

An NSAC Best Practice



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# Internal Controls To Prevent & Detect Fraud

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## **Best Practices: Internal Controls to Prevent & Detect Fraud**

A recent “KPMG Fraud Survey” found that organizations are reporting more experiences of fraud than in prior years and that three out of four organizations have uncovered fraud. Below are some internal control “Best Practices” that can reduce fraud opportunities or help detect fraud.

- 1. Use a system of checks and balances to ensure no one person has control over all parts of a financial transaction.**
  - Require purchases, payroll, and disbursements to be authorized by an appropriate designated person.
  - Separate handling (receipt and deposit) functions from record keeping functions (recording transactions and reconciling accounts).
  - Separate purchasing functions from payables functions.
  - Ensure that the same person isn’t authorized to write and sign a check.
  - When opening mail, endorse or stamp checks “For Deposit Only” and list checks on a log before turning them over to the person responsible for depositing receipts. Periodically reconcile the incoming check log against deposits. If possible use a lock box deposit system so that checks are sent directly to the bank and deposited.
  - Require supervisors to approve employees’ time sheets before payroll is prepared.
  - Require paychecks to be distributed by a person other than the one authorizing or recording payroll transactions or preparing payroll checks. Where possible, require direct deposit of payroll checks to the employees’ bank accounts.
  - If the company is so small that you can’t separate duties, require an independent check of work being done.
  - Require accounting department employees to take vacations.
  
- 2. Reconcile bank accounts every month.**
  - Require the reconciliation to be completed by an independent person who doesn’t have direct bookkeeping responsibilities for the accounts or check signing responsibilities or require supervisory review of the reconciliation.
  - Examine canceled checks to make sure vendors are recognized, expenditures are related to company business, signatures are by authorized signers, and endorsements are appropriate.
  - Examine bank statements and cancelled checks to make sure checks are not issued out of sequence.
  - Initial and date the bank statements or reconciliation report to document that a review and reconciliation was performed and file the bank statements and reconciliations.



3. **Restrict use of company credit cards and verify all charges made to credit cards or accounts to ensure they were business-related.**
  - Limit the number of company credit cards and users.
  - Establish a policy that credit cards are for business use only; prohibit use of cards for personal purposes with subsequent reimbursement.
  - Set account limits with credit card companies or vendors.
  - Inform employees of appropriate use of the cards and purchases that are not allowed.
  - Require employees to submit itemized, original receipts for all purchases.
  - Examine credit card statements and corresponding receipts each month, independently, to determine whether charges are appropriate and related to company business.
  
4. **Prepare all fiscal policies and procedures in writing and obtain Board of Directors approval. Include policies and/or procedures for the following:**
  - cash disbursements
  - attendance and leave
  - expense and travel reimbursements
  - use of company assets
  - purchasing guidelines
  - petty cash
  - conflicts of interest
  
5. **Ensure that company assets such as vehicles, cell phones, equipment, and other company resources are used only for official business.**
  - Examine expense reports, credit card charges, and telephone bills periodically to determine whether charges are appropriate and related to company business.
  - Maintain vehicle logs, listing the dates, times, mileage or odometer readings, purpose of the trip, and name of the employee using the vehicle.
  - Periodically review the logs to determine whether usage is appropriate and related to company business.
  - Maintain an equipment list and periodically complete an equipment inventory.
  
6. **Protect petty cash funds and other cash funds.**
  - Limit access to petty cash funds. Keep funds in a locked box or drawer and restrict the number of employees who have access to the key.
  - Require receipts for all petty cash disbursements with the date, amount received, purpose or use for the funds, and name of the employee receiving the funds listed on the receipt.
  - Reconcile the petty cash fund before replenishing it.
  - Limit the petty cash replenishment amount to a total that will require replenishment at least monthly.
  - Keep patient funds separate from petty cash funds.



**7. Protect checks against fraudulent use.**

- Prohibit writing checks payable to cash.
- Deface and retain voided checks.
- Store blank checks in a locked drawer or cabinet, and limit access to the checks.
- Require that checks are to be signed only when all required information is entered on them and the documents to support them (invoices, approval) are attached. If using facsimile or stamped signatures, secure the signature plates or stamp.
- Require two signatures on checks above a specified limit. (Ensure that blank checks are not pre-signed.)
- Mark invoices "Paid" with the check number when checks are issued.
- Enable hidden flags or audit trails on accounting software.

**8. Protect cash and check collections.**

- Ensure that all cash and checks received are promptly recorded and deposited in the form originally received.
- Issue receipts for cash, using a pre-numbered receipt book.
- Conduct unannounced cash counts.
- Reconcile cash receipts daily with appropriate documentation (cash reports, receipt books, mail tabulations, etc.)
- Centralize cash receipts whenever possible.

**9. Avoid or discourage related party transactions.**

- Require that a written conflict of interest and code of ethics policy is in place and that it is updated annually.
- Require that related party transactions be disclosed to the appropriate management or the Board of Directors.
- Require competitive bidding for major purchases and contracts.
- Discourage the hiring of relatives of Board members and employees, where possible. If not possible, do not let family members supervise each other.

**10. Provide for Board of Directors oversight of company operations and management.**

- Monitor the company's financial activity on a regular basis, comparing actual to budgeted revenues and expenses and report to the Board of Directors.
- Provide to the Board explanations of any significant variations from budgeted amounts.
- Document approval of financial procedures and policies and major expenditures in the board meeting minutes.
- Require independent auditors to present and explain the annual financial statements to the Board of Directors and to provide management letters to the Board.
- Evaluate the Manager's performance annually against a written job description.
- Participate in the hiring/approval to hire consultants including the independent auditors.

*DISCLAIMER FOR NSAC BEST PRACTICES The NSAC Best Practices are developed from accounting literature, Internet articles, and from personal experiences and are intended to be instructive and illustrative in nature and should not be considered all inclusive, nor a guarantee. If utilized individual results may vary.*