Internal Controls for Nonprofits

from the National Council of Nonprofits

"Internal controls" are financial management practices that are systematically used to prevent misuse and misappropriation of assets, such as occur through theft or embezzlement. Internal controls are generally described in written policies that set forth the procedures that the nonprofit will follow, as well as who is responsible. The goal of internal controls is to create business practices that serve as "checks and balances" on staff (and sometimes board members) and/or outside vendors, in order to reduce the risk of misappropriation of funds/assets.

Example of a basic internal control: A policy that requires two signatures on a check is a basic internal control. This business practice is designed to prevent one person from having sole authority for writing checks on the nonprofit's behalf.

Example of an internal control that every nonprofit can put into practice: A policy to lock the office door when no one is monitoring the entrance. This policy is designed to minimize the risk of theft of computers that can happen in broad daylight, and with very little time needed to unplug, pick up, and carry away some of the nonprofit's most precious assets.

More examples of internal control policies:

- A policy requiring that employees may only be reimbursed for expenses that are approved in advance, in writing;
- A "segregation of duties" policy requiring that the person who logs in checks received in the mail is not the same person who is responsible for depositing checks. Similarly, the same person should not both prepare the payroll, and also distribute or have custody of the payroll checks.
- A periodic review by an objective person of the list of all vendors receiving fees/checks from the nonprofit (because a common scheme involves creating a fictitious vendor).
- A policy to keep all cash in a locked drawer and to deposit cash and checks in the bank, soon after they are received.
- A policy to conduct a background check of employees who handle money, prior to hire and periodically throughout employment.

Where should you start? The top priority for any nonprofit is to put in place at least the basic internal controls that address *who has access* to the nonprofit's bank accounts, and *who has authority* to spend money on the nonprofit's behalf, whether via check, cash, credit card, or some other means.

Most internal controls are common sense – but not all those described in the resources below may make sense for your nonprofit. Your nonprofit's insurance agent or broker, or an accountant, can provide advice about what is needed at your nonprofit.

Practice Pointers

- If your nonprofit uses checks, who has access to blank checks? And who is authorized to sign them? Perhaps using other methods to transfer payments than check-writing is a risk management strategy to consider.
- Does everyone in your nonprofit (including board members) know how money moves through the organization? Creating a flowchart will help everyone visualize the journey, which can also prompt discussion about who is responsible at which stages, and where internal control weaknesses could exist. Read more practical tips in this guest blog post: 3 rules for strong internal controls for small nonprofits (Andy Robinson and Nancy Wasserman)
- Know what documentation you should be keeping, and be consistent. Adopting a written policy helps everyone know what the expectations are, such as for requesting reimbursements. Examples: Reimbursement of expenses over $5 requires a receipt; All vendors must submit invoices that include a detailed description of services rendered. Other examples described here: Protecting assets with sound internal controls (Minnesota Council of Nonprofits)
- Two easy steps even very small nonprofits can take to strengthen internal controls are: (1) conduct a "surprise internal audit" - An unexpected examination of how cash and checks flow through the organization, and what vendors are receiving payments for, can deter fraudulent schemers; (2) Make sure that a second person, besides the designated "bookkeeper," sees bank statements. This offers another layer of transparency and protection to the organization. You can read more about these two easy strategies here: How to lessen segregation of duties problems in two easy steps (CPA Scribo)
- This is very basic: Define who is responsible for what functions in your organization. Read about Five Internal Controls for the Very Small Nonprofit (Blue Avocado)

Additional Resources

- Guide to Internal Controls and Financial Accountability for not-for-profit-boards (New York State Attorney General)
- Internal controls (Greater Washington Society of CPAs)
- A primer on detecting, preventing, and investigating nonprofit fraud, embezzlement and charitable diversion (Venable, LLP)

Internal Controls Checklist

	Yes	No	Not Sure	Not Applicable
Cash Receipts				
1. Are checks endorsed "for deposit only" immediately upon receipt?	________	________	________	________
2. Does someone prepare a daily list of all cash and checks immediately upon receipt?	________	________	________	________
3. Are duplicate deposit slips and copies of checks retained in the files?	________	________	________	________
4. Is the person who has custody of actual cash and checks different from the person recording them and acknowledging them in case of contributions?	________	________	________	________
5. Are all cash and checks deposited intact and on a timely basis?	________	________	________	________
6. Are restricted contributions clearly identified and recorded as restricted on the general ledger?	________	________	________	________
7. Is all cash received, counted and verified by two employees?	________	________	________	________
8. When events involve admission fees, does the agency issue pre-numbered tickets, with a record of tickets printed, issued, used and unused, which is then compared to funds deposited?	________	________	________	________
9. Does the organization send acknowledgements to contributors and are copies of or record of such acknowledgements kept on file?	________	________	________	________

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Cash Disbursements				
10. Are all disbursements, except those from petty cash, made by pre-numbered checks?	________	________	________	________
11. Are void checks preserved and filed after appropriate mutilation?	________	________	________	________
12. Is there a written prohibition against issuing checks payable to “cash”?	________	________	________	________
13. Is there a written prohibition against signing checks in advance?	________	________	________	________
14. Is a cash disbursement voucher prepared for each invoice or request for reimbursement that details the description of expense account to be charged and contains authorization signature and accompanying receipts and/or vendor invoices?	________	________	________	________
15. Are all expenses approved in advance by authorized persons?	________	________	________	________
16. Do the check signors review supporting documentation of expenses and approvals at the time of signing checks?	________	________	________	________
17. Are signed checks mailed promptly?	________	________	________	________
18. Are paid invoices marked paid or attached to a copy of the check prior to filing?	________	________	________	________
19. Are requests for reimbursement checked for mathematical accuracy and reasonableness before approval?	________	________	________	________
20. Is check-signing authority vested in persons at appropriately high levels in the organization who do not have any accounting responsibility?	________	________	________	________
21. Do checks require two signatures?	________	________	________	________
22. Are bank statements and cancelled checks received and reviewed by a person independent of the accounting functions?	________	________	________	________
23. Are unpaid invoices maintained in an unpaid invoice file?	________	________	________	________
24. Is a list of unpaid invoices regularly prepared, reviewed and compared to those invoices in the unpaid invoice file?	________	________	________	________

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25. If purchase orders are used, are all purchases supported by a pre-numbered purchase order?	________	________	________	________
26. Are advance payments to vendors and/or employees recorded as receivables and controlled in a manner which assures that they will be offset against invoices or expense vouchers?	________	________	________	________
27. Are employees required to submit expense reports for all travel related expenses on a timely basis?	________	________	________	________
Petty Cash				
28. Is an imprest petty cash fund maintained for payment of small, incidental expenses?	________	________	________	________
29. Does the organization follow a policy limiting the amount that can be reimbursed by the petty cash fund?	________	________	________	________
30. Is supporting documentation required for all petty cash disbursements?	________	________	________	________
31. Is a petty cash voucher filled out with supporting documentation, name of person being reimbursed, and proper authorization?	________	________	________	________
32. Is access to petty cash limited to one person who is the fund custodian?	________	________	________	________
33. Are unannounced counts of petty cash made by someone within the organization other than the fund custodian?	________	________	________	________
Payroll				
34. Are time sheets required documenting employee hours, overtime and what activity the employee worked on?	________	________	________	________
35. Are time sheets signed by employees and reviewed and signed by their immediate supervisors?	________	________	________	________
36. Are employment records maintained for each employee that detail wage rates, benefits, tax rates, and other pertinent information?	________	________	________	________
37. Are withheld employment taxes and employer taxes paid on a timely basis to the taxing authorities?	________	________	________	________

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38. Do written policies and procedures exist for accounting for vacations, holidays, sick leave, and other benefits?	________	________	________	________
Fixed Assets				
39. Does the organization have a capitalization and depreciation policy?	________	________	________	________
40. Are additions to fixed assets recorded in a fixed asset ledger?	________	________	________	________
41. Does the fixed asset ledger list description of each item, serial number, location, date of acquisition, cost or fair value if donated, useful life, depreciation method, accumulated depreciation and funding source if funds were provided by a funding source with restrictions on disposition of assets?	________	________	________	________
42. Is the fixed asset ledger reconciled with the general ledger periodically?	________	________	________	________
43. Are purchase, transfer and disposal of fixed assets promptly recorded in the ledger?	________	________	________	________
44. Does the organization conduct a physical inventory annually and update the fixed asset and the general ledgers?	________	________	________	________
Financial Statements				
45. Is a statement of financial position prepared monthly and reviewed by the management and the finance committee?	________	________	________	________
46. Are monthly reports comparing income and expenses with approved budget by activity and for the organization as a whole prepared and reviewed by the management and the finance committee?	________	________	________	________
47. Is an updated cash flow projection prepared and reviewed by the management and the finance committee?	________	________	________	________
General Area				
48. Is a chart of accounts used?	________	________	________	________
49. Does the chart of accounts provide for tracking expenses by activity?	________	________	________	________
50. Does the chart of accounts provide for tracking direct and indirect expenses if the organization receives federal funds?	________	________	________	________

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51. Does the chart of accounts provide for tracking unallowable costs if the organization expends federal funds?	________	________	________	________
52. Are accounting and program staff knowledgeable about all fund source rules, regulations and requirements?	________	________	________	________
53. Is fund accounting used to track restricted grants and the spending related to them?	________	________	________	________
54. Are accounting records up to date, and monthly financial statements prepared on a timely basis (timely being defined as 10 days to 3 weeks maximum)?	________	________	________	________
55. Does the board of directors approve the annual budget?	________	________	________	________
56. Does an accounting procedure and policies manual exist that is reviewed and revised annually?	________	________	________	________
57. Do accounting staff take annual vacation and are their basic duties performed by someone else in their absence?	________	________	________	________
58. Are all appropriate federal, state, and local information returns filed on a timely basis?	________	________	________	________