

Internal Controls

Team B

University of Phoenix

Accounting for Managerial Decision Making ACC 539

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## Internal Controls

Internal control is broadly defined as a process, affected by an entity's board of directors, management and other personnel designed to provide reasonable assurance regarding the achievement of objectives in 1) effectiveness and efficiency of operations, 2) reliability of financial reporting, and 3) compliance with applicable laws and regulations. Controls can be preventive or detective. An internal control can be thought of as something that prevents or detects errors or omissions.

Preventive controls attempt to prevent or deter undesirable acts from occurring. They are proactive controls, designed to prevent a loss, error, or omission. Examples of preventive controls are separation of duties, proper authorizations, adequate documentation, and physical security over cash and other assets.

Detective controls attempt to detect undesirable acts that have occurred. They provide evidence after-the-fact that a loss or error has occurred, but do not prevent them from occurring. Examples of detective controls are variance analyses, supervisory reviews of account activity, reconciliations, and physical inventories. Both types of controls are essential for an effective internal control system.

A control conscious environment is also necessary. It is an environment that supports ethical values and business practices. Management is responsible for "setting the tone" for their areas and encouraging the highest levels of integrity and ethical behavior, as well as exhibiting leadership behavior that promotes internal control and accountability. The following steps are examples of this leadership behavior:

- Communicate to employees that fraud and conflicts of interest will not be tolerated.
- Communicate to employees that policies and procedures are important and will be followed.
- Make employees fully aware of their responsibilities, including internal controls.
- Monitor the internal controls system on an on-going basis (Washington University, 2004).

Adequate internal controls in the accounts payable (AP) process are critically important to protect against fraud. While the recent accounting debacles and the enactment of the Sarbanes-Oxley Act have brought the issue home to roost, accounts payable professionals have long been aware of the importance of all sorts of controls. At Carr, Cox, Douglas and Parrott (CCDP), we are dedicated to providing businesses with the tools needed to effectively define, develop, monitor, and reassess their internal control policies.

In reviewing the accounts payable internal controls of Jamona.com, several areas need to be addressed. CCDP has devised a tool to help with self assessment of internal controls. This questionnaire aids management in defining both weaknesses and strengths, and serves as a starting point in revamping policies and procedures.

## Self Assessment of Internal Control

## Purchasing/Accounts Payable Cycle

<u>Yes</u>	<u>N/A</u>	<u>No</u>	
			<b>A. Control Activities / Information and Communication</b>
			1. Is there a formal organizational chart defining the responsibilities of preparing, recording, approving and follow up of all purchases and accounts payable functions?
			2. Is a written policy established to ensure that the best possible price is obtained for purchases?
			3. If construction contracts are awarded, are bid and performance bonds as well as retainage required to assure performance?
			4. Are procedures established to identify, before purchase orders are issued, cost and expenditures not allowable under grant federal/state) programs?
			5. If a receiving department is not used, do adequate procedures exist to ensure that goods for which payment is to be made have been verified and inspected by someone other than the individual approving payment?
			6.
			7. Do procedures exist ensuring accurate account distribution of all entries resulting from invoice processing?
			8. Do procedures exist for disbursement approval and check-signing?
			9. Has the agency established procedures to ensure that all voided checks are properly accounted for and effectively canceled?
			10. Has an effective small purchase or emergency purchase policy been documented and implemented?
			11. Do invoice processing procedures provide for:
			a. Obtaining copies of requisitions, purchase orders and receiving reports as applicable?
			b. Comparison of invoice quantities, prices, and terms with those indicated on the purchase order?
			c. Comparison of invoice quantities with those indicated on the receiving reports?
			d. As appropriate, checking accuracy of calculations?
			e. Alteration/mutilation of extra copies of invoices to prevent duplicate payments?
			f. All file copies of invoices are stamped paid to prevent

				duplicate payments?
			12.	Are payments made as close to the discount date as possible?
			13.	Is splitting orders to avoid higher levels of approval prohibited?
			14.	Is an adequate record of open purchase orders and agreements maintained?
			15.	Are receiving reports prepared for all purchased goods?
			16.	Are goods received accurately counted and examined to see that they meet quality standards?
			17.	Are copies of receiving reports sent directly to purchasing or accounting?
			18.	If an invoice is received from a supplier not previously dealt with, are steps taken to ascertain that the supplier actually exists?
			19.	Are payments made only on the basis of original invoices and to suppliers identified on supporting documentation?
			20.	Are the accounting and purchasing departments promptly notified of returned purchases, and are such purchases correlated with vendor credit advices?
			21.	Is proper control maintained over vendor credit memos?
			22.	Are signed checks delivered directly to the mail room, making them inaccessible to persons who requested, prepared, authorized or recorded them?
			23.	Are monthly reconciliations performed on the following:
				a. All petty cash accounts?
				b. All bank accounts?
				c. All subsidiary accounts to the general ledger accounts?
			24.	Are the following duties generally performed by different people:
				a. Custodian of funds and disbursements.
				b. Recording disbursement activity and adjustments in subsidiary or general ledger
				c. Authorization of transactions
				d. Reconciliation of check logs, subsidiary ledger, general ledger, bank statement, etc.
			25.	Is check signing limited to only authorized personnel?
			26.	Are disbursements approved for payment only by properly designated officials?

			27.	Are travel expenses for out-of-state, out-of-country, and excess allowances approved in advance?
			28.	Are invoices (vouchers) reviewed and approved for completeness of supporting documents?
			29.	Is responsibility fixed for seeing that all cash discounts are taken and if applicable, that exemptions from sales, federal excise, and other taxes are claimed?
			30.	Is the individual responsible for approval or check-signing furnished with invoices and supporting data to be reviewed prior to approval or check-signing?
			31.	Are adjustments of recorded accounts payable or other liabilities properly approved?
			32.	Are unused checks adequately controlled and safeguarded?
			33.	Is it prohibited to sign blank checks in advance?
			34.	Is it prohibited to make checks out to the order of "cash"?
			35.	If facsimile signatures are used, are the signature plates adequately controlled and separated physically from blank checks?
			36.	Are purchases of goods and services initiated by properly authorized requisitions bearing the approval of officials designated to authorize requisitions?
			37.	Are all invoices received from vendors in a central location, such as the accounting department?
			38.	Are purchase orders pre-numbered and issued in sequence?
			39.	Are signature plates only under the signer's control and does that person, or an appropriate designee, record machine readings to ascertain that all checks signed are properly accounted for?
			40.	Are original invoices and supporting documents marked to indicate that payment has been made?
			41.	Are changes to contracts or purchase orders subject to the same controls and approvals as the original agreement?
			42.	Are there checks in the processing procedures to prevent or detect duplicate payments?
				<b>B. Monitoring:</b>
			43.	Are transfers or loans between funds approved by management and allowable under applicable law?

			44.	Before commitment, are funds not obligated, but remaining in the budget verified as available?
			45.	Are purchase orders or contracts required to be approved by appropriately designated officials before issuance?
			46.	Is a government representative required to inspect construction projects before approval of payment?
			47.	Are requests for progress payments under long-term contracts related to contractors' efforts and are they formally approved by a designated contract administrator/officer with formal approval authority?
			48.	Is the coding of charges in the accounting department reviewed by a person competent to pass on the propriety of the distribution?
			49.	Are debit balances in accounts payable and other liabilities reviewed and followed up?
			50.	Are all records, checks and supporting documents retained according to the applicable (state or federal) record retention policy?
			51.	Does the accounting department record and follow up partial deliveries?

(State of Maine, n.d.)

After reviewing the results of the questionnaire, the management team is better equipped with the type of controls that should be adopted. To better explain the types of risks businesses are susceptible to; please refer to the chart below. Both the self assessment and the objectives/risks chart are tools to help prevent internal control issues.

### Objectives and Risks

<u>Objectives</u>	<u>Risks</u>
all requests for goods and services are initiated and approved by authorized individuals, and are in accordance with budget and appropriation guidelines.	<ul style="list-style-type: none"> <li>-Purchases from unauthorized vendors.</li> <li>-Purchases are in violation of a conflict of interest policy.</li> <li>- are not timely.</li> <li>-Purchases not in accordance with budget and/or appropriations provisions.</li> </ul>

All purchase orders are based on valid, approved requests and are properly executed as to price, quantity and vendor.	<ul style="list-style-type: none"> <li>-Payment in excess of optimum price.</li> <li>-Quantities not adequate or in excess of need.</li> <li>-Quality of materials or services received or substandard.</li> </ul>
All materials and services received agree with the original orders.	<ul style="list-style-type: none"> <li>-Payment for materials or services not received.</li> <li>-Damaged or missing goods not reported.</li> <li>-Inferior quality of materials or services received.</li> </ul>
All invoices processed for payment represent goods and services received and are accurate as to terms, quantities, prices and extensions; account distributions are accurate and agree with established account classifications.	<ul style="list-style-type: none"> <li>-Payment based on improper price or terms.</li> <li>-Accounting distribution of cost is inaccurate.</li> </ul>
All checks are prepared on the basis of adequate and approved documentation, compared with supporting data and properly approved, signed and mailed.	<ul style="list-style-type: none"> <li>-Incorrect or duplicate payments.</li> <li>-Alteration of checks.</li> <li>-Disbursement for materials or services not properly documented or approved.</li> </ul>
All disbursement, accounts payable, encumbrance transactions are promptly and accurately recorded as to date and amount.	<ul style="list-style-type: none"> <li>-Improper cash, accounts payable, and encumbrance balances.</li> </ul>
All entries to accounts payable, reserve for encumbrances, asset and expense accounts and cash disbursements are properly accumulated, classified and summarized in the accounts.	<ul style="list-style-type: none"> <li>-Misstated financial statements/internal financial data.</li> <li>-Inoperable budgetary control.</li> </ul>
Division of Purchases policies are followed in procurement, sufficient competitive bids/quotes are obtained and the State receives the best possible price	<ul style="list-style-type: none"> <li>-Purchasing policies violated.</li> <li>-Insufficient opportunity for potential bidders/suppliers.</li> <li>-Paid unnecessarily high price for goods or services.</li> <li>-Goods procured are of lower quality than those for same or lower price.</li> <li>-Loss of funds from procurement fraud.</li> </ul>

(State of Maine, n.d.)

Segregation of duties is essential to effective internal control. It reduces the risk of both erroneous and inappropriate actions, and is a deterrent to fraud. CCDP found Jamona.com to be in need of assistance in this area. To ensure proper separation of duties, no one person should initiate and approve a transaction, record transactions and reconcile balances, handle cash and verify deposits, be both a procurement card holder and a petty cash custodian, handle assets and



reconcile perpetual records to physical counts, nor enter or approve a check request and have the check returned to himself. Jamona.com should correct all policies and procedures where evidence exists that support these findings.

Management has an important job of monitoring controls in order to detect, and correct anything that arises. CCDP suggests Jamona.com do the following: 1) perform budget to actual expense comparisons, and investigate significant differences, 2) routinely spot-check transactions, records, and reconciliations to ensure expectations are met as to timeliness, completeness, segregation of duties, propriety of the transaction, etc., 3) follow up on unexpected results or unusual transactions. They might be indications of theft or fraud, 4) ask for explanations of unexpected results, and ask for reasons for unusual transactions, 5) question the explanations and reasons if they don't seem right, ask to see the items that were purchased, etc. (Washington University, 2004).

Management should also document reviews of reports and reconciliations by initialing, dating, and briefly indicating the resolution of any follow-up performed on any unexpected results or unusual transactions. These documents will be needed once the section is audited.

Adopting the tools and suggestions of CCDP above will improve the internal controls of Jamona.com. It will also help in assessing other risks within the organization. There is value added in the ability to detect, prevent, and correct internal operations.

## References

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