What Internal Controls Are Needed for Cash Disbursement?

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The objectives of internal controls for cash disbursements are to ensure that cash is disbursed only upon proper authorization of management, for valid business purposes, and that all disbursements are properly recorded. Grantees will find this resource useful when maintaining internal control for cash disbursements.

While it is impossible to guarantee that these objectives will be met at all times for all transactions, the following practices provide reasonable assurance that they will usually be accomplished.

Segregation of Duties

Segregation of duties means that no financial transaction is handled by only one person from beginning to end. For cash disbursements, this might mean that different people authorize payments, sign checks, record payments in the books, and reconcile the bank statements. If your organization is a small nonprofit, managed by volunteers and possibly one staff person, this principle can be hard to put into practice. You might consider having one person, such as the paid staff member, sign checks and assign a different person, such as the board treasurer, to review disbursements, bank statements, and canceled checks on a monthly basis.

Authorization and Processing of Disbursements

You will want to develop policies regarding who in your organization can authorize payments. Some organizations designate this function solely to the executive director to ensure that a single person is paying attention to monies going out of the organization. In other cases, a department head might authorize purchases for that department, as long as they are within the department's budget. In most organizations, once the board approves the budget, it does not need to authorize individual purchases within that budget. However, unbudgeted purchases would require additional approval. Also, in very small organizations, the board treasurer or board president may be asked to authorize all purchases. Even larger organizations have policies requiring the board to authorize significant expenditures, such as purchases for computers or other assets. It is important to agree and formally define what constitutes a significant expenditure and how these purchases will be handled.

All disbursements should be accompanied by adequate documentation, in the form of receipts or an invoice. Cash withdrawals should never be made via automatic teller machine (ATM) cards.

Managing Restricted Funds

Restricted contributions are a form of revenue unique to the nonprofit sector. Money which has been restricted by the donor for a specific use (such as buying a new building, starting a new program, building an endowment, etc.) should only be used for the purpose for which it has been given. However, most nonprofits find themselves tempted to borrow against restricted monies when facing a cash shortage. In cases where the funder clearly prohibits such borrowing, such action clearly violates the funder's trust and instructions and may lead to revocation of the grant. In other cases, donors allow temporary borrowing as long as the money is replaced within a certain period of time, usually within the grant year.

Ultimately, it is the role of the board to ensure that the organization fulfills its obligations to donors. Therefore, in cases where borrowing against restricted funds is permitted, the board should establish policies which describe the circumstances under which such borrowing is allowed. These policies might include how often borrowing may occur, who may authorize the interfund loan, and how much can be borrowed (such as a percentage of the total grant). In addition, a repayment plan should be established and the board should be advised regularly on the status of any interfund loans.

Check Signing

There is some debate regarding the number of signatures required on a check. In many cases, it is useful to require two signatures on checks, especially for purchases over a certain amount. This amount will vary with the organization's budget; your accountant may be able to help you determine how much is significant. Even though checks require two signatures, three or four people might have check signing authority to ensure that two signers are available to make disbursements. The number of authorized signers should be kept to a minimum, while ensuring that daily business is not unnecessarily hampered.

The purpose of this internal control is to make sure that there are deliberate decisions made about who to pay, how much to pay, and when to pay bills. If you habitually have one or more checks that are pre-signed by one of the two required signatories, it defeats that purpose. If more than one signer is not regularly available, and this inhibits your ability to meet your obligations, you might consider having an imprest checking account. This means that the board establishes a policy regarding the amount of money which can be available in the checking account at any one time, say $500. All other money is kept in a separate account which the check signer does not have access to. The check signer is allowed to pay bills until that amount is substantially depleted. At that time, the treasurer or other board members may review the disbursements and make sure that they are within the guidelines established by the board. Once these disbursements have been reviewed and accepted, the authorized board representative then transfers enough money to bring the imprest account back to its $500 maximum balance.

Seek to balance your internal accounting control in such a way as to ensure public confidence and maintain the integrity of your financial systems and assets, without unduly inhibiting your ability to get on with your work.

Internal Accounting Controls Checklist

The following questions reflect common internal accounting controls related to paying bills. You may wish to use this list to review your own internal accounting controls and determine which areas require further action.

- Are all disbursements, except those from petty cash, made by pre-numbered checks?
- Are voided checks preserved and filed after appropriate mutilation?
- Is there a written prohibition against drawing checks payable to cash?
- Is there a written prohibition against signing checks in advance?
- Is a cash disbursement voucher prepared for each invoice or request for reimbursement that details the date of check, check number, payee, amount of check, description of expense account (and restricted fund) to be charged, authorization signature, and accompanying receipts?
- Are all expenditures approved in advance by authorized persons?
- Are signed checks mailed promptly?
- Does the check signer review the cash disbursement voucher for the proper approved authorization and supporting documentation of expenses?
- Are invoices marked paid with the date and amount of the check?
- Are requests for reimbursement and other invoices checked for mathematical accuracy and reasonableness before approval?
- Is a cash disbursement journal prepared monthly that details the date of check, check number, payee, amount of check, and columnar description of expense account (and restricted fund) to be charged?
- Is check-signing authority vested in persons at appropriately high levels in the organization?
- Are the numbers of authorized signatures limited to the minimum practical number?
- Do larger checks require two signatures?
- Are bank statements and canceled checks received and reconciled by a person independent of the authorization and check signing function?
- Are unpaid invoices maintained in an unpaid invoice file?
- Is a list of unpaid invoices regularly prepared and periodically reviewed?

- Are invoices from unfamiliar or unusual vendors reviewed and approved for payment by authorized personnel who are independent of the invoice processing function?
- If the organization keeps an accounts payable register, are payments promptly recorded in the register to avoid double payment?
- If purchase orders are used, are all purchase transactions used with pre-numbered purchase orders?
- Are advance payments to vendors and/or employees recorded as receivables and controlled in a manner which assures that they will be offset against invoices or expense vouchers?
- Are employees required to submit expense reports for all travel related expenses on a timely basis?

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[Internal controls]

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