Internal Control: The Human Risk Factor

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PRESENTATION FOR THE
SPD NEW CFO ORIENTATION PROGRAM
MAY 15, 2017

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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

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Protect the assets that are most easily misused.

Reduce the risk of misstatement *due to error* or misstatement *due to fraud*.

Purposes of Internal Control

Misstatement due to fraud can occur two ways:

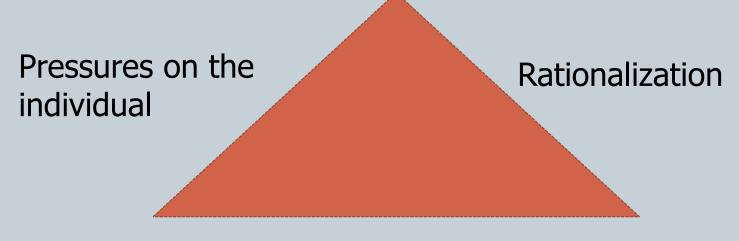
Fraudulent financial reporting ("cooking the books")

Misappropriation of assets (theft)

The Control Environment

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Control Pressure Points:



Perceived Opportunity

Elements of Good Internal Control

- 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 Good Internal Control

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Segregation of Duties:

Establish responsibility for each task to one person.

Separate the record keeping for the assets from the custody of the asset.

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.

(10)

What problems do you see?

What should have been done differently?

- (11)
- 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.



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.

(13)

What problems do you see?

What should have been done differently?

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- Whenever possible, disbursements should be made by prenumbered check. Checks should be disbursed in numerical order.
- 2. Blank and unsigned checks should be left in a secure location.
- 3. The petty cash fund should be a small amount. Location of the petty cash box should be secure, locked, and under the custody of one individual.

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- 4. If you have a petty cash box, do you make sure the location of the key is not common knowledge?
- 5. Blank checks should never be signed in advance.
- 6. Bank reconciliations should be done monthly.



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.
- 5. Employees with cc should not submit expense reports.

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Cash Disbursements by Electronic Methods:

- Do you limit the number of individuals who are allowed to perform electronic transfers?
- Computers, programs, and passwords used to electronic transfers should be physically secured.
- Computers used for electronic transfers should be cybersecurity protected and have limited or prohibited remote access.

- (18)
- 4. Do you require all employees who have anything to do with the payment process to take at least five consecutive days of vacation?
- 5. Do you prohibit the ability to both approve invoices and enter invoice data?
- 6. Do you prevent one or more of your managers from having access to all phases of the payment process?
- 7. Do you have a strong policy prohibiting the return of checks to requisitioners?

- 8. Are all changes made to the master vendor file periodically checked, no less frequently than once a month; ideally every week?
- 9. Do you annually deactivate inactive accounts in your master vendor file?
- 10. Do you have an anonymous tip hotline?
- 11. Do you check that your processors are not writing their passwords down where they can be seen?
- 12. Are open receivers and purchase orders always extinguished when an invoice is paid?

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- 13. When employees making electronic payment transfers are terminated or leave voluntarily, is the bank immediately notified? Passwords changed?
- 14. Are open access to the master vendor file for entering vendors or changing vendor information severely limited?
- 15. When a new vendor is to be entered into the master vendor file, do you require at least two signatures or approvals before adding them?

- 16. When a new vendor is to be entered into the master vendor file, do you check to make sure the vendor is legitimate before adding them?
- 17. Are the bank accounts reconciled on a timely basis by a person independent of those involved with electronic transfers?
- 18. Do you have a written fraud policy, signed by a toplevel executive, indicating zero tolerance for employee fraud?



Two-Person Segregation: Accountant and CFO

Accountant:

Post accounts receivable

Mail checks

Write checks

Post general ledger

Reconcile bank statements

Post credits/debits

Give credits and discounts

Approve payroll

Open mail/receive cash

Disburse petty cash

Authorize purchase orders

Authorize check requests

Authorize invoices for payment

CFO:

Sign checks

Sign employee contracts

Custody of securities

Complete deposit slips

Perform inter-fund transfers

Distribute payroll

Reconcile petty cash

Record initial charges/pledges

Approve employee time sheets

Prepare invoices

Complete check log



Three Person Segregation: CFO, Accountant, Bookkeeper

CFO

Sign checks
Sign employee contracts
Custody of securities
Complete deposit slips
Perform inter-fund 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

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

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 electronically; use an imprest petty cash fund for small disbursements.

4. Reconcile bank accounts monthly.

I/C for the Small Organization

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- 5. Use serially numbered invoices, purchase orders, and receiving reports.
- 6. Issue payments 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

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Questions or Comments?

References

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