and Canada Pension Plan deductions), payment of sales and income taxes, payroll taxes and other government remittances as well as ensuring the organization is complying with the terms of grants and contracts.

Best practices

- Know your organization's reporting and filing obligations
- Clarify responsibilities and timing for filing of relevant documents and submitting remittances
- Consult an accountant and lawyer who specializes in not-for-profits and their requirements

By -Laws

Under ONCA, all by-laws in Ontario will need to be reviewed by the Board and amended with a vote to the members once it is passed in 2016.

Best practices

- Start early
- Appoint a by-law committee, and ensure a lawyer and accountant are part of it
- Review ONCA requirements and draft new by-laws
- Arrange for Board meeting to review
- Put vote to members once ONCA passes

Directors: Know your Personal Responsibilities for Diligent Financial Stewardship

Although directors can delegate many financial matters to an executive director or finance or audit committee, when it comes to ensuring that a not-for-profit or charitable organization is financially secure, every member of the Board is personally accountable.
The following Board practices will help to ensure that all directors understand their responsibilities and obligations with respect to the financial integrity of the enterprise they govern.

- Clearly define director roles and expectations and terms of reference for committees
- Ensure that all directors are financially literate (understand budgets, statements of financial position, statements of operations and fund balance and cash flow statements) or willing to learn
- Build the financial competence of new board members (e.g. with briefings, workshops, mentoring, reference materials)
- Provide a board orientation program that includes equipping new members with the organization's strategic plan, complete financial information, by-laws and past minutes for review
- Require all board members to dedicate sufficient time to be informed, diligent and probing
- Require all directors to review relevant materials provided prior to board meetings and to be prepared to discuss and debate financial reports and issues

Board members are now held to a higher degree of accountability for the financial integrity of the not-for-profit and charitable organizations they govern. Serving in this role, however, is also a privilege — an opportunity to learn best practices that will contribute lasting value to your own expertise and to the organizations you serve today and in the future.