

INTERNAL CONTROLS – WHAT NOW?

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As Published in The Bottom Line

“Internal control can help an entity achieve its performance and profitability targets, and prevent loss of resources. It can help ensure reliable financial reporting. And it can help ensure that the enterprise complies with laws and regulations, avoiding damage to its reputation and other consequences. In sum, it can help an entity get to where it wants to go, and avoid pitfalls and surprises along the way.”

-Committee of Sponsoring Organizations (COSO) of the Treadway
Commission

Over the last year, this column has addressed a number of accounting issues and highlighted the changes that will be coming into effect for year ends after December 15, 2006. The message has been clear that the way things were done in the past may not be sufficient going forward and that the price of your audit will increase as a result. This article will not focus on the pronouncements but rather one of the probable outcomes. Your auditors will focus more on the club's internal controls and, as a result, so should the club. Much has been written on internal controls, not the least of which is the COSO. A primary responsibility of directors and officers is to make sure that the club is responsible to its members for its programs and finances. Internal controls are systems that are installed to assist the board in its duties. In clubs, internal controls are the practices performed by each department to provide management with overall reasonable assurance that the Club's assets are safeguarded and that transactions occurring are properly authorized, valid, complete and accurate. The inherent problem with most Clubs is how to achieve all of these goals with limited staff, limited time and limited resources. It is important to note that trust does not come into play in designing a system. It is not whether an employee would steal but rather could the employee.

The first stage is to define your objectives. Management should encourage adherence to prescribed policies and procedures outlined in the Club's current policies and procedures manual over each major department. The policies should promote efficiency through implementation of internal controls that will provide the Club with the highest level of benefit for the lowest cost. The final objective should be that the Club's assets are safeguarded from theft, loss, and destruction.

The benefits of a strong internal control structure will aid in the prevention of errors, and if errors do occur the structure will allow for early detection. If a smart crook is placed in a job and designs a scheme, the system should flag a discrepancy that requires another person to investigate. A strong internal control structure will protect employees by clearly outlining daily tasks and responsibilities, providing checks and balances. Employees will be held accountable for their level of duties and they will be provided feedback on a more routine basis with proper management oversight.

The internal control system should be implemented by all employees of the club. Management should communicate the importance of the internal control policy to each employee and has the overall responsibility to monitor the internal control structure and to ensure that controls are not being overridden during any process.

The first component in any system, and the one that clubs have the most difficulty with, is proper segregation of duties. In light of the new accounting standards clubs will be seeing the terms significant deficiency more than ever due to the lack of proper segregation of duties. Simply defined, no one person should have control over a transaction from beginning to end. In a perfect system no person should be able to record, authorize, and reconcile a transaction.

Lets face it fraud happens everyday, even in clubs. A strong internal control system will help prevent and detect fraud when it happens. The problem that faces most clubs is with the limited number of employees, how detailed do you need to be with separating duties among team members. The key point is that internal controls over segregation of duties may vary depending on each club's size and structure and what the board is willing to risk. The duties may be separated by department, or by individuals, and a simple sharing of duties between



managers may eliminate weaknesses. Any time proper segregation of duties cannot be achieved management should increase the documented review and oversight functions. This includes getting Board Members involved in the oversight functions.

The second component is proper authorization of daily transactions. Authorization is defined as persons acting within the range of their authority. All transactions should be authorized and executed with proper oversight, and review. The authorization function will aid in preventing invalid transactions. Once the authority has been clearly defined then management can hold those individuals accountable for authorizing transactions. Employees should have knowledge of the transactions being approved, and the supporting documentation to verify the transactions. Management should communicate the importance of this role, and ensure understanding that these individuals should not be authorizing their own transactions. Management should spot check to ensure controls are being followed. Management should clearly communicate proper chain of command for any unusual transactions.

The third component is documentation. All transactions should be clearly and thoroughly documented and reviewed. This includes ensuring that all transactions are supported by proper support, and that all the proper signoffs have been received through the authorization process. Documentation provides a record of the club's activities. Adequate documentation also helps provide the auditors evidence that the transactions actually occurred. . Management should also educate its employees of the normal retention period to the keeping of these documents for tax and audit purposes.

The fourth and final component is reconciliation. Reconciliation is defined as the process of comparing the entries in the general ledger to supporting documentation and resolving any discrepancies. This process should include weekly, monthly, and quarterly reconciliations of all major cycles such as accounts payable, accounts receivable, cash, fixed assets, among others. This is a very important in ensuring adequate and accurate accounting records and statistics. The best way to ensure this component is being completed is to commit to the monthly process of closing the books. The monthly reconciliation process will benefit the club by ensuring the accuracy and validity of all entries in the accounting system.



Unfortunately, any system has its limitations, no matter how strong. If management can override the controls, it is as if they do not exist. A cost benefit analysis must be done to determine the extent of the controls. Collusion among employees can overcome any control and probably the most common problem is that the control system is not updated reflect changes in operations, technology, personnel or other circumstances. If nothing else, the new standards and emphasis on internal controls will spark discussions at the board level and ensure that the decision makers are comfortable with the system. That can only be a good thing.

KEY CONTROL CONCEPTS

- Prevent before you detect
- Divide the duties
- Fix responsibility
- Limit the accessibility of assets
- Surprise your employees
- Use cost – benefit analysis
- Communicate the control ethos
- Don't overlook the obvious

David Scott of PKF Witt Mares contributed to this article

