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Dear Client:

How are you managing your business finances? Many business owners are discovering that their assets are not as well protected as they thought. This is especially true in small business environments where a single employee manages all the finances. Often there are no "checks and balances" to verify that transactions are accurate.

When proper, consistent procedures are not in place, employees can learn to manipulate the accounting system to their benefit. Whether they take money from the company or their mistakes are undiscovered, the end result can greatly impact your company's management decisions, financial reports, and tax filings.

Unfortunately, once your financial records have been altered, discovering problems is extremely difficult. Most standard accounting practices are not designed to uncover internal problems such as embezzlement.

Therefore, the best way to safeguard your company's assets is to recognize and improve weaknesses in your internal procedures. The following business practices can help you minimize potential internal control problems:

- **Related duties should be assigned to different people.** Certain accounting functions are designed to cross-reference each other for accuracy and these procedures can help to reveal inconsistencies in your records in a timely manner. Some examples include:
 - Writing and signing checks
 - Ordering, paying for, and receiving materials
 - Handling and recording cash
- **Reconcile and scrutinize your bank statements every month.** A bank statement can tell you a lot about your business if you review the information in a timely manner. Examine checks and endorsements, track transactions between accounts, compare payroll checks with employee records, and ask questions.

Strength in Numbers

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- **Always ask for proof before you sign a check or authorize a transaction.** When you insist on reviewing original documentation, your employees become more accurate and communicate their needs more clearly. You should also verify the names of your vendors and your employees occasionally. And, remember to cancel supporting materials after signing a check.
- **Lock and protect your valuables.** Keep blank checks and signature stamps secured, and deposit cash and checks daily. It's also important to secure fidelity bonds and insurance for all accounting and key personnel.
- **Know your employees and examine behavior changes.** Always verify employee references before hiring. Also, consider the need for conducting other background checks as appropriate, including but not limited to the need for credit information, motor vehicle report, and criminal searches. Many white-collar crimes go unreported and continue to be repeated. Watch for trouble signs: possible substance abuse, change in lifestyle, living beyond means, possessiveness of work.

These internal controls can help you reveal many discrepancies, as well as recognize the excellent efforts of your staff. Attached is an internal control checklist that may assist you in identifying areas where your business may have weaknesses in internal control. Although the list does not include every area that may be of concern for your business, it may help you to assess problem areas. Please contact our office if you have any questions. We would be happy to assist you any way we can.

Sincerely,

McDonald Jacobs, P.C.

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An Internal Control Checklist Recognizing Warning Signs and Prevention Problem Situations

I. Introduction/Concept

Why are consistent internal controls important?

1. Management decisions, financial reports, and company taxes rely on the accuracy of figures recorded.
2. Gives owner control of dollars in and out.
3. Standardizes good management practices and procedures.

Advantages of improved internal control:

1. Can reveal errors and omissions
2. Discourages employee theft
3. Protects assets

How to use the checklist:

1. Review the concept for each internal control area and answer the questions following each section.
2. Each answer identifies an area that needs stronger internal controls.

II. Segregation of Duties

CONCEPT:

- Certain accounting/bookkeeping functions are designed to cross-reference each other for accuracy. If the same person is responsible for multiple duties, the natural checks and balances of the system are missing.
- Trust is not the issue; verifying business transactions is. Giving a single person unquestioned authority of your finances is not a wise business practice.

CHECKLIST: Each "yes" answer identifies a potential problem area.

1. Is the person who handles your cash also responsible for recording the cash?
2. Does the person who pays or orders inventory also receive the materials?
3. Are two or fewer people responsible for the accounting function?
4. Is only one person responsible for reviewing financial statements each month?
5. Is your review of financial journals sporadic?

III. Bank Reconciliations

CONCEPT:

- Bank statements can only flag discrepancies if they are reconciled on a timely basis. Reconciliations should be done once a month. Bank adjustments need to be tracked carefully from one month to another.
- Segregating duties is also important in this area. Reconciliations should be performed by one person and reviewed by another. Also, the person who writes the checks should not have the authority to sign checks.

CHECKLIST: Each "no" answer identifies a potential problem area.

1. Is the bank statement delivered, unopened, directly to the owner?
2. Do you review canceled checks and endorsements on a monthly basis?
3. Do you compare payroll checks with your current employee records?
4. Do you question funds transferred between bank accounts?
5. Do you track the number of credit card bills you sign per month?
6. Are bank reconciliations performed on a timely basis?
7. Is someone responsible for reviewing the reconciliations each month?
8. Do you verify reconciled items?

IV. Supporting Documentation

CONCEPT:

- Enhances communications and serves as final checkpoint

CHECKLIST: Each "yes" answer identifies a potential problem area.

1. Do you ever sign blank checks?
2. Do you ever sign checks without original supporting documentation?
3. Do you ever sign checks without canceling supporting documentation?
4. Have funds ever been transferred between accounts without review or verification?
5. Do you ever sign checks for new business vendors without knowing or verifying their name and association with your company?

V. Employees/Personnel

CONCEPT:

- Know your employees and be aware of changes in behavior

CHECKLIST: Each "yes" answer identifies a potential problem area.

1. Are any of your employees extremely possessive of their work records and reluctant to share their tasks?
2. Are any of your employees apprehensive about vacations and time off, while always being the first in the office and the last out?
3. Have you noticed a substantial change of lifestyle in any of your employees?
4. Do any of your employees have a possible substance abuse problem?
5. Are any of your employees living beyond their means?
6. Have you ever hired an employee before checking references?
7. Do you permit your accounting personnel to work longer than a year without taking a vacation?
8. Do you have any accounting staff or key personnel who have not been secured with a fidelity bond?

VI. Safeguarding Assets

CONCEPT:

- Limit and monitor access to important documents and supplies

CHECKLIST: Each "no" answer identifies a potential problem area.

1. Are blank check stocks and signature stamps safely secured?
2. Do you restrictively endorse all checks when received?
3. Do you deposit cash and checks daily?
4. Do you maintain a list of office furniture, equipment, and company vehicles?

VII. Other

- Adequate insurance coverage for assets
- Off-site storage
- Importance of backing-up information
- Password restriction and security

This is not intended to be an all-inclusive list, but rather a tool to assist you in beginning to identify key areas of your business where risks may exist.