



Internal Controls for Small Businesses

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You may have noticed in the news that employee embezzlement is on the rise. Many business owners are not aware that the scope of a typical accounting engagement with our firm, including bookkeeping, does not include specific business services relating to the disclosure of employee fraud.

How are you managing your business finances? Many business owners are discovering that their assets are not as well protected as they thought. This is especially true in small business environments where a single employee manages all the finances. Often there are no “checks and balances” to verify that transactions are accurate.

When proper, consistent procedures are not in place, employees can learn to manipulate the accounting system to their benefit. Whether they take money from the company or their mistakes are undiscovered, the end result can greatly impact your company’s management discussions, financial reports, tax filings and bottom line.

Unfortunately, once your financial records have been altered, discovering problems can be extremely difficult. Most standard accounting services are not designed to uncover internal problems such as embezzlement.

Therefore, the best way to safeguard your company’s assets is to recognize and improve weaknesses in your internal control procedures. The following business practices can help you minimize potential internal control problems that can cost you money:

- **Related duties should be assigned to different people.** Certain accounting functions are designed to cross-reference each other for accuracy, writing/signing checks, ordering/receiving/paying materials, handling cash/recording cash, etc. Proper segregation of these procedures between different people can prevent errors and fraud before they occur.
- **Reconcile and scrutinize your bank statements every month.** A bank statement can tell you a lot about your business if you review the information in a timely manner. Examine checks and endorsements; track transactions between accounts; compare payroll checks with employee records, and ask questions.
- **Always ask for proof before you sign a check or authorize a transaction.** When you insist on reviewing original documentation, your employees become more accurate and communicate their needs more clearly. You should also verify the names of your vendors and your employees occasionally. And, remember to cancel supporting materials after signing a check.

- **Provide antifraud training to your employees.** Be sure your employees understand what constitutes fraud and that a zero tolerance policy is communicated through words and actions. Employees should be taught how and who to communicate concerns about known or potential wrongdoing.
- **To increase employees' perception of fraud detection, take proactive measures that are publicized to employees.** Surprise fraud audits are recommended in addition to regularly scheduled fraud audits. Audit software can be employed internally or by outside forensic accountants to detect fraud. Audits and use of such software should be made known to employees.
- **Know your employees and examine behavior changes.** Always verify employee references before hiring. Many white-collar crimes go unreported and continue to be repeated. Watch for trouble signs: possible substance abuse, change in lifestyle, living beyond means, possessiveness of work.
- **Lock and protect your valuables.** Keep blank checks and signature stamps secured, and deposit cash and checks daily. It's also important to secure fidelity bonds and insurance for all accounting and key personnel.

These internal controls can help you reveal many discrepancies, as well as recognize the excellent efforts of your staff.

In addition, please find below a simple internal control checklist. This checklist highlights some of the internal control weaknesses common to closely-held businesses. Please complete the checklist. If upon completion of the checklist, you have identified any weaknesses in your internal control system or have any concerns, please call us.

Our firm can provide fraud information and training, perform fraud procedures and help you develop and implement internal controls to address the weaknesses you identified and/or your areas of concern.

Please call if you have any questions. We will be happy to assist you anyway we can.

I. SEGREGATION OF DUTIES

Concepts:

- Certain accounting/bookkeeping
- Segregating duties is also important in this area. Reconciliations should be performed by one person and reviewed by another. Also, the person who writes the check should not have the authority to sign checks.

CHECKLIST (each "yes" answer identifies a potential problem area):

	YES	NO	N/A
1. Is the person who handles your cash also responsible for recording the cash?			
2. Does the person who pays or orders inventory also receive the materials?			
3. Are two or fewer people responsible for the accounting function?			
4. Is only one person responsible for reviewing financial statements each month?			
5. Is your review of financial journals sporadic?			

II. BANK RECONCILIATIONS

Concepts:

- Bank statements can only flag discrepancies if they are reconciled on a timely basis. Reconciliations should be done once a month. Bank adjustments need to be tracked carefully from one month to another.
- Segregating duties is also important in this area. Reconciliations should be performed by one person and reviewed by another. Also, the person who writes the check should not have the authority to sign checks.

CHECKLIST (each “yes” answer identifies a potential problem area):

	YES	NO	N/A
1. Do you review canceled checks and endorsements on a monthly basis?			
2. Do you compare payroll checks with your current employee records?			
3. Do you question funds transferred between bank accounts?			
4. Do you track the number of credit card bills you sign each month?			
5. Are bank reconciliations performed on a timely basis?			
6. Is someone responsible for reviewing the reconciliations each month?			
7. Do you verify reconciled items?			
8. Does the owner receive and open the bank account prior to turning it over to the person who performs the bank reconciliation?			

III. SUPPORTING DOCUMENTATION

CONCEPTS:

- Enhances communication and serves as final checkpoint.

CHECKLIST (each “yes” answer identifies a potential problem area):

	YES	NO	N/A
1. Do you ever sign blank checks?			
2. Do you ever sign checks without original supporting documentation?			
3. Do you ever sign checks without canceling supporting documentation?			
4. Have funds ever been transferred between accounts without review or verification?			
5. Do you ever sign checks for new business vendors without knowing or verifying their name and association with your company?			

IV. EMPLOYEES/PERSONNEL

CONCEPTS:

- Know your employees and be aware of changes in behavior.

CHECKLIST (each “yes” answer identifies a potential problem area):

	YES	NO	N/A
1. Are any of your employees extremely possessive of their work records and reluctant to share their tasks?			
2. Are any of your employees apprehensive about vacations and time off, while always being the first into the office and the last out?			
3. Have you noticed a substantial change of lifestyle in any of your employees?			
4. Do any of your employees have a possible substance abuse problem?			
5. Are any of your employees living beyond their means?			
6. Have you ever hired an employee before checking references?			

7.	Do you permit your accounting personnel to work longer than a year without taking a vacation?			
8.	Do you have any accounting staff or key personnel who have not been secured with a fidelity bond?			

V. SAFEGUARDING ASSETS

CONCEPTS:

- Limit and monitor access to important documents and supplies.

CHECKLIST (each “yes” answer identifies a potential problem area):

		YES	NO	N/A
1.	Are blank check stocks and signature stamps safely secured?			
2.	Do you restrictively endorse all checks when received?			
3.	Do you deposit cash and checks daily?			
4.	Do you maintain a list of office furniture, equipment and company vehicles?			
5.	Do you have adequate coverage for assets?			
6.	Are all systems backed up on a daily basis and is backup stored off-site?			
7.	Is there a password restriction and security for all computer systems and programs?			
8.	Are passwords changed at least every six months?			

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