

Internal Controls Every Nonprofit Organization Needs

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Regardless of the size of its budget, every nonprofit needs to have a variety of internal controls in place. With the proper controls, an organization will have reliable financial information for sound decision making, while also protecting its assets and records and increasing the likelihood that policies are followed and governmental regulations are satisfied.

Segregation of Duties

Perhaps the most important internal control is the segregation of duties. Segregation mandates that no financial transaction should be handled by a single employee from start to finish. Even small organizations can abide by this principle by dividing transactional duties among a bookkeeper or office manager, the executive director, and the treasurer.

Two areas particularly ripe for abuse without the appropriate segregation of duties are cash disbursement and payroll.

Cash Disbursement Controls

The goal of internal cash disbursement controls is to ensure payments are made only with proper authorization, for valid business purposes, and are properly recorded. To accomplish this, a nonprofit should require that different individuals authorize payments, sign checks, record payments, and reconcile bank statements.

The organization should have a formal policy for authorizing payments, i.e., who can authorize which payments. It should also develop policies to ensure proper use of restricted funds. Some organizations require multiple signatures for

check payments over certain amounts, but such a requirement can present practical difficulties.

Payroll Controls

The goal of payroll controls should be to ensure payments are made only with proper authorization and only to legitimate employees, is recorded properly, and satisfies legal requirements. This is achieved by adhering to the general cash disbursement controls and making use of detailed time sheets, as well as promulgating and complying with employee record, payroll tax, and employee benefit policies.

Evaluating Internal Controls

Once established, internal controls must be monitored regularly for effectiveness. An auditor's management letter can be a good place to begin.

The board of directors and executive director should review the letter, arrive at explanations for why each recommendation or problem area exists, and compare the letter with past letters for continuing issues. 

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