

Every small business should establish controls

Every week reporters publish stories about companies that have lost thousands, even millions of dollars because of fraud. They recount the dreadful details of business owners who learned — too late — that a lack of basic controls left their companies vulnerable to pilferage, embezzlement, and other types of misappropriation.

How do these lessons apply to small businesses? After all, small firms generally can't afford to hire internal auditors or set up separate divisions to break up incompatible duties. While it's true that a small company can't always protect itself in ways larger firms might, management can establish controls in certain high-risk areas, such as the following:

- **Cash disbursements.** If at all possible, the owner/manager should sign checks. This control has a dual purpose: management sees how the company is spending its money, and the cash disbursement function is kept separate from bookkeeping or accounting. If the same person signs checks and enters disbursement transactions in the accounting records, embezzlement is harder to prevent. Requiring two signatures on checks above a certain amount also provides greater control.
- **Customer collections.** Consider having the owner/manager open the mail, especially if customer collections are a regular part of your business. Alternatively, you might ask someone separate from the accounting function to open the mail and prepare the deposit slip. Of course, the practice of making daily deposits is also a good control.
- **Personnel practices.** By taking care to perform background checks before hiring key employees, especially those who will be handling cash or other high-risk assets, you can prevent problems later on. Of course, financial pressures, addictions, and other factors can corrupt even good employees. That's why managers might consider discreetly monitoring employee lifestyles (without invading anyone's privacy, of course). An observant manager might note that certain lower-level employees are living well beyond their means, or that warehouse staff are carrying off company materials to remodel personal residences.

Perhaps a small business's greatest control is the "tone at the top." If management sets a high standard, employees generally follow. However, if a manager is perceived as lax — for example, he or she doesn't respond quickly when evidence of misappropriation surfaces — employees might conclude that theft isn't such a big deal.

Remember this: A company that fails to establish minimum controls is providing a golden opportunity for fraud. If you'd like help reviewing your firm's controls, give us a call.