



Combatting Workplace Fraud through Internal Controls

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In the ACFE 2012 “Report to the nations on Occupational Fraud and Abuse” the observation was made that “the frauds reported to us lasted a median of 18 months before being detected.” The speed at which fraud is detected is a function of the effectiveness of internal controls and, surprisingly, the relationship of management/ownership with staff.

In the ACFE fraud study, the leading means of discovery was tips by individuals with knowledge of the fraud. However, relying on tips to alert management to embezzlement or other forms of fraud is a risky strategy.

Make it Difficult to Steal

A better option is to establish a system of internal controls. It is important to note that no system has yet been devised that will prevent human error or fraud. A good system of internal controls will cause mistakes to be discovered and corrected in a timely manner. Additionally, the goal of any system of internal control is to reduce the opportunity for fraud and the incentives to commit fraud as much as possible and, to the extent fraud still takes place, expose it as early as possible.

An effective control system reflects recognition that the organization has a responsibility to make it difficult to steal. An effective system of internal control also protects employees performing financial responsibilities from baseless suspicion or even accusation.

5 Basic Assertions of Reporting

A system of internal control is concerned with five basic assertions as they relate to the reporting of financial/economic activities of the organization:

- Existence and/or occurrence – the activity recorded in the company’s accounting records reflect actual transactions
- Completeness – all transactions are recorded in the organization’s accounting records with none excluded
- Rights and obligations – the organization holds title to all assets and are actually obligated for all recorded liabilities
- Valuation – amounts (values) used to record economic activity are accurate



- Presentation/disclosure – financial reporting is not misleading, but fairly reflects the economic activity of the organization

Separation of Duties

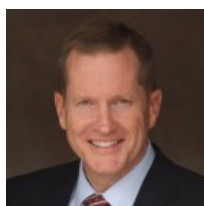
For each element of internal control, the organization must determine whether the control is reasonable and effective given the size of the organization, the skills of the accounting staff, etc. If it is a small staff care should be given to maximize the effect of a separation of duties. For example, dividing duties between two people is much more difficult than establishing a system of safeguards with five people.

The following is a list of major functions that, if possible, should be separated in the accounting department:

- Receiving – The function of receiving customer payments, inventory shipments, vendor invoices, bank and credit card statements, and other information from external sources should be isolated from the other accounting functions.
- Recording – Entries in the accounting system recording the economic activity of a business should be done by staff that do not generate or participate in the activity.
- Reconciling – Bank statements, credit card statements, and detailed accounting records should be reconciled to the accounting records of the company on a contemporaneous basis. Failure to maintain current reconciliations should be viewed as a major warning sign indicating that, at minimum, the system of internal control is weak or temporarily vulnerable.
- Reporting – senior management, ownership, or both should be receiving regular reporting of financial results including cash activity and other information that evidence current and complete accounting. This also provides a sense of accountability even if the reporting is not reviewed every time it is received.

These examples of separation of duties should be maintained to prevent fraud or to cause errors and defalcations to be discovered as quickly as possible.

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