



# What is SAS 112 and How Will It Affect You?

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# Your Presenters

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# Webinar Feedback

- Attendee Control Panel
  - My Details – Satisfaction Rating
  - Question and Answer
    - Question and Answer Log
    - Enter a question for the staff



# Today's Agenda

- Overview of Risk Assessment Standards and SAS 112
- Definitions of Key Terms
- Examples of their application and strategies for addressing common control deficiencies in nonprofits
- Next steps



# SAS 112

- Statement on Auditing Standards (SAS) 112
- Effective for FY ending 12/31/2006
- If the auditor finds a gap in internal controls, they are required to:
  - Evaluate it
  - Classify it
  - Report it



# Risk Assessment Standards

- Effective for FY ending 12/31/2007
- Require:
  - More in-depth understanding of organization
  - More rigorous assessment of risk of material misstatement



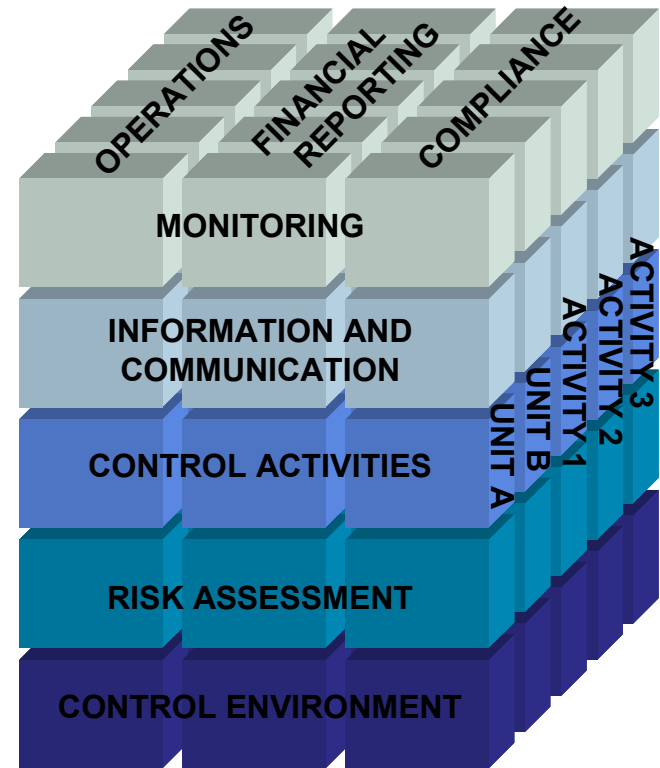
# Internal Controls

- COSO
  - Process, affected by
  - An entity's board of directors, management and other personnel,
  - Designed to provide reasonable assurance
  - Regarding the achievement of objectives in the following categories:
    - Effectiveness and efficiency of operations.
    - Reliability of financial reporting.
    - Compliance with applicable laws and regulations.



# COSO Framework

1. Consists of three objectives:
  - Effectiveness and efficiency of operations
  - Reliability of financial reporting
  - Compliance with applicable laws and regulations
2. Consists of five components:
  - Control environment
  - Risk assessment
  - Control activities
  - Information/Communication
  - Monitoring
3. Requires an entity level focus and an activity level focus



# Internal Control Gaps

SAS 60	SAS 112
N/A	Deficiency
Reportable Condition	Significant Deficiency
Material Weakness	Material Weakness



# Deficiencies

- A **control deficiency** “exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.”
- A **significant deficiency** “is a control deficiency, or combination of control deficiencies, that adversely affects the entity’s ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP such that there is more than a remote likelihood that a misstatement of the entity’s financial statements that is more than inconsequential will not be prevented or detected.”
- A **material weakness** “is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.”



# Control Consciousness

- Many organizations have insufficient control consciousness within the organization
  - Board level
  - Management
  - Non-financial personnel
- Trust but verify
- Policy, procedure, forms and approvals make internal controls explicit internally and demonstrable to outsiders



# Examples

Using corporate credit card for personal use

Board of Directors rarely meets / sketchy minutes from meetings

No audit committee / lack of communication with auditors

Senior management sees controls as “red tape”

# Strategies to Address

- Define internal controls
  - Be realistic
  - Keep it simple
- Incorporate internal controls responsibilities into board member position and job descriptions
- Educate board members, management team members, and staff
  - Recruitment
  - Orientation
  - Training



# Management Override

- Controls apply to everyone all the time
- Checks and balances must be in place and maintained
- One person should not be able to make unilateral decisions



# Examples



Failure to submit receipts for items charged on corporate credit card



Alteration of functional allocation on financial statements



Entering into significant contracts without board approval

# Strategies to Address

- Secure board and senior management commitment to internal controls and willingness to practice what they preach
- Champion the creation or revitalization of an audit committee
- Define a whistleblower policy
- Implement a whistleblower hotline or submission mechanism



# Documentation of Internal Control

- If it's not documented, it doesn't happen



# Strategies to Address

- Start with policy
  - Revise or create board committee charters
  - Revise or create conflicts of interest policies
  - Revise or create records retention policies
  - Revise or create whistleblower policies
  - Revise or create accounting policy and procedure manual
- Train everyone on the manual.
- Incorporate policies and procedures into orientation.
- Periodically evaluate compliance and report to the board.



# Financial Statement Prep

- The financial statements and related footnotes are the responsibility of management not the auditors.
- Capacity constraint – not a deficiency
- Capability constraint – may be a deficiency



# Examples

- Accountant is capable of preparing financial statements
  - Has consistently prepared statements in past but cannot do it this year due to computer installation
- Accountant cannot prepare financial statements
  - Can accurately keep the cash basis books and records and prepare unadjusted trial balance but does not know how to compute the accruals or prepare the financial statements



# Strategies to Address

- Talk with the auditors
- Perform a cost/benefit analysis
- Recruit a Treasurer with desired capability
- Bring in a financially competent volunteer
- Hire a part-time or as needed CFO or Controller with an audit background and/or CPA license
- Design financial reports in your accounting software
- Get a disclosure checklist from the auditor
- Attend a course on how to prepare financial statements



# Reconciliations

- Failure to perform reconciliations of significant accounts in a timely or accurate manner:
  - AR balance in the GL to accounts receivable subsidiary ledgers.
  - AP balance in the GL to accounts payable subsidiary ledgers.
- Failure to have someone review reconciliations performed



# Strategies to Address

- Use the subsidiary ledgers to record transactions not the general ledger
- Keep data entry current
- Perform reconciliations on a monthly basis – don't get behind
- Supervisor should review reconciliations



# Segregation of Duties

- Typically inadequate amongst small organizations and nonprofits, in particular
- The goal is to separate
  - Custody
  - Authorization
  - Record Keeping
  - Reconciliation



# Strategies to Address

- Have contributions, member fees, and other cash receipts go to lockboxes
- Do not maintain petty cash funds
- Keep check stock stored in a locked location
- Do not allow the person with access to check stock to have access to a signature stamp
- Utilize positive pay
- Utilize the board treasurer to prepare reconciliations
- Utilize a payroll service and make electronic deposits
- Don't give the accountant authority to approve transactions
- Conduct random audits of transactions
- Set up system access to mirror segregation of duties



# Next Steps

1. Educate your audit and/or finance committee as well as your board of directors.
2. Conduct your own risk assessment.
3. Meet with your external financial statement auditors to review the results of their risk assessment and understand their audit approach.
4. Request your auditors to communicate deficiencies early and often.
5. Improve your segregation of duties.
6. Enforce your segregation of duties with controlled system access.
7. Document your current accounting policies and procedures and make them available to everyone.
8. Write management's response.
9. Request a communication from your auditors if no material weaknesses were found.



# Resources

- BoardSource – [www.boardsource.org](http://www.boardsource.org)
- Center for Nonprofit Advancement - [www.nonprofitadvancement.org](http://www.nonprofitadvancement.org)
- MANO - [www.marylandnonprofits.org](http://www.marylandnonprofits.org)
- Greater DC Cares - [www.dc-cares.org](http://www.dc-cares.org)
- GWSCPA NFP Accountability Task Force [www.nonprofitaccountingbasics.org](http://www.nonprofitaccountingbasics.org)



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