

**Internal Controls:**  
What Every Executive & Board Member Needs to Know



Presented by:  
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## What are Internal Controls?

**Internal controls are a set of policies and procedures to prevent deliberate or misguided use of funds for unauthorized purposes.**

### Why have Internal Controls?

**Reliable**

Internal controls help to provide **reliable data** by ensuring that information is recorded in a consistent way that will allow for useful financial reports.

**Promote Operational Efficiency**

Internal controls **promote operational efficiency** by reducing unnecessary duplication of effort and guarding against misallocation of resources.

**Prevent Fraud**

They also help **prevent fraud and loss** by safeguarding assets and essential records.

**Adherence to Management Policies**

They encourage **adherence to management policies** and funding source requirements.

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## Who is Responsible?

- Management is **primarily** responsible for internal control.
- Governing board is **ultimately** responsible for internal control.
- Auditors are not responsible for your organization's internal controls.



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## Reducing the Risk of Errors & Fraud

“Some organizations have significantly lower levels of misappropriation of assets and are less susceptible to fraudulent financial reporting than other organizations because these organizations take proactive steps to prevent or detect fraud.”

“It is only those organizations that seriously consider fraud risks and take proactive steps to create the right kind of climate to reduce its occurrence that have success in preventing fraud.”

- AICPA, **Management Antifraud Programs and Controls**



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## Why Does Fraud Occur?



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## Why Does Fraud Occur?

### Motivation

- Economic factors such as personal financial distress, substance abuse, gambling, overspending or other similar addictive behaviors may provide motivation.
- The current national economic recession may serve to increase the incidence of such financial modifications.

### Rationalization

- The person finds a way to rationalize fraud.
- Such rationalization can include perceived injustice in compensation as compared to their colleagues, unhappiness over promotions, the idea that they are simply “borrowing” from the organization and fully intent to return the assets at a future date, or a belief that the organization does not really “need” the assets and will not even realize they are missing.

### Opportunity

- The person has sufficient access to assets and information that allows him or her to believe the fraud can be committed and also successfully concealed.

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## Double Signatures & Authorizations

**Multiple layers of approval will make it far more difficult for embezzlers to steal from your organization.**

- 💡 For expenditures over a pre-determined amount, require two signatures on every check and two authorizations on every cash disbursement.
- 💡 Consider having an officer or director be the second signatory or provide authorization for smaller organizations.
- 💡 With credit cards, require prior written approval for costs estimated to exceed a certain amount.
- 💡 The person using the credit card cannot be the same person approving its use.
- 💡 Have a board member or officer review the credit card statements and expense reports of the Executive Director, CFO, CEO, etc.



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## Require Backup Documentation

- ☑ All check and cash disbursements must be accompanied by an invoice showing that the payment is justified.
- ☑ If possible, the invoices or disbursement request should be authorized by a manager who will not be signing the check.
- ☑ Only pay from original invoices.



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## Never Pre-Sign Checks

- Many nonprofits do this if the Executive Director is going on vacation.
- Keep blank checks and signature stamps locked up.



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## Segregation of Duties

- One individual should not be responsible for an entire financial transaction.
- **Money Coming In:** No single individual should be responsible for receiving, depositing, recording and reconciling the receipt of funds.
- **Money Going Out:** No one person should be responsible for authorizing payments, disbursing funds, and reconciling bank statements.
- If the organization does not have enough staff to segregate these duties, a board director or officer should reconcile the bank and credit card statements.
- **Require employees holding financial positions to take an uninterrupted vacation for two weeks**





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## Conduct Background Checks

- **Background checks on new employees and volunteers are important. Many organizations skip this basic step.**

 The Association of Certified Fraud Examiners reports that 7% of embezzlers have been convicted of a previous crime.

 Background checks can reveal undisclosed criminal records and prior instances of fraud, allowing you to avoid a bad hire in the first place.

- They are also fairly inexpensive, and should be made a part of your hiring process.



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## Fair Bidding Process, Fixed Asset Inventories, Audits & Board Level Oversight

### Fair Bidding Process

- All contracts should be subject to at least three bids, and approved by a manager uninvolved in the transaction.
- Large contracts should be reviewed and voted on by the board.

### Fixed Asset Inventories

- Conduct a fixed asset inventory review at least 1x per year to ensure no equipment (computers, printers, etc.) is missing.
- Record the serial numbers of the equipment and consider engraving an identifying mark on each item.

### Audit and Board Level Oversight

- Regular audits will not catch every instance of fraud, however, they are critical to prevent fraud and there should be board level review, if not oversight, of the audit.



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## Encourage Whistleblowers

- Provide a means of anonymous communication.
- Employees may not report theft or mismanagement if they believe their job is in jeopardy.
- Employees must have a manner in which to contact a board member in the event something needs to be reported, and they do not feel comfortable reporting to management.
- Board members must be prepared to take these reports seriously, keep the reporting employee protected and contact legal counsel.



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## See Attached Sample Checklists



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## Stay Connected for Additional Questions

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