# Internal Controls for Small Organizations

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# Fraud Statistics:

The following statistics about fraud and white-collar crime are from the Association of Certified Fraud Examiners' **2004 Report to the Nation**.

- Fraud and abuse costs U.S. organizations more than $660 billion annually.
- **The average organization loses about 6 percent of its total annual revenue to fraud and abuse committed by its own employees.**
- The median loss caused by males is about $160,000; by females, about $60,000.
- Men commit nearly 53 percent of the offenses.
- Median losses caused by men are nearly three times those caused by women.

# Fraud Statistics:

- Losses caused by managers are double those caused by employees.
- Median losses caused by executives are 14 times those of their employees.
- The most costly abuses occur in organizations with less than 100 employees.
- The education industry experiences the lowest median losses.
- Occupational fraud and abuses fall into three main categories: **asset misappropriation, fraudulent statements, and bribery and corruption**.

# What is Fraud?

**Fraud** is any intentional act or omission designed to deceive others and results in the victim suffering a loss and/or the perpetrator achieving a gain.

## Three Categories of Fraud

| | | |
|---|---|---|
| **Misappropriation of Assets** | **Fraudulent Financial Reporting** | Corruption |

# Financial Reporting Fraud

**Definition**

Financial reporting fraud is any intentional manipulation of financial statements.

**Most Common Methods of Fraudulent Financial Reporting**

- Overstating sales and valuation of assets
- Understating costs of sales, expenses, and liabilities
- Manipulating the timing of when transactions are recorded or events are recognized
- Incorrectly measuring or estimating the effects of transactions or events
- Intentional misapplication of generally accepted accounting principles (GAAP)
- Misrepresenting or omitting material events or disclosures to users of financial
- information
- Concealing misappropriation of assets

**Impact on Financial Reporting**

Direct impact on financial reporting.

# Misappropriation of Assets

**Definition**

Misappropriation of assets fraud is when assets, both tangible or intangible, are stolen by employees, customers, or vendors.

**Examples**

- Theft of inventory, fixed assets
- Lapping schemes (theft of cash receipts)
- Fictitious vendors and invoices (theft of cash disbursements)
- Employees writing checks to themselves

**Impact on Financial Reporting**

*Direct* impact on financial reporting if fraud includes a component of financial reporting fraud to conceal the theft. Also *may* impact financial reporting if controls are not in place that would timely detect and adjust for the misappropriation.

# Corruption

**Definition**

Corruption is a misuse of entrusted power for private gain.

**Examples**

- Bribery and gratuities to companies, private individuals, public officials
- Receipt of bribes and gratuities
- Aiding and abetting fraud by other parties (e.g., customers, vendors)
- Misuse of employee or customer data (e.g., to perpetrate identify theft)

**Impact on Financial Reporting**

Not likely to impact financial reporting, but poses a significant risk to a company's reputation and may lead to significant regulatory or civil liabilities.

# Addressing Fraud Risks

How does your organization respond to the risks associated with Fraud?

# What is Internal Control?

**Definition**

Internal control is the process designed to ensure reliable financial reporting, effective and efficient operations, and compliance with applicable laws and regulations. Safeguarding assets against theft and unauthorized use, acquisition, or disposal is also part of internal control.

# Why have Internal Controls?

- Internal controls help to provide *reliable data* by ensuring that information is recorded in a consistent way that will allow for useful financial reports
- They also help *prevent fraud and loss* by safeguarding assets and essential records.
- Internal controls *promote operational efficiency* by reducing unnecessary duplication of effort and guarding against misallocation of resources.
- They encourage *adherence to management policies* and funding source requirements.

# Examples of Internal Controls

| Cash Receipts | Yes | No | Not Sure | Not Applicable |
| --- | --- | --- | --- | --- |
| Does someone prepare a daily list of all cash and checks immediately upon receipt? | | | | |
| Are all cash and checks deposited intact and on a timely basis? | | | | |
| Are restricted contributions clearly identified and recorded as restricted on the general ledger? | | | | |
| I all cash received, counted, and verified by two employees? | | | | |
| When events involve admission fees, does the agency involve pre-numbered tickets? | | | | |

# Examples of Internal Controls

| Cash Disbursements | Yes | No | Not Sure | Not Applicable |
|---|---|---|---|---|
| Are all disbursements, except those from petty cash, made by pre-numbered checks? | | | | |
| Is there a written prohibition against issuing checks payable to “cash”? | | | | |
| Are all expenses approved in advance by authorized persons? | | | | |
| Are signed checks mailed promptly? | | | | |
| Do checks require two signatures? | | | | |

# Examples of Internal Controls

| Petty Cash | Yes | No | Not Sure | Not Applicable |
|---|---|---|---|---|
| Is an imprest petty cash fund maintained for payment of small, incidental expenses? | | | | |
| Does the organization follow a policy limiting the amount that can be reimbursed by the petty cash fund? | | | | |
| Is supporting documentation required for all petty cash disbursements? | | | | |
| Is access to petty cash limited to one person who is the fund custodian? | | | | |
| Are unannounced counts of petty cash made by someone within the organization other than the fund custodian? | | | | |

# Examples of Internal Controls

| Payroll | Yes | No | Not Sure | Not Applicable |
|---|---|---|---|---|
| Are time sheets required documenting employee hours, overtime, and what activity the employee worked on? | | | | |
| Are time sheets signed by employees and reviewed and signed by their immediate supervisors? | | | | |
| Are employment records maintained for each employee that detail wage rates, benefits, tax rates, and other pertinent information? | | | | |
| Do written policies and procedures exist for accounting for vacations, holidays, sick leave, and other benefits? | | | | |