

Best Practices for Internal Controls of Nonprofit Organizations

Cash Disbursements

- All invoices should contain the signature or initials of the Executive Director (ED), or another individual with the authority to approve them, to indicate authorization for payment.
- All reimbursements to employees should have sufficient documentation that is signed or initialed by the ED (or another individual with the authority to approve them) to indicate authorization of the reimbursement. No expense reimbursement should be authorized by the individual seeking payment.
- All disbursements should be backed by sufficient documentation, clearly indicating the date incurred, name of the vendor, and amount of the charge. When appropriate, the particular program to be charged should be noted on the documentation as well. The documentation should be easily accessible.
- Documentation behind all individual credit card charges should be attached to the monthly statements.
- Ideally, checks should have two signers. (Some organizations choose to require a second signer for disbursements over a certain dollar amount, such as \$1,000 or \$5,000.)
- The number of authorized signers should be relatively small - for example, the ED, one or two managers, and the board president and treasurer. When positions change, the bank(s) should be notified almost immediately to facilitate signature changes.
- The blank check stock should be maintained in a locked file cabinet or locked desk drawer. The number of people with access to the check stock should be limited.
- The use of a signature stamp is not recommended. If utilized, however, the stamp should be kept in a locked cabinet or locked drawer.

Bank Statements

- Bank statements should be reconciled each month shortly after the month's end.
- Someone independent of the check preparation process should review the bank statements each month, noting any unusual transactions and ensuring that all electronic transfers and withdrawals were for legitimate business purposes.
- Someone independent of the check preparation process should review the canceled check images each month, noting any unusual payees, amounts, and unauthorized signers. Special attention should be paid to payments to authorized check signers, related parties, and unfamiliar vendors.
- The results of the reviews of the bank statements and canceled check images should be explicitly documented and signed each month. The results of any items that required follow-up procedures should be noted.

Cash Receipts

- Dual control over incoming donations is important – paper checks are almost as liquid as currency. Two individuals should open the mail together every day and note the incoming checks in a cash receipts log. The log should be signed or initialed by both individuals. Periodically, a third individual should compare the amounts noted in the cash receipts log to the amounts actually deposited into the bank account.
- All checks should be endorsed by the organization almost immediately after receipt.
- Deposits should be made frequently - daily if possible.
- Dual control over cash receipts at special events is also important. During special events, at least two individuals should have custody and oversight of the cash at all times. At the end of the event the cash proceeds should be counted by two individuals. The total should be noted and both individuals should sign a log verifying the total count. This total should later be compared with the amount actually deposited into the bank account.

Payroll Processes

- All timesheets should be completed reasonably thoroughly and signed by the employees and their supervisors.
- Employees who work among different programs should have their time devoted to the various programs noted on their timesheets.
- All payroll reports should be reviewed for reasonableness by someone independent of the payroll preparation process. The reviewer should sign or initial the report after the review has been complete, noting any issues that required additional follow-up.
- On a quarterly basis, someone outside the accounting department (an individual from human resources, for example) should conduct a spot check on selected employees listed on the payroll reports, ensuring that the individuals actually are legitimate employees of the organization and that their wages match their formal pay rates noted in their personnel files.
- The ED should verify with the accounting department a couple times a year to make sure that all the tax payments and filings are up to date. Unpaid employer taxes are an area where the government can hold the individual leaders of the organization personally liable.

Donations

- The organization should develop a process for documenting in-kind donations received, including donor names, addresses, and estimates of value (as determined by the donor, not the organization). The in-kind donations should formally be reported to the accounting department to ensure that they are properly recorded in the financial statements.
- For all contributions of at least \$250, a written acknowledgment must be given to the donor. It's best if an individual uninvolved with the cash receipts process generates these letters.
- A charitable organization must provide a written disclosure statement to donors of a "quid pro quo" contribution (a donation for which the donor receives something of value from the

organization) in excess of \$75. The statement must list the amount of the contribution that is tax deductible.

Funding Requirements

- Know the requirements of all the entities that provide funding to the organization. Know the terms of the contacts.
- Develop - and implement - an effective Cost Allocation Plan to make sure all expenditures of the organization are charged to the various funding sources appropriately.

Reviews of the ED's Expenditures

- A member of the board of directors should retroactively review the ED's monthly credit card statements to make sure all charges appear to be for legitimate business use.
- All expense reimbursements paid to the ED should be retroactively reviewed by a board member to make sure all reimbursed expenses appear to be for legitimate business use.

Organizational Policies: Reckenen *can supply templates of all these policies to the organization if desired:*

- Whistle Blower
- Conflict of Interest
- Document Retention
- Disaster Recovery
- Wireless Devices
- Capitalization Policy - acquisitions of fixed assets over a certain threshold (such as \$2,500) should be capitalized, while those under the threshold should be expensed.

Board Conduct

- Minutes of all board meetings should be stored in a central location.
- Annual budgets should be approved by the board, and board members should take the time to understand all budgetary categories.
- Board members should expect to receive regular budgetary and other financial reports from accounting staff. These reports should be reviewed by board members, who should inquire about significant unexplained budgetary deviations.
- Board members should be cognizant of the financial health of the organization and ask questions when appropriate.
- The board should evaluate the performance of the ED as appropriate.
- In setting the ED's salary, the board should document how it arrived at the compensation amount and should be able to justify the compensation as reasonable for the position.
- Conflict of Interest statements should be signed by all board members on an annual basis. New board members should be asked to sign one at the start of their terms.

Personnel Issues

- Formal staff reviews should be conducted on at least an annual basis.
- The organization should have a succession plan in place in the event of sudden and unexpected departures of key employees.
- All personnel files should be kept in a locked cabinet. All changes in personnel - hiring, termination, promotions, pay rate changes, etc. - should be documented and signed by the individual authorizing the change.

Other Asset Safeguards

- The following items should not be freely accessible for individuals to appropriate without proper authorization:
 - Petty cash
 - Inventory
 - Supplies of more than insignificant value
 - Fixed assets. Also, make sure the individual items that have been capitalized are maintained on a master spreadsheet; that these items are all identifiable; and that the spreadsheet is updated to record any additions and dispositions of fixed assets.
 - Equipment that has not been capitalized (laptop computers, for example).

Information Technology Controls

- Selected computers, software, and files should have adequate password protection.
- Appropriate access of individual workers to the organization's computers, software, and files should be mapped out and evaluated regularly.
- Backups of electronic information should be conducted frequently. Backups should be stored offsite.

Other Segregations of Duties

- Financial information that is tracked separately from the accounting software (in Excel spreadsheets or membership databases, for example) should be periodically reconciled to the data in the accounting software.
- The individuals charged with billing customers and funders and recording payments on amounts billed should not have the authority to write off receivable balances as uncollectible.

Organizational Approaches to Effective Internal Control

- In addition to the specific activities noted above, the organization should have a positive, constructive attitude toward internal control, including
 - A healthy control environment – a demonstrated commitment to sound controls and ethical practices set by the leadership of the organization.
 - Ongoing risk assessments of where things could possibly go wrong.

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- Proper methods of dissemination and communication of financial information to make sure that all the relevant information is recorded in the accounting system.
- Effective monitoring of internal controls, to ensure that all the activities listed above have actually been implemented properly.