

Internal Controls

Any business, regardless of size, should have an internal control system in place to protect against losses, both intentional and unintentional. An internal control system will:

- 1) Protect cash and other assets,
- 2) Promote efficiency in processing transactions, and
- 3) Ensure reliability of financial records.

Most internal control systems are based on the principle of separation of duties. Separating duties makes it more difficult for theft and errors to go undetected.

Example: Barker Company's internal control system requires different individuals to be involved with each purchase. Blanche must authorize each purchase by submitting a voucher to Clyde. Clyde then writes and submits the check to the payee. Bonnie is responsible for bookkeeping and reconciling the checkbook at the end of the month. Buck is the CPA who audits Bonnie's books once per year.

Suggestions for internal controls:

- Allow only specific designated individuals to handle cash.
- Give responsibility for bookkeeping to an individual who does not handle cash.
- Use numbered receipts to document all payments.
- Make all bank deposits promptly.
- Make deposits intact with no amounts withdrawn to pay expenses.
- Keep cash and checkbook in a locked drawer or cash register.
- Since tills will never be 100% correct all the time, establish a tolerance level for overages and shortages to determine the point at which corrective measures will be triggered.
- Make all disbursements by check, except minimal amounts paid from petty cash.
- Make certain every payment is related to a paper document, such as a voucher, to ensure that a verifiable trail exists.
- Conduct surprise counts of petty cash and cash drawers.
- Count inventory and other assets frequently and compare with company books.

In general:

- All employees should be required to take annual vacations, with a different individual taking over their duties.
- A public accounting firm that specializes in internal controls can give an objective evaluation of the needs of a specific business.
- An internal control system set up early as a preventative measure is more efficient than establishing a corrective system in reaction to a loss.
- An internal control system should have detective functions in place to identify sources of intentional or unintentional losses.

- See PPC's Guide to Internal Control and Fraud Prevention for a more detailed discussion on internal controls.