Internal Control: It’s More Than A Locked Safe

Ann Gibson, PhD, CPA
Andrews University
WHERE'S THE ROYAL ACCOUNTANT?

HE'S ON VACATION, SIRE...

...HE'S TAKING A CRUISE ON THE MEDITERRANEAN...

TREASURY

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The purpose of Internal Control is to:

- Protect the assets of the organization
- Ensure the reliability of the accounting records
Purpose of Internal Control

More specifically, internal control should:

Reduce the Risk of:
  Misstatement due to error
  Misstatement due to fraud
  Fraudulent financial reporting ("cooking the books")
  Misappropriation of assets (theft)
The Control Environment

Control Pressure Points:

- Pressures on the individual
- Rationalization
- Perceived Opportunity
Elements of Internal Control

Control Cues
Policy Communication
Record Keeping
Budgets
Reporting
Segregation of Duties
Control Cues:

The signals that management and the Board send about the importance of safeguarding the assets and the accuracy of financial reporting.
Policy Communication:

Written policies/procedure manuals
Communication via technological means
Elements of Internal Control

Record Keeping:

Common examples of good practices:
- Pre-printed sales invoices, cash receipts, checks
- Use of an imprest petty cash system
- Use of passwords for computer records
- Use of a cash register for cash sales
Budgets:

Constant monitoring of the budget and investigation of any significant variations from the plan are effective forms of financial control.
Elements of Internal Control

Reporting:

Management should require regular monthly reports on the financial status of the organization.
Elements of Internal Control

Regular reports to management include:

- Statement of Financial Position
- Revenue and Expense Statements
- Aged Accounts Receivable
- Cash Flow Projections
- Utilization Reports (such as payroll and related employee benefit cost reports or similar usage reports)
Elements of Internal Control

Segregation of Duties:

Establish responsibility for each task to one person

Separate the record keeping for the assets from the custody of the asset
Specifics for Segregation of Duties

Cash Receipts:

Use pre-numbered receipts
Be sure that no single person is responsible for all aspects of the transaction
Deposit the cash in the bank as quickly as possible—preferably daily
Specifics for Segregation of Duties

Cash Disbursements:
- Make all disbursements by check
- Use pre-numbered checks; use them in order
- Store blank checks in a secure location
- No checks should be made out to “Cash” or “Bearer”
- Only authorized individuals should sign the checks
- Do bank reconciliations monthly
Specifics on Segregation of Duties

Petty Cash:
Use as infrequently as possible
Keep the amount small
Reimburse monthly
No more than one or two custodians
Custodians should have no access to the accounting records or cash receipts
Use imprest petty cash fund
# Specifics of Segregation of Duties

## Two-Person Segregation: Accountant and CFO

<table>
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<tr>
<th><strong>Accountant:</strong></th>
<th><strong>CFO:</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Post accounts receivable</td>
<td>Sign checks</td>
</tr>
<tr>
<td>Mail checks</td>
<td>Sign employee contracts</td>
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<tr>
<td>Write checks</td>
<td>Custody of securities</td>
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<tr>
<td>Post general ledger</td>
<td>Complete deposit slips</td>
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<tr>
<td>Reconcile bank statements</td>
<td>Perform interfund transfers</td>
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<tr>
<td>Post credits/debits</td>
<td>Distribute payroll</td>
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<tr>
<td>Give credits and discounts</td>
<td>Reconcile petty cash</td>
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<tr>
<td>Approve payroll</td>
<td>Record initial charges/pledges</td>
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<tr>
<td>Open mail/receive cash</td>
<td>Approve employee time sheets</td>
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<tr>
<td>Disburse petty cash</td>
<td>Prepare invoices</td>
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<tr>
<td>Authorize purchase orders</td>
<td>Complete check log</td>
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<tr>
<td>Authorize check requests</td>
<td>Authorize invoices for payment</td>
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</tbody>
</table>
Specifics of Segregation of Duties

Three Person Segregation: CFO, Accountant, Bookkeeper

**CFO**
- Sign checks
- Sign employee contracts
- Custody of securities
- Complete deposit slips
- Perform interfund transfers

**Accountant**
- Prepares invoices
- Records initial charges/pledges
- Opens mail/receives cash
- Mails checks
- Approves invoices for payment
- Distributes payroll
- Authorizes purchase orders
- Authorizes check requests
- Approves employee time sheets
Specifics of Segregation of Duties

Three Person Segregation: CFO, Accountant, Bookkeeper

Bookkeeper:
- Post accounts receivable
- Reconcile petty cash
- Write checks
- Post general ledger
- Reconcile bank statements
- Post credits/debits
- Give credits and discounts
Pressure Point Signals

- Ineffective controls with reliance on the employees’ sense of moral duty
- Dominant leadership who does not wish to give authority to a control system
- Overemphasis on enterprise goals which may override good business judgment
Pressure Point Signals

Lack of accounting orientation or education of staff, especially when volunteers are used

Failure to operate in a business-like fashion; a temptation for largely humanitarian organizations

Negative viewpoints regarding the accounting function
Pressure Point Signals

Over-reliance on one individual in the accounting function

Volunteer Boards; do not fail to require an audit
Lessening the Chance of Fraud

Provisions established by Sarbanes/Oxley (2002) that non-profits are incorporating:

CEOs and CFOs personally certify that the financial statements and disclosures are accurate and complete.

Audit committees, composed of independent members and members with financial expertise, are required.
Lessening the Chance of Fraud

Provisions of Sarbanes/Oxley Continued:

Establishment of a code of ethics for senior financial officers

Requirement that management attest to the effectiveness of the organization’s internal controls
I/C for the Small Organization

Record all cash receipts immediately

Deposit all cash receipts intact daily

Make all payments by serially numbered checks; use an imprest petty cash fund for small disbursements

Reconcile bank accounts monthly
I/C for the Small Organization

Use serially numbered sales invoices and purchase orders

Issue checks to vendors after the invoices are matched with source documents and approved for payment

Balance subsidiary ledgers with control accounts monthly
I/C for Small Organizations

Prepare comparative financial statements monthly in sufficient detail to disclose significant variations in revenue or expense
Questions?
References


