

Internal control case study



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LJB Company's Internal Control Recommendation Report February 2012

Prepared for: LJB Company President Finance Department Prepared by:

Cauretta Bell Recommendation Report 2012 It is my immense pleasure to report and evaluate the findings of the internal control procedures to the President of LJB Company regarding recommended changes for the organization to utilize internal control requirements. We will provide useful recommendation so that LJB Company will be fully prepared to go public in the near future.

Being completely open to our recommendation, the President of LJB Company can expect the organization proficiency level of internal control will secure assets, improve the trustworthiness of the accounting records, amplify efficiency of operations, and guarantee compliance with laws and regulations. In order to accomplish this success, LJB would need to apply five primary components that are consistent of control environment, risk assessment, control activities, monitoring, information and communication.

The internal control activities establish simple principles such as: segregation of duties, establishment of responsibility, physical controls, human resource controls, independent internal verification, and documentation procedures.

The activities presented are the backbone in a company's efforts to identify and address the risks a company faces, such as fraud. Segregation of Duties

The most indispensable internal control system would be segregation of duties.

With LBJ main purpose going public the company would benefit from

Segregation of duties should the President correct the violated principle due

to the individual responsible for the record keeping of this asset should be separated from the physical custody of that asset. The trusted account is the individual that presently retrieves all the paychecks on payday and the checks are placed in the safe in his office after the account is gone for the day. Evaluating this method the accountant has adopted I would have to commend your account for keeping confidential information secure with he has left for the day.

Sirens are being awakened due to there is one person that serves as treasurer and controller with streamlines many of the company's processes. The accountant also purchases all of the supplies and pays for the purchases. He also receives all the checks and completes the monthly bank reconciliation. The example that the President of LJB provided the accounting firm with are superb detailed example of the present principle Segregation of Duties. You may be wondering why this principle is important?

Segregation of duties establishes and balances the organization of human assets of LBJ that assists with defining the individual employee connections to other employees. The system of segregating duties will provide a reliable basis for evaluating the work of another employee, without a duplication of efforts. The current practices of handling cash and other forms of payments violate the Principle of Internal Controls. To make matters worse, the accountant should not receive the checks and complete the monthly bank reconciliation that violates the Segregation of Duties principle.

To illuminate the account opportunity to comment check fraud in the future our recommendation is to hire more staff to have separate individuals collect

the checks, make bank deposits, make supply purchases and then the accountant can approve payment of the items purchased. As the President of LJB, appoint an executive that will be responsible to sign the checks as payment for the supplies. The company wants to provide guidelines to help with transition to go public in the near future.

These guidelines will provide the company's staff to be aware of their individual duties, limitations, responsibilities, the personal use of company property, the protection of company assets and cash, and these examples will create checks and balances for the company. Establishment of Responsibility An essential principle of internal control is to assign responsibility to specific employees. This system limits access to specific authorized employees in order to provide proficient control devices and individual responsibility.

Control is most effective when only one person is responsible for a given task but it is extremely difficult to hold only one individual accountable when every employee is given the same access, this is in reference to the computer network and petty cash fund. We will discuss the recommendations for establish responsibility for the petty cash fund in detail later. How can you implement this control on your devices? Utilizing the monitoring component by integrating passwords and pass-codes, this give the company the opportunity to label, identify, and track the ins and outs of the employees.

This makes the employees accountable for all of their actions and duties throughout the duration of their employment. Currently, the duties of the

acting accountant for the company include, purchasing, approving all financial decisions, bank reconciliation, treasurer and controller that streamlines the process. Presently, the company is in violation of the principle establishment of responsibility. The accountant should only be responsible for the duties of an accountant and these duties need to be outlined thoroughly in the company's guidelines.

Overall, the recommendations I want to implement is for LJB Company to promote the account Treasurer of Controller. This recommendation was suggested because the trustworthy account proved and gained the experience of this position while performing multiple duties. I also recommend that the company should hire or promote an account to fill his old position. Now, if the President of LJB feels as if the current accountant is not qualified for the promotion then please employ a Treasurer of Controller.

Physical Controls

The uses of physical controls are extremely important. It relates to the safeguarding of assets and enhancing the accuracy and reliability of the accounting records. There should be some form of regularity for the company to benefit. Examples of regularity would include monitoring equipment, safes, locks, alarms, and time clocks for employees. Documents are presented as evidence that the transaction and events have occurred. As a result, the accountant established procedures for documents by using pre-numbered invoices, to ensure that all documents are accounted for.

The company needs to have something in place to prevent a transaction from being recorded more than once, or conversely, from not being recorded

at all. We recommend a log system to be implemented to confirm that all invoices are processed, accounted for and documented within an accounting period. In the aforementioned paragraph pertaining segregation of duties the account with multiple duties ensure that he places the checks in the safe overnight and weekends so that unauthorized personnel that do not have access will the opportunity to take checks that does not belong to them.

It is apparent there are not guidelines for petty cash. This system needs to be addressed and modified immediately. There are two essential steps in establishing petty cash funds: (1) appointing a petty cash custodian who will be responsible for the fund, and (2) determining the size of the fund.

Ordinarily, a company expects the amount in the fund to cover anticipated disbursements for a three- to four-week period I recommend you appoint one individual accountable to secured the lockbox.

In addition to securing the lockbox I recommend that each payment from the petty cash fund must be documented on a prenumbered petty cash receipt. The signatures on the receipt must include both the custodian and the individual receiving payment. Each payment from the fund must be documented on a prenumbered petty cash receipt. The signatures of both the custodian and the individual receiving payment are required on the receipt. Another recommendation we would like to implement would be to secure paychecks at all times.

Paychecks should be handed out to all employees and a log should be keep to verify retrieval. In addition, we recommend if the company is unable to handle the obligations of maintaining a detailed paycheck log then I advice

the company to invest in a pay card and/or direct deposit for the employees.

Human Resource Control We cannot ignore the fact that the accountant has an abundance amount of responsibility with the company. I have to comment on the fact the company is petite and it is doing a wonderful job at maintaining retention within the company.

This shows your employees respect top management. However, having the accountant and the president interview employees, and the President hiring and firing of all employees is in complete violation of the Principle Human Resource Control. Our accounting firm does not want you to be embarrassed about hiring a convicted felon; the mistake was rectified by termination of the employee. By examining the Human Resource controls principle it is the Human Resource department that should always be responsible for background checks, interviewing, hiring and firing. Acknowledging, the petite company we recommend that LJB employ an staffing agency to handle these duties if the current Human Resource department is unable to handle these duties. Having an established Human Resources department can prevent employing individuals that may affect the overall reputation of the company.

Independent Internal Verification Now we are getting to the important control principle.

With this control principle involves the review of data prepared by employees. To obtain the maximum benefit from independent internal verification there are some rules that the company needs to follow. First, the company should verify records periodically or on a surprise basis. The second, an employee who is independent of the personnel responsible for the information should make the verification. Third, discrepancies and

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exceptions should be reported to a management level that can take appropriate corrective action.

We understand that LJB may not have the man power to have a designated internal control auditor. Segregation of duties can serve as a comparison for the principle Independent Internal Verification. We recommend Independent Internal Verification principle involves the review of data prepared by employees by verifying records periodically or on a surprise basis. We recommend the President of the LJB company review and make it his goal to segregate all responsibilities within the company so that the employees can audit each other.

However, if you do have the opportunity to employ or promote a individual to conduct unscheduled audits; employees whose daily responsibilities are independent of the duties being audited should make the verifications with all discrepancies and exceptions being reported to a management level that can take appropriate corrective action. Independent internal verification is constructed to evaluate all recorded transactions with existing assets. The types of audits we recommended will be extremely informative for pinpointing any abnormal activity.

We recommend that surprise audit are implemented on the petty cash, accounting reports, monitoring controls on computers and other electronic device so that employees are unable to deviate to unauthorized websites. Documentation Procedures Have you heard of the saying, “ documentation beats conversation”? For business transactions documents provide evidence that transactions and events occurred. We recommend that every employee

needs to have a background check on file. The petty cash should be in a secured spot as previously suggested and each payment from the petty cash fund must be documented on a prenumbered petty cash receipt.

The signatures on the receipt must include both the custodian and the individual receiving payment. Each payment from the fund must be documented on a prenumbered petty cash receipt. In the world of business, documentation is everything and documents provide evidence that transactions and events have occurred which provide paper trails.

Documentation will benefit the company in order to clarify deposit slips, email, keeping logs on transactions, memos, notices and other forms of communication. There is one more problem we did not address which is the indelible ink machine.

The LJB Company is still petite and the company will continue to grow with a president that has high expectations for the company. We enjoy the tenacious spirit of the company to reduce cost by producing their own checks but we do not recommend the purchase of the indelible ink machine. The compliance needed to use this particular equipment would not benefit the company at the present moment. Focus on the recommendations that we suggest and in the future once the company has grown then I think the purchase of the indelible ink machine would be an assets to the company.

Final Recommendations In conclusion, the internal controls are necessary to discourage employees from fraudulent activities. My goal is to limit the opportunity for an employee to commit fraud. Opportunities occur when the workplace lacks sufficient controls to deter and detect fraud. Another factor

that contributes to fraud is financial pressure. Employees tend to participate in the pressure of committing fraud is because of personal financial problems. The third factor that contributes to fraudulent activity is rationalization.

Employees will justify their actions by rationalizing the event that caused their dishonesty. We want LJB Company to prosper. The President of this company has initialized this by asking for recommendations to improve their company. The components that we suggested will benefit the company if LJB decides to continue on with public transition or not. Again, it was an immense pleasure writing this recommendation for the LJB Company. Please contact us with any question you may have about improving the overall quality of your company.