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## MEMORANDUM INTERNAL CONTROL REQUIREMENTS FOR NON-PROFITS

**TO:** NON-PROFIT INSTITUTIONS  
**FROM:** HEALTH AND NUTRITION UNIT  
**SUBJECT:** INTERNAL CONTROLS  
**DATE:** FEBRUARY 24, 2016

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### SUMMARY

This Memorandum provides information on the written internal control requirements for non-profit entities that receive federal awards. The information and technical assistance related to Internal Controls is divided into the following sections:

- Comparison of Policies, Procedures, & Internal Controls;
- Internal Control Requirements – lists the OMB 2 CFR PART 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, dated December 26, 2013, (a/k/a Uniform Guidance) requirements for Institution’s internal controls;
- Green Book – summarizes the principles in the “Standards for Internal Control in the Federal Government” issued by the Comptroller General of the United States dated September 2014;
- Additional Internal Control Examples; and
- Resources - provides resources for identifying and developing internal controls.

Internal controls refer to the process implemented by an institution’s board of directors, management, and staff that is designed to provide reasonable assurance that the institution achieves its objectives related to (1) Effectiveness and efficiency of operations, including safeguarding assets against loss; (2) Reliability of reporting for internal and external use; and (3) Compliance with applicable laws and regulations. (See 2 CFR §200.61, Green Book, and COSO Internal Control Framework).

The Green Book provides that “Internal control comprises the plans, methods, policies, and procedures used to fulfill the mission, strategic plan, goals, and objectives of the entity. Internal controls serve as the first line of defense in safeguarding assets. In short, internal control helps managers achieve desired results through effective stewardship of public resources.” (GAO, OV1.03)

The Super-Circular at 2 CFR §200.303 requires that institutions establish and maintain effective internal control over Federal awards, and indicates that the institution’s internal controls should be in compliance with “Standards for Internal Control in the Federal Government” issued by the Comptroller General of the United States (September 2014) {hereafter referred to as the Green Book} and the Committee of Sponsoring Organizations of the Treadway Commission (COSO), “Internal Control Integrated Framework” (New York: American Institute of Certified Public Accountants, 2013).

**COMPARISON OF POLICIES, PROCEDURES, & INTERNAL CONTROLS**

It is important to understand the difference between policies, procedures, and internal controls. Policies may be described as a high level overall plan that states the institution’s goals and objectives. Procedures are a detailed set of instructions that define how the Institution is implementing its policies. BusinessDictionary.com defines Internal controls as *systematic measures (such as reviews, checks and balances, methods, policies and procedures) that are implemented by an Institution to (1) conduct its business in an efficient manner, (2) safeguard its assets, (3) deter and detect errors, fraud and theft, (4) ensure accuracy and completeness of its accounting data, (5) produce reliable and timely financial and management information, and (6) ensure adherence to its policies and plans.* Internal controls generally are incorporated within an institution’s policies and procedures.

The person that is performing the internal control should never be the same person that performs the procedure. Examples of policies, procedures and internal controls are listed below.

<b>POLICY</b>	<b>PROCEDURE</b>	<b>INTERNAL CONTROL</b>
Pay bills for allowable SFSP expenses.	Every Monday, bills received during the prior week will be paid. Each bill must be accompanied by a Purchase Order signed by the responsible SFSP management official and the original receipt or invoice. The purchase order must be coded to the proper accounts.	Perform bank reconciliations to ensure that all checks are properly captured in the records. Spot check a few items from the reconciliation and trace back to Purchase Order and bill/invoice.
All time should be documented and approved using weekly timesheets.	Employees should log their time into the timekeeping system on a daily basis and then should have supervisor approve every Friday.	Timekeeping system will not generate a payroll request for employees whose supervisors have not authorized the time in the system. Unique passwords for every employee (if automated).
Sufficient milk should be served to children who participate in the SFSP.	Only half-pints of milk are purchased to serve milk.  10 ounce cups are purchased for use in the SFSP and all staff are trained to fill the cups to the 8 ounce line. Milk may only be poured at sites with a current Health Inspection in the Institution’s name.	Monthly milk testing is done to ensure sufficient quantities of milk are purchased to meet serving policy.

## INTERNAL CONTROL REQUIREMENTS

OMB 2 CFR PART 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, dated December 26, 2013, (a/k/a the Super-Circular), establishes the requirements for a non-profit institution's internal controls as provided below.

The Super-Circular at 2 CFR §200.303 provides that a non-profit institution's internal controls must:

- (1) Establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award.
- (2) These internal controls should be in compliance with guidance in "Standards for Internal Control in the Federal Government" issued by the Comptroller General of the United States and the "Internal Control Integrated Framework", issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).
- (3) Comply with Federal statutes, regulations, and the terms and conditions of the Federal awards.
- (4) Evaluate and monitor the non-Federal entity's compliance with statute, regulations and the terms and conditions of Federal awards.
- (5) Take prompt action when instances of noncompliance are identified including noncompliance identified in audit findings.
- (6) Take reasonable measures to safeguard protected personally identifiable information and other information the Federal awarding agency or pass-through entity designates as sensitive or the non-Federal entity considers sensitive consistent with applicable Federal, state and local laws regarding privacy and obligations of confidentiality.

Additionally, the Super Circular at 2 CFR § 200.62 states that Internal Control over compliance requirements means a process implemented by a non-Federal entity designed to provide reasonable assurance regarding the achievement of the following objectives for Federal awards:

- (1) Transactions are properly recorded and accounted for, in order to:
  - Permit the preparation of reliable financial statements and Federal reports;
  - Maintain accountability over assets; and
  - Demonstrate compliance with Federal statutes, regulations, and the terms and conditions of the Federal award;
- (2) Transactions are executed in compliance with:
  - Federal statutes, regulations, and the terms and conditions of the Federal award that could have a direct and material effect on a Federal program; and
  - Any other Federal statutes and regulations that are identified in the Compliance Supplement; and
- (3) Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

## GREEN BOOK

“Standards for Internal Control in the Federal Government” dated September 2014, issued by the Comptroller General of the United States (also referred to as the “Green Book”), provides a framework for establishing and maintaining effective internal controls. The Green Book lists five (5) components of internal control that are supported by seventeen (17) requirements for internal controls (Principles). The Green Book states that “the five components of internal control must be effectively designed, implemented, and operating, and operating together in an integrated manner, for an internal control system to be effective,” and that “The 17 Principles support the effective design, implementation and operation of the associated components and represent requirements necessary to establish an effective internal control system.” See also Committee of Sponsoring Organizations of the Treadway Commission (COSO), Internal Control –Integrated Framework (New York: American Institute of Certified Public Accountants, 2013).

A summary of the 5 Components and 17 Principles of Internal Control are reproduced or summarized below:

- (1) Control Environment – The foundation for an internal control system. It provides the discipline and structure to help an entity achieve its objectives.
  - Commitment to integrity and ethical values
  - Oversight of internal control system
  - Organizational structure, assign responsibility, delegate authority
  - Recruit and develop competent individuals
  - Evaluation of performance and hold individuals accountable
- (2) Risk Assessment – Assess the risks facing the entity as it seeks to achieve its objectives. This assessment provides the basis for developing appropriate risk responses.
  - Define clear objectives to enable identification of risks and define risk tolerances
  - Identify, analyze and respond to risks
  - Consider the potential for fraud
  - Identify, analyze and respond to significant changes that could impact the internal control system
- (3) Control Activities – The actions management establishes through policies and procedures to achieve objectives and respond to risks in the internal control system, which includes the entity’s information system.
  - Design control activities to achieve objectives and respond to risks
  - Design information system and related control activities to achieve objectives and respond to risks
  - Implement control activities through policies

- (4) Information and Communication – The quality of information management and personnel communicate and use to support the internal control system.
- Use quality information to achieve objectives
  - Internally communicate necessary quality information to achieve objectives
  - Externally communicate necessary quality information to achieve objectives
- (5) Monitoring – Activities management establishes and operates to assess the quality of performance over time and promptly resolve the findings of audits and other reviews.
- Establish and operate monitoring activities to monitor the internal control system and evaluate results
  - Remediate identified internal control deficiencies on a timely basis

Selected pages of the Green Book are enclosed with this Memorandum, and the entire Green Book (GAO Standards for Internal Control in the Federal Government) is available on the SNP website resource library under the Financial Management and Budget section.

Examples of Common Categories of Control Activities from the Green Book (GAO-14-704G, page 46)

- **Top level reviews of actual performance:** Ex. Management compares monthly financial statements against budget and investigates any discrepancies.
- **Reviews by management at the functional or activity level** – Management reviews weekly meals submitted by sites and compares to expected performance and meals prepared for or sent to the site, any significant differences are analyzed.
- **Management of human capital** – Personnel are provided with appropriate training, tools, structure, and responsibilities. Management supervises the performance of employees and provides appropriate feedback.
- **Controls over information processing** – Examples: Edit checks of data entered, accounting for transactions in numerical sequences; comparing file totals with control accounts; and controlling access to data, files and programs.
- **Physical control over vulnerable assets** – Ex. Security and limited access to cash, inventory, equipment. Periodic physical counts of assets and comparison to control records.
- **Establishment and review of performance measures and indicators** – Monitors performance measures and indicators. – Ex. Comparison of food purchases to meals claimed (Cost per Meal); Comparison of results of monitoring visits to meal claiming at sites.
- **Segregation of duties** – Separating the responsibility for authorizing transactions, processing and recording transactions, reviewing transactions, and handling any related asset so that no one individual controls all key aspects of a transaction or event.
- **Proper execution of transactions** – Transactions are authorized and executed only by persons acting within the scope of their authority. This is the principle means of assuring that only valid

transactions to exchange, transfer, use, or commit resources are initiated or entered into. Management clearly communicates authorizations to personnel.

- **Accurate and timely recording of transactions** – Transactions are promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. In addition, management designs control activities so that all transactions are completely and accurately recorded.
- **Access restrictions to and accountability for resources and records**
- **Appropriate documentation of transactions and internal control**

### **ADDITIONAL INTERNAL CONTROL EXAMPLES**

As noted above, each Institution's internal controls will be unique based upon many factors including the institution's size, objectives, risk factors, complexity, and staff. Following are additional examples of internal controls policies and procedures to assist you with identifying internal controls that your institution may already have in place and to provide further examples of internal controls. Please note that these examples will not work for all institutions and they are not "perfect." All circumstances surrounding the institution's policies, procedures, and internal controls are taken together to determine if appropriate internal controls exist. Each institution must determine and design internal controls that work best for its specific circumstances.

The most effective procedures are those that have Segregation of Duties since more than one individual is involved in the process and one person does not control all key aspects of the transaction. Segregation of duties means that the responsibility for authorizing the transaction, processing and recording the transaction, reviewing the transaction and handling the asset related to the transaction are separated. In the event an institution does not have sufficient staff to segregate all duties, the institution should document such and put into place other internal controls.

#### General Controls:

The Board of Directors is responsible for authorizing all bank accounts and check signers on an annual basis. The Board of Directors approves the institution's budget on an annual basis. Financial Statements are presented to the Board of Directors on a monthly basis, and the Board of Directors compares the budget to actual results (Financial Statements) on a monthly basis. Based upon the Board of Director's review, any discrepancies are investigated and the budget is adjusted as appropriate. The institution utilizes a chart of accounts that tracks expenses by function/activity (i.e. church activities, Summer Food Service Program, Child and Adult Care Program, etc.) Unallowable expenses (expenses that may not be paid with child nutrition funds) are tracked separately from expenses that are paid with child nutrition funds. Recordkeeping duties are separate from custody of assets and operations.

### Cash Receipts:

All donation checks received by the institution are immediately recorded in a donations received list by the Administrative Assistant who receives all mail and donations (separate from accounting) and immediately stamped "For Deposit Only and the Institution's name and/or bank account number." A duplicate receipt is prepared with a copy to the individual donating the funds and the other copy to the accounting department with the restrictively endorsed check to be recorded. The accounting department records the check in the accounting system and either mails or electronically deposits the check in the bank.

### Cash Disbursements:

Checks may only be made payable to the specific vendor listed on the invoice. The institution prohibits issuing checks payable to cash and signing blank checks. Checks may only be prepared from an authorized invoice, not from a vendor statement. The Program Director and Board Treasurer are the only individuals authorized to sign checks on behalf of the Institution. The Program Director and Treasurer are not authorized to prepare checks and do not have access to blank checks. (Authorized signors do not have access to the blank checks). All blank checks are kept in a locked file cabinet in a locked office. Access to blank checks is limited to accounting staff authorized to prepare the check.

The Program Director approves all disbursements and must approve all expenses prior to the institution incurring the expense. The Program Director approves all invoices received and indicates approval with his or her initials and date. The accounting staff prepares the check once an approved invoice and approved request for disbursement have been submitted. The check and supporting documentation are delivered to the Program Director for signature. The Program Director reviews the supporting documentation and check prior to signing the check. (Someone other than the person writing the check should review the documentation and sign the check, and the person who authorizes the invoice should approve the invoice.) The invoice is stamped paid and a copy of the check is attached to the invoice.

All bank statements are mailed to the Program Director or Treasurer of the Board of Directors, who are independent of the accounting function (i.e. recording of transactions or preparation of written checks for disbursement of funds), for review. (Someone other than the person writing and mailing the checks should receive the unopened bank statement and review its contents before it is reconciled.) After review, the Program Director or Treasurer initials the bank statement and forwards it to the Accounting Manager for reconciliation of the bank statement to the accounting system records. Upon completion of the Reconciliation, the Accounting Manager forwards the reconciliation and supporting documentation to the Program Director for his or her review. (NOTE: If at all possible, an individual other than the person writing the checks and making deposits should reconcile the bank account each month. However, the Program Director's receipt of unopened bank statements and review of bank statements and bank reconciliation for the validity of transactions is an internal control in this area.)

All check numbers must be accounted for. Checks outstanding over 90 days must be periodically investigated, with payment stopped and an entry made restoring such items to cash if appropriate.

#### Cash Transactions:

Cash transactions, if necessary, should be minimal in frequency and amount. Cash transactions are only allowed in the case of emergencies and may not be in excess of \$25. (A maximum transaction amount should be established.) If a Petty Cash fund is utilized, only one person should have access to the petty cash fund, and it should be maintained in a locked drawer at all times. A voucher and related receipts should be placed in the petty cash box any time cash is withdrawn. The Petty Cash fund should be audited on a regular basis by an individual who does not have control of the cash on an unannounced basis.

#### Fixed Assets:

The Institution's capitalization policy is to capitalize the purchase of all capital assets (equipment and supplies) with an individual dollar value of \$500 or more. The capital asset is recorded in the fixed asset ledger which lists a description of the item, serial number, location, date of acquisition, cost of acquisition, useful life, and depreciation method to be used, funding source, and any restrictions on the use of the asset. A physical inventory is conducted annually and the fixed asset ledger and general ledger are updated as necessary. All capital asset purchases or disposals should be approved in advance.

#### Travel and Expenses:

Employees must submit a detailed expense record and supporting documentation in order to be reimbursed for expenses. The documentation must include a description of the reason for the expense and the program to which it relates. Prior to payment of the expense, the expense must be approved by the director.

#### Payables:

All credit cards must be paid in full so as not to incur interest. All credit card charges must be approved in advance. All vendors must be paid in full within 30 days of charges.

### **RESOURCES**



In developing and improving your internal controls, many resources are available. The Institution's Board of Directors, financial personnel and accountants should be able to assist with information related to internal controls. On the internet a search for "Internal Controls Non-Profit" or "Non-Profit Internal Controls Checklist" will provide additional resources and examples that may be helpful in developing internal controls. The following website contains helpful information for Non-Profits related to accounting, financial management, and internal controls: <http://www.nonprofitaccountingbasics.org>

- GAO – United States General Accounting Office
  - GAO Standards for Internal Control in the Federal Government dated September 2014 (aka "Green Book")
- COSO – Committee of Sponsoring Organizations of the Treadway Commission – not included in the resource library. May be located at [www.coso.org](http://www.coso.org)
  - COSO Internal Control – Integrated Framework Executive Summary dated May 2013
  - COSO Internal Control – Integrated Framework Principles
  - COSO Enhancing Board Oversight (March 2012)