

Internal Control: The Human Risk Factor



**PRESENTATION FOR THE
TREASURER ORIENTATION FOR THE NAD
MARCH 7, 2018**

**Ann Gibson, PhD, CPA
Andrews University**

Purposes of Internal Control



**Although gold dust is precious,
when it gets in your eyes
it obstructs your vision.**

Hsi-Tang Chi 735-814

Purposes of Internal Control



The **primary purposes** of internal control are to:

1. Protect the assets of the organization
2. Ensure the reliability of the accounting records

Purposes of Internal Control



Protect the assets that are most easily misused (e.g., cash and inventory).

Reliability requires the reduction of the risk of misstatement *due to error* or misstatement *due to fraud*.

Purposes of Internal Control



Misstatement due to fraud can occur two ways:

Fraudulent financial reporting

(“cooking the books”)

Misappropriation of assets (theft)

Report to the Nations - 2016



Occupational Fraud:

“The use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization’s resources or assets.”

Association of Certified Fraud Examiners

Report to the Nations - 2016



Three categories:

Asset misappropriation – 83.5%; \$125,000

Corruption – 35.4%; \$200,000

Financial Statement Fraud – 9.6%; \$975,000

Report to the Nations - 2016



Not-for-profit organizations: 10.1% of the cases;
median loss: \$100,000

Religious, Charitable, or Social Service organizations:
2.4% of the cases; median loss: \$82,000

Report to the Nations - 2016



Primary areas of fraud in Religious, Charitable, and Social Services Organizations:

Billing	25.0%
Cash	23.1%
Check Tampering	25.0%
Corruption	28.8%
Expense Reimbursement	25.0%
Skimming	19.2%
Payroll	13.5%

Report to the Nations - 2016

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Primary Internal Control Weaknesses for all types of fraud:

Lack of internal controls	29.3%
Override of existing controls	20.3%
Lack of management review	19.4%
Poor “tone at the top”	10.4%
Lack of competent personnel in oversight roles	6.4%

The Control Environment

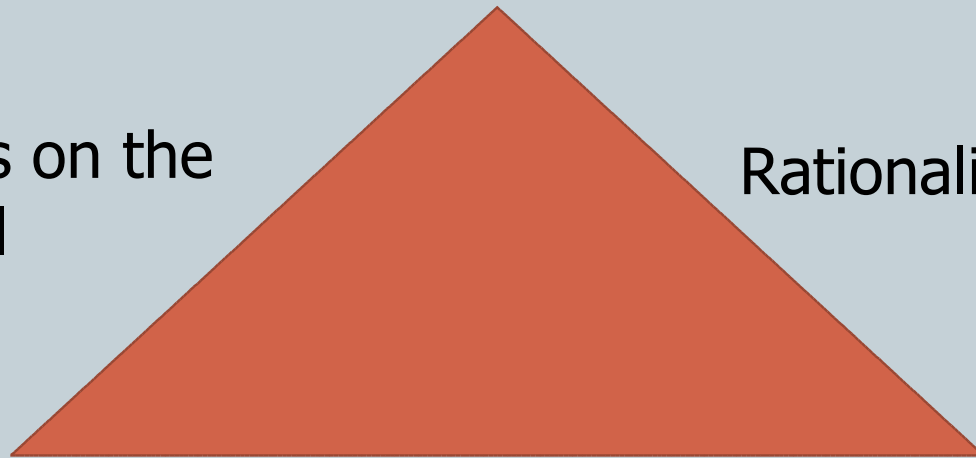


Control Pressure Points:

Pressures on the individual

Rationalization

Perceived Opportunity



Elements of Good Internal Control

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1. Putting the cash in the bank as soon as possible.
2. Not leaving the door to the safe wide open.
3. Accurate record-keeping and timely reporting.
4. Monitoring the budget; examining any variances.

Segregation of duties.

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

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Case Study for Cash Receipts:

The deacons collect the offerings at the local church.

The funds are handed over to the local church treasurer.

The local church treasurer takes the money home; puts it in a drawer; counts it at home on Sunday evening; takes the funds to the bank on Monday morning.

Specifics for Segregation of Duties

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What problems do you see?

What should have been done differently?

Specifics for Segregation of Duties

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1. More than one deacon should count the monies before handing them over to the church treasurer.
2. Deacons should retain a separate slip indicating the amount collected.
3. Separate slip should be given to the pastor or the chair of the church finance committee.
4. Funds should be deposited immediately; not taken to the treasurer's home.

Specifics for Segregation of Duties

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Case Study for Cash Disbursements by check:

Unused checks are kept in a box just inside the safe.
Check signing machine next to box of unused checks.
Large petty cash fund on hand.
Petty cash drawer just inside safe; usually unlocked.

Specifics for Segregation of Duties

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What problems do you see?

What should have been done differently?

Specifics for Segregation of Duties

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1. Make all disbursements by prenumbered checks and disburse checks in numerical order.
2. Store blank checks in a secure location.
3. Blank checks should never be signed in advance.
4. Use petty cash for small expenditures; keep petty cash box locked and under the custody of only one person.
5. Bank reconciliations should be done monthly.

Specifics on Segregation of Duties

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General Controls for Disbursements:

1. Require all employees who have anything to do with the payment process to take at least five consecutive days of vacation.
2. Checks awaiting signature should be left in a secure location--not on someone's desk in an empty office.

Specifics for Segregation of Duties

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3. Checks should only be printed when they are going to be mailed--not earlier so they reflect a date that matches your payments terms.
4. By policy, checks should not be returned to the individual who requisitioned the check.
5. Open receivers and purchase orders should always be extinguished when an invoice is paid, even if the invoice is paid outside of accounts payable.

Specifics for Segregation of Duties

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6. The organization should have an anonymous tip hotline.
7. The organization should have a written fraud policy, signed by a top-level executive, indicating zero tolerance for employee fraud.

Specifics on Segregation of Duties

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Cash Disbursements by credit card:

1. Use corporate credit cards sparingly.
2. Employees should sign an agreement for cc use.
3. Employees are responsible for detailed documentation for all purchases.
4. CC statements should be reviewed regularly.
5. Employees with cc should not submit expense reports.

Specifics on Segregation of Duties

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Cash Disbursements by Electronic Methods:

1. Changes made to the master vendor file should be periodically checked, no less frequently than once a month; ideally every week.
2. Inactive accounts in the master vendor file should be annually deactivated.

Specifics on Segregation of Duties

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3. Access to the master vendor file for entering vendors or changing vendor information should be severely limited.
4. The positive pay file should be uploaded only when checks are mailed.
5. Processors should not be writing their passwords down where they can be seen.
6. Managers should be prevented from having access to all phases of the payment process.

Specifics on Segregation of Duties

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7. The same individual should not both approve invoices and enter invoice data.
8. When a new vendor is to be entered into the master vendor file, two signatures should be required before adding them.
9. When a new vendor is to be entered into the master vendor file, checking should be done to be certain that the vendor is legitimate before adding them.

Specifics on Segregation of Duties

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10. When an employee making electronic payment transfers is terminated or leaves voluntarily, the bank should be notified immediately and passwords should be changed.

Specifics on Segregation of Duties

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Petty Cash:

- Use an imprest petty cash fund
- Use as infrequently as possible
- Keep the amount small
- Reimburse monthly
- No more than one custodian
- Custodian should have no access to the accounting records or cash receipts

Specifics on Segregation of Duties

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- Make sure the location of the key to the petty cash box is not common knowledge.
- Hold surprise audits, and let everyone know that surprise audits occur.

Two Person Segregation of Duties

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CFO	Accountant
Sign checks	Post accounts receivable
Sign employee contracts	Mail checks
Custody of securities	Write checks
Complete deposit slips	Post general ledger
Perform inter-fund transfers	Reconcile bank statements
Distribute payroll	Post credits/debits
Reconcile petty cash	Give credits and discounts
Record initial charges	Approve payroll
Approve employee time sheets	Open mail/receive cash
Prepare invoices	Disburse petty cash
Complete check log	Authorize purchase orders
	Authorize check requests
	Authorize invoices for payment

Three Person Segregation of Duties

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CFO	Accountant	Bookkeeper
Sign checks	Prepare invoices	Post accounts receivable
Sign employee contracts	Records initial charges	Reconcile petty cash
Custody of securities	Open mail/receive cash	Write checks
Complete deposit slips	Mail checks	Post general ledger
Perform inter-fund trfs	Approve invoices for pymt	Reconcile bank statements
	Distribute payroll	Post credits/debits
	Authorize purchase orders	Give credits & discounts
	Authorize check requests	
	Approve time sheets	
	Approve payroll	
	Complete check log	
	Disburse petty cash	

I/C for the Small Organization

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1. Record all cash receipts immediately
2. Deposit all cash receipts intact daily
3. Make all payments by serially numbered checks; use an imprest petty cash fund for small disbursements

I/C for the Small Organization

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4. Reconcile bank accounts monthly
5. Use serially numbered sales invoices and purchase orders
6. Issue checks to vendors after the invoices are matched with source documents and approved for payment

I/C for Small Organizations

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7. Balance subsidiary ledgers with control accounts monthly

8. Prepare comparative financial statements monthly in sufficient detail to disclose significant variations in revenue or expense

Internal Controls



Questions?

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