

Memo

To: All Clients
From: Weber • O'Brien, Ltd.
Re: Internal Controls

Each year many business owners discover that their assets are not as well protected as they thought when they become victims to employee theft. This is particularly true in small-business environments where a single employee manages all the finances. Often, there are no “checks and balances” to verify the transactions are accurate. Most employee thefts are perpetrated by highly trusted employees in key positions, involving substantial sums of money.

When proper, consistent policies and 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 decisions, financial reports, and tax filings.

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

Depending on your accountant to protect against acts of one employee is a dependence that is a false comfort. *A review, compilation, or tax engagement is not designed nor intended to uncover or search for defalcations.* In conducting a review, compilation, or tax engagement, the accountant does not gather evidence that may be necessary to uncover a defalcation. However, you and/or your accountant will most likely focus on large transactions and major accounts that, if in error, could have a material effect on the company’s financial statements. *For this reason, an employee who tampers with a number of small accounts over an extended period of time will usually escape detection.*

Many people holding key financial positions may have gained an understanding of the review, compilation, or tax engagement process and their inherent limitations. Therefore, they are in a position to access the company’s assets by methods not subject to detection.

The odds are that you will probably never experience a major defalcation. Yet, statistics are high that at least one of our clients will be victimized every few years.

Therefore, the best way to safeguard your company's assets is to recognize and improve weaknesses in your internal procedures. Defalcations are most likely to be discovered if there is an appropriate separation of duties between asset handling and recording functions. It is also critical that you exercise managerial oversight.

The following business practices can help you minimize potential internal control problems:

1. *Related duties should be assigned to different people.* Certain accounting functions are designed to cross-reference each other for accuracy; writing/signing checks, ordering/paying/receiving materials, handling cash/recording cash, etc. These procedures can reveal inconsistencies in your records in a timely manner.
2. *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. Actions you should do on a monthly basis include the following:
 - a. Receive the unopened bank statement directly and open it personally.
 - b. Scan the front and back of all canceled checks.
 - c. Question the purpose of all transfers.
 - d. Compare payroll checks with employee records, and ask questions.
 - e. Have the banks statement reconciled by someone other than the bookkeeper/controller, if possible.
3. *Signing checks:*
 - a. Never sign a check with out inspecting original supporting documentation including the invoice, shipping documents, and the purchase order.
 - b. Cancel all supporting documentation after signing a check.
 - c. Never sign a check that is not completely filled in.
 - d. Do not pay from vendor statements.
 - e. Verify names of your vendors.
4. *Protection of valuables:*
 - a. Keep blank checks and signature stamp secure.
 - b. Deposit all cash and checks daily.
 - c. Get fidelity bond insurance for all accounting and key employees.
 - d. Backup all computer files on a regular basis and store the backup in a secure, remote location.
 - e. Periodically change computer system passwords.
5. *Prepare and use budgets.* Read your monthly financial statements and investigate significant variances from the budget.

6. *Watch out for changes in employee behavior:*
 - a. Always verify employee references before hiring.
 - b. Be aware of substance abuse, changes in lifestyle, living beyond means, possessiveness of work.
 - c. Require all employees to take vacations.
7. *Even though you are the owner, don't abuse the company.* If you take cash, stamps, inventory, etc., others might just think they can too.
8. *Purchase Employee Dishonesty Insurance.* Bond all employees who have access to cash.
9. *Review all payroll records regularly.*
10. *Cancel all paid invoices.* Consider use of a voucher type stamp with approvals from key people.

These are some of the internal controls that can help you reveal and minimize many discrepancies. *However, there is no assurance that all fraud will be discovered or totally eliminated.* Our Firm can help you develop and implement any of these important internal controls. If you have any questions, we would be happy to assist you any way we can. Please contact either R. David O'Brien, dobrien@weberobrien.com, or James F. Weber, jweber@weberobrien.com.