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INTERNAL CONTROLS FOR NONPROFITS

Best Practice Principles, Policies, and Procedures

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INTERNAL CONTROLS FOR NONPROFITS:

Best Practice Principles, Policies, and Procedures

Audits and internal controls – two common terms in the finance and accounting world. Whether your organization is large or small, and no matter your mission, there are certain policies and procedures that must be invoked to protect your cause and community.

The National Council for Nonprofits best describes the goal of internal controls as, "the creation of business practices that serve as 'checks and balances' on staff (and sometimes board members) or outside vendors in order to reduce the risk of misappropriation of funds/assets." Without prescribed controls and policies in place, an organization can easily put itself at risk for audit issues, fraud, and negative perceptions from donors and constituents.

Implementing a set of internal controls can seem arduous, so we've put together this resource guide to help you establish best practice principles, policies, and procedures.

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SETTING THE CONTROL ENVIRONMENT

The control environment is the foundation to building an effective infrastructure of internal control at your organization. Good controls are derived from the right policies, practices, activities, and behaviors. Framework for the control environment needs to be established and delivered by organizational leadership and financial management, and should include these key steps:

- Emphasize the importance of controls at every level of the organization. Everyone within the organization is responsible and plays a vital role in ensuring the standard of internal control is met.
- Communicate a commitment to integrity, ethical values, and competence. Then, model the behaviors you expect.
- Develop policies and procedures around how management assigns authority and responsibility in managing business risk.
- Share management's operating style and approach toward financial reporting and how information is processed through accounting and other personnel or departments.

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SEGREGATION OF DUTIES

A segregation of duties policy helps reduce the likelihood of errors and irregularities when it comes to authorization, approvals, and recordkeeping. Below are a few general controls when it comes to separating duties for employees and management handling cash disbursements.

Accounts Payable Segregation of Duties:

- **Process –** The person who authorizes the goods or service purchased should provide approval for the invoice. A threshold can be put in place to require additional leadership approval for invoices over a certain amount.
- **Approval –** Someone other than the individual processing check payment/ writing checks should review and sign the check.
- **Authorization –** Require two signatures on checks above a certain amount.
- **Tracking –** A copy of the check should be attached to the original invoice and filed or entered into the accounting system for reconciliation and recordkeeping.

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SEGREGATION OF DUTIES (CONTINUED)

Accounts Receivable Segregation of Duties:

- **Process –** The person responsible for the receipt of payment and preparing the deposit should not also be the person responsible for recording and authorizing transactions or for bank reconciliations.
- **Approval –** Require formal approval from a manager for credit memos (over a certain threshold or amount) to avoid any interception of incoming cash or payment.
- **Authorization –** The person who opens the mail and logs payment receipts should not be the same person to actually perform the deposit.
- **Tracking –** Bank reconciliations and customer follow-up or complaints should be handled by someone who is independent of cash receipts and/or cash handling.

Oftentimes, segregation of duties expands beyond just accounts payable and receivable. You may find your organization requires defined and thorough segregation of duties within payroll, vendor set-up, purchasing, reconciliations, fixed assets, and more.

PROCESS DOCUMENTATION

Having documented processes is crucial to maintaining internal controls. They clearly establish accounting procedures, process steps, associated rules, and ownership. A few best practices to consider when documenting key financial processes are:

- Understand who is the accounting process owner for each procedure, and identify other process owners who may be involved in authorizations, approvals, or reviews.
- Keep things simple. Too much detail can take up time and energy. Instead, focus on describing the accounting procedure with a simple step-by-step checklist or list of rules.
- Assign timelines to transaction cycles, clearly identifying how long each step of authorization should take to process.
- Outline, build, and automate appropriate workflows within technology systems and solutions.

Once complete, these processes should be communicated to all finance and accounting staff members, and individuals or new employees who may be affected by process requirements. This can be communicated through training, meetings, manuals, or other types of internal communication. The main goals are to simply outline appropriate processes for the organization, and designate key roles that need to be engaged throughout the process.

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MONITORING OPERATIONS

Ongoing and routine monitoring is important to assessing whether or not controls and processes are implemented effectively and maintained consistently. Monitoring activities can and should typically include:

- **Supervision and proper segregation of duties –** via management oversight and process review
- **Reconciliations –** identifying and resolving any discrepancies that have been discovered
- **Checklists –** ensuring control activities are followed based on step-by-step protocol
- **Physical controls –** lockboxes, password-protected computers and equipment, access levels, and security features implemented within software systems
- **Internal audits –** ensuring efficiency and effectiveness of current internal controls
- **Performance reviews –** on both systems and employees

If deficiencies are found, they should be immediately assessed and rectified. Is the process correct? Was there accidental oversight or should the process be updated/changed based on previously unforeseen internal or external factors? Consistent monitoring helps an organization identify and foresee opportunities for improvement ... before a breach occurs.

MAINTAINING CONSISTENCY

Those responsible for the organization's finances and financial reporting should periodically assess risks and how they:

- Monitor major expenses, such as payroll, travel, investments, expense accounts, contracts, consultants, etc.
- Comply with all financial and compliance regulations (federal, state, etc.)
- Oversee and manage the audit process
- Protect individuals of the organization and the organization itself from financial misconduct or fraudulent activity

One of the biggest challenges to maintaining consistency may be limited resources and turnover. If your organization is small with a lean finance and accounting staff, properly documenting step-by-step processes and keeping checklists up-to-date will help ensure retention of policies even after staff or organizational changes.

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IMPROVING INTERNAL CONTROLS WITH TECHNOLOGY

Maintaining consistency is perhaps easiest with the help of technology solutions and integrated systems – for organizations both large and small. Technology and the right fund accounting solution can provide you with the ability to:

- Limit system access and level to appropriate users (and, based on role)
- Automate approval hierarchy processes
- Provide auditable ledger entries that cannot be deleted, improving audit trails and security
- Separate tasks in accounts payable and receivable for strong internal controls activity
- Detect possible fraudulent activity
- Implement and monitor preventive and detective control activities

Learn more about how Abila MIP Fund Accounting™ and MIP Advance™ – our purpose-built, true fund accounting™ systems – can provide your organization with all the tools and resources needed to keep your organization compliant and efficient, from internal controls, to audit trails, and more.

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