



Internal Controls: Essential Periodic Testing & Maintenance

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Fraud and embezzlement have become a growing problem for many Los Angeles and Southern California business owners and entrepreneurs. A recent survey published by KPMG noted that businesses are currently reporting more fraud than in prior years, and that three out of every four companies have uncovered some type of fraud.

In previous articles, we have discussed in detail how companies can combat and detect fraud by implementing appropriate internal controls.

[Prevent & Detect Fraud Before It's Too Late](#)

[Preventing Fraud: 12 Recommendations for People, Processes & Technology](#)

After internal controls are put in place, however, it's just as important to perform regular checks and balances to make sure the controls are properly maintained. Not maintaining adequate internal controls could open the door to fraud and embezzlement schemes that can cost companies tens of thousands of dollars (or more) and create chaos and an uncomfortable environment for all staff.

Are Qualified Employees In Charge?

With many companies having eliminated upper management finance positions during and after the recession, it can be easy for controls that worked when first implemented to become ineffective due to inadequate oversight by qualified finance staff. So the first step in maintaining adequate internal controls is to ensure that qualified employees are in charge of overseeing controls and making sure they are still working as originally intended.

If you do not have such high-level finance employees on your staff, you should consider hiring an outsourced CFO services provider to come in and perform a comprehensive review of your company's internal controls. In addition to reviewing your controls to gauge their effectiveness, an outsourced CFO can also train your staff (including the owner and CEO) so that you can maintain the internal controls yourself going forward.

A CPA will likely review your internal controls as part of an annual audit, review or compilation of your financial statements. However, such a review is fairly limited in scope when compared to the comprehensive review that will be performed by an outsourced CFO. This high-level finance professional will look at your internal controls through the lens of a forensic accountant and train your employees to do the same. This, in turn, will enable your company to spot areas where you could be vulnerable to fraud and embezzlement before they occur — and you have to hire a forensic accountant to come in and sort out the mess.

Steps to Maintaining Internal Controls

Maintenance of internal controls to prevent fraud and embezzlement should incorporate the following six steps:

1. Perform surprise testing of internal controls and observe how employees behave during the testing process.
2. Create a list of questions to ask finance employees to try to determine whether or not they might be trying to hide fraudulent activities.
3. Verify the accuracy of petty cash and related vouchers during a surprise testing.

4. Make sure the owner is set up as an active user of the company's accounting software and knows how to run key reports.
5. Keep a close eye on accounts payable by reviewing the list of all vendors and be certain that all vendors are legitimate vendors. One of the most common types of embezzlement is a finance employee setting up bogus vendors and make unauthorized payments to them.
6. Kiting of accounts receivable is also another example of common type of embezzlement. Review accounts receivable aging report on a periodic basis.

Also, the owner should be encouraged to take an active role in the company's financial management. Many owners have a limited financial background and take little if any interest in financial management, instead leaving this to the "finance guys." This is an open invitation to unscrupulous employees to "play fast and loose" with the company's money by committing fraud and embezzlement.

For example, company bank statements should be mailed directly to the owner, who should open and review them each month. This simple step will uncover many frauds in their early stage and serve as a deterrent to employees to commit fraud in the first place. The same goes for company credit card statements: There have been instances where employees took extravagant vacations and charged them on business credit cards — but this wasn't discovered until much later because the employees committing the fraud were the only ones who reviewed the credit card statements.

Finally, remember to use a good dose of common sense when it comes to your internal controls. View your company's financial operations through the eyes of a dishonest or unscrupulous employee to look for easy ways they might be able to commit fraud and embezzlement. Often, it's the simple, easy-to-correct things that dishonest employees exploit to steal from their employers.

The bottom line: Implementing and then maintaining adequate internal controls will help severely limit the opportunities employees have to commit fraud and embezzlement. And when fraud does occur, such controls will help you uncover it during the early stages so it can be stopped before too much financial damage is done to the company.

Concluding Thoughts

Fraud and embezzlement have become a growing problem, with businesses reporting more fraud now than in prior years. Implementing and maintaining appropriate internal controls is the best way to combat and detect fraud. An outsourced CFO services provider can perform a comprehensive review of your company's internal controls to make sure they are still working as an effective fraud deterrent.

About CFO Edge

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