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# Internal Control: The Human Risk Factor

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# 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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Andrews University

# Purposes of Internal Control

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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

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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

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Misstatement due to fraud can occur two ways:

Fraudulent financial reporting  
("cooking the books")

Misappropriation of assets (theft)

# The Control Environment

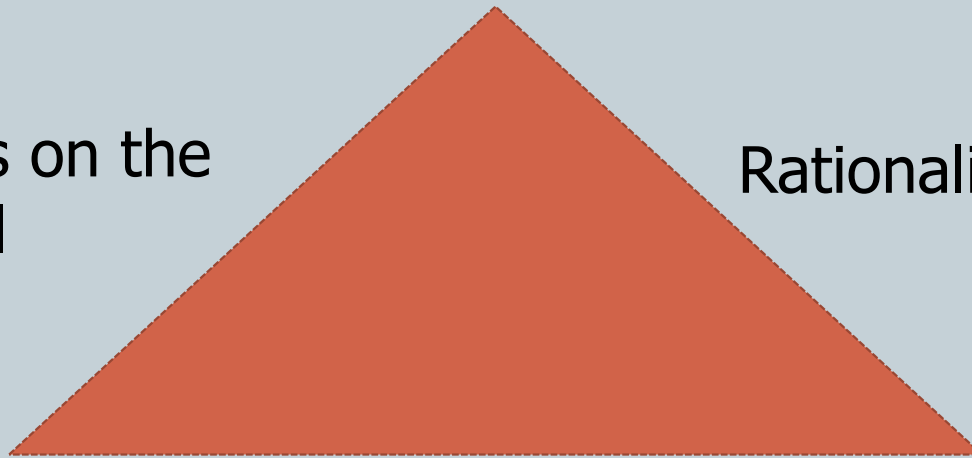
6

## 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 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.

# 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

13

What problems do you see?

What should have been done differently?

# Specifics for Segregation of Duties

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1. 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.

# Specifics for Segregation of Duties

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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.



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

# Specifics on Segregation of Duties

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## **Cash Disbursements by Electronic Methods:**

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

# Specifics on Segregation of Duties

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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?

# Specifics on Segregation of Duties

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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?

# Specifics on Segregation of Duties

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?

# Specifics on Segregation of Duties

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 top-level executive, indicating zero tolerance for employee fraud?

# Specifics of Segregation of Duties

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## **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

# Specifics of Segregation of Duties

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## 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



# Specifics of Segregation of Duties

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## **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?

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