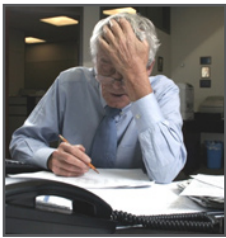




Creating and Implementing an Internal Controls Program for Small Businesses

By Joe Wilcynski

The January 2008 headlines reporting Société Générale's \$7 billion loss from trading fraud seemed unfathomable: one of Europe's largest banks had experienced one of the largest financial losses ever caused by a single employee. While it's easy to dismiss this as an isolated incident, there are important lessons for small businesses about how to manage their own affairs. CPAs who work with small business clients can provide needed guidance on tightening up policies and procedures when handling financial transactions.



An internal controls program is like a home security system for financial records. If designed accurately, this system of checks and balances can ensure the safety of clients' financial assets. Just as an alarm warns homeowners of intruders, an effective internal controls program alerts business owners when something does not add

up right.

Most small businesses, though, don't have the same resources to dedicate to internal controls that large corporations do, especially when it comes to separation of accounting functions to ensure the security of assets. Your role as a CPA is to help clients see that these challenges are not insurmountable.

The Top 10

From establishing a program for monthly reconciliations to making minor changes such as stamping each check "deposit only," CPAs can use the following checklist to offer easy-to-implement suggestions that will make a big impact on the security of clients' everyday transactions.

1. Reconcile cash accounts monthly.

Monthly reconciliations prevent costly errors. Advise your clients to reconcile the balance the bank shows to the amount that the trial balance shows just as they would a personal checkbook. Any errors can be spotted early on and fixed before getting out of control.

2. Establish closing procedures.

Suggest that the business's bookkeeper match third-party documentation to the balances shown on the balance sheet at least once a month or quarter. If there is any discrepancy between the balances, a reconciliation needs to be done to explain the difference.

3. Have a senior-level manager review financials on a monthly basis.

When reviewing the financials, a senior manager should look at whether the balances match third-party documentation or the reconciliations are reasonable. This step should stress the importance and perception of control to both the bookkeeper and the manager responsible for reviewing the books. It creates a system of accountability that will carry through to all employees.

4. Review accounts payable and accounts receivable for accuracy.

Regular monitoring of the detail listing of both accounts payable and accounts receivable alerts businesses to anything unusual. Encourage clients to look for anything out of the ordinary. If an account is delinquent for an extended time, have someone other than the person who records the payments contact the client or vendor. This is the prime area for misapplication of payments.

5. If possible, separate the duties of signing and recording checks.

Emphasize that the person who prepares the checks should not be the one who signs them. A detailed expense report should accompany each check so that the person who signs the check knows its purpose. This step prevents someone from arbitrarily writing checks to himself or herself or to accounts that might not exist.

6. The person that opens the mail should be different than the person who records the checks.

The person opening the mail should keep a log of all checks received. At the end of every day, week, or month, this log should be reviewed and compared to a separate log the bookkeeper maintains. Any discrepancies will be immediately apparent.



Accounting Trends

7. Check for unknown lines of credit.

Advise clients to check for unknown lines of credit by having their banker run a credit report every six months. The banker can inform them of any credit lines that should not be open. Bankers can also tell your clients if anyone has tried to open any accounts and alert businesses to anything that looks unusual.

8. Review the financial history.

Evaluating data from previous years will help management detect anything out of the ordinary. Instruct clients to look for consistency from one year to the next — this will help them to identify patterns and to see if anything looks out of sync. Reviewing past records will not only alert business owners to potential fraud, it will also give them a greater understanding of the company's cost structures.

9. Establish a yearly budget.

Help clients use financial history to forecast future budgets. Compare benchmark ratios from management to make sure the budgets created are realistic. For example, if labor has historically been 40% of revenue, then the business can budget based on that expectation.

10. Make yourself available for your small business clients.

Meet with your clients at regular intervals to review their finances. While the company's in-house bookkeeper is good at handling day-to-day accounting functions, a CPA can offer greater insight into the company's financial health. This regular checkup is an important opportunity to develop a positive relationship with your clients.

Conclusion

Just like a home without a security system, small businesses are vulnerable without an internal controls program. Offering these tips will not only help your clients' businesses prosper, but you'll also be seen as a trusted advisor who has your clients' best interests in mind.

About the Author

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