

# Preparing for an Audit

or  
(Why you Should Do Your Best Every Day)

- I. Words that come to mind when you hear “**Audit**”  
  
Proctology  
Chinese Water Torture  
Root Canal
- II. “Audit” almost invariably has a negative context to it – it comes from several sources.

## **Fear**

## **Lack of Understanding**

## **Hearsay**

It is mostly a matter of **perspective** and **approach** and **attitude**

## **Internal Control**

### **What is internal control?**

Internal control is anything that you do to safeguard, or make more efficient or effective use of, the assets of Longwood College.

Internal control provides reasonable assurance regarding the achievement of objectives.

Types of internal controls include approvals, reconciliations, reviews of performance, physical security, and segregation of duties.

Examples of internal controls:

- Locking your desk and office when you are not there;
- Keeping your computer passwords secret;
- Verifying the accuracy of another staff member’s work;
- Reviewing monthly department financial reports;
- Depositing cash receipts daily with the College cashier.

## **Why is internal control important?**

Without internal controls or with weak internal controls, the College is more susceptible to:

- Waste of College assets;
- Inaccurate or incomplete information;
- Misuse of College assets
- Embezzlement and theft.

## **Where can I learn more about internal control?**

Internal Audit's web page ([www.lwc.edu/administrative/audit](http://www.lwc.edu/administrative/audit)) contains some information on internal control and an internal control questionnaire that you can use to assess your internal controls. Additionally, you can call Internal Audit (x2283) to discuss control issues in your department.

## **How can I determine if the internal controls in my area are adequate?**

The central theme of internal control is (1) to identify risks to the achievement of the organization's objectives, and (2) to do what is necessary to manage these risks.

- 1. Identify the objectives of your area.** Objectives may concern operations, financial reporting, regulatory compliance, or safeguarding assets.
- 2. Identify the risks that could prevent your department from achieving these objectives.** Risks are anything that could jeopardize the achievement of an objective. You should consider the likelihood and impact of each risk.
- 3. Identify the controls that will manage the risks identified above.** Controls provide reasonable assurance that objectives are achieved. An appropriate internal control structure will minimize risk while balancing the cost and benefit of the internal control in place. You should also be aware of the control environment. Does everyone in your area understand internal control and think that it is important?
- 4. Implement the controls that were identified which minimize risk in a cost effective manner.**
- 5. Periodic review of objectives and controls to determine if they still apply and are functioning as intended.**

# Fraud

## Impact of Fraud on an organization

According to statistics from the Association of Certified Fraud Examiners cited in its publication titled “Report to the Nation on Occupational Fraud and Abuse” (a report issued in 1996 using 2 ½ years of survey results) –

1. Organizations lose 6% of annual revenues to fraud or abuse.
2. Fraud and abuse cost U.S. organizations more than \$400 billion annually.
3. About 10 percent of the \$100 billion this nation spends on healthcare each year is lost to fraud, according to the U.S. General Accounting Office.
4. The average organization loses more than \$9 a day per employee to fraud and abuse.

## Myths about Fraud

(source Joseph T. Wells, “Six Common Myths about Fraud” – Journal of Accountancy, February, 1990, pp. 82-83)

The four most common are:

1. **Myth:** Most people will not commit fraud.  
Truth: Most people will commit fraud. The greater the promise of reward, or the more persuasive the threat of punishment, the higher the motivation for antisocial behavior.
2. **Myth:** Fraud is not usually material.  
Truth: Fraud is often material, because immaterial fraud has a way of turning into material fraud.
3. **Myth:** Fraud goes undetected.  
Truth: Fraud is often detected. In a continuing fraud the amounts get bigger and the perpetrator gets more careless about concealment.
4. **Myth:** Fraud is usually well concealed.  
Truth: Fraud is often not well concealed. Half of the instances of fraud are discovered by accident.

## **Examples of fraudulent behavior**

### Payment to fictitious vendor

Weakness – lack of required documentation to process payment, no delegation of signing authority, no limits on signing authority, and checks for payment that can be picked up by individuals

### Diversion of cash receipts

Weakness – no segregation of billing and collections, no reconciliation of logs to Deposits, no reconciliation of bills processed to revenues

### Extra compensation to perpetrator

Weakness – payroll approver allowed to sign their own timesheet

### Personal benefit from travel expenses

Weakness – subordinate allowed to approve expenses

### Restricted funds manipulation

Weakness – authorized signer has complete control, no other employee reviews

## **How does fraud occur?**

### Poor internal controls

Lack of proper authorization  
No separation of authorization, custody, and record keeping  
No independent checks on performance  
Lack of clear lines of authority  
Inadequate documentation

### Management override of internal controls

### Collusion between employees and 3<sup>rd</sup> parties

### Collusion between employees and management

### Poor or non-existent ethics policy

### Limited, unclear, or no policies and procedures to direct department processes

## **What to do if you discover fraud in your area**

Notify Internal Audit (x2283) or call the Fraud Hotline (800-723-1615)

Internal Audit will be responsible for performing an examination of the process and the alleged perpetrator.

Internal audit will notify the appropriate law agencies if necessary

Internal audit will conduct the examination confidentially and will allow confidential communications with those who have information concerning suspected fraud

### **How to prevent fraud**

Implement a system of strong internal controls

Let employees know that you're aware of the potential for fraud and are actively looking for it

Create a positive work environment

Set an honest tone from the top for employees to follow

## **Common Audit Issues**

Unlicensed software is installed on department computers

Cash receipts are not deposited in accordance with College policies and procedures

College assets, including cash, are not safeguarded

Monthly FRS statements are not reconciled to transaction activity

Asset handling and accounting responsibilities are not segregated

Written and procedures, or updated policies and procedures, are not maintained

Job descriptions are not updated on a regular basis to reflect changes in job responsibility

Departments maintain external bank accounts, which are not subject to College internal controls

Contracts with outside vendors are not properly maintained

College telephones used for personal business and personal long distance phone calls charged to department