

VITALICS™

# Vital Internal Control System

---

Vitalics™ Inc.  
P.O. Box 7275  
Loveland, CO 80537  
Phone 970.776.8395 • Fax 970.692.2492  
[www.thevitalicsystem.com](http://www.thevitalicsystem.com)

©2010 – 2011 Julie A. Aydlott, CFE  
First Printing – February 2010  
The Small Business Fraud Prevention Toolkit

Revised January 5, 2011 – Vitalics™

All rights reserved. No part of this book may be reproduced in any form or by any electronic or mechanical means including information storage and retrieval systems – except in the case of brief quotations embodied in critical articles or reviews – without permission in writing from its publisher, Vitalics™.

**Published by:** Vitalics™  
P.O. Box 7275  
Loveland, CO 80537  
970-776-8395

---

Vitalics™

# Table of Contents

<b>Part 1</b>	<b>Fraud in the Workplace</b>	
	Small Business Fraud Statistics .....	4
	The Fraud Triangle.....	6
	Workplace Conditions .....	8
	Behavioral Warning Signs.....	9
<b>Part 2</b>	<b>Warning Signs, Detection &amp; Prevention</b>	
	Occupational Fraud.....	10
	Billing Schemes .....	13
	Check Tampering Schemes.....	16
	Bribery and Corruption .....	20
	Skimming Schemes .....	23
	Expense Reimbursement Schemes.....	26
	Cash Schemes.....	29
	Non-Cash Schemes.....	31
	Payroll Fraud Schemes.....	34
	Fraudulent Financial Statements.....	37
	Register Disbursement Schemes.....	39
<b>Part 3</b>	<b>Internal Control Procedures</b>	
	Internal Control Procedures .....	43
	Using Ratios to Prevent Fraud .....	46
	Bad Accounting vs. Fraud.....	50
	Fraud Prevention Maintenance .....	54
<b>Part 4</b>	<b>Creating your Business ICP</b>	
	Risk Assessment Form .....	58
	Internal Control Template.....	65
	Index for Forms and Checklists.....	75
	<b>Fraud Glossary</b> .....	77
	<b>Index</b> .....	79

## Small Business Fraud Statistics

The following fraud statistics were presented by the Association of Certified Fraud Examiners (ACFE) in their 2010 Report to the Nation on Occupational Fraud and Abuse<sup>1</sup>.

***It is estimated that US organizations lose 5% of their annual revenue to fraud.***

### 2010 Fraud Statistics

- This loss totals roughly \$994 billion dollars and counting.
- Occupational fraud schemes frequently continue for years before they are detected.
- Financial Statement fraud was the most costly, with a median loss of \$2 million.
- Small Businesses were the leader of occupational fraud frequency in the 2006, 2008, and 2010 Report to the Nation Study, with ***30% greater frequency than large corporations, government and non-profits.***
- **The median loss from fraud for small businesses with 100 employees or fewer was \$155,000.**
- Anti-Fraud controls have a measurable impact on a company's exposure to fraud.
- Lack of adequate internal controls was the most common factor which allowed fraud to occur.
- It is estimated that 78% of victim organizations modified or implemented new internal controls after discovering that fraud had occurred.

---

<sup>1</sup>The Association of Certified Fraud Examiners (ACFE) is the world's largest anti-fraud organization and premier provider of anti-fraud training and education. The entire Report can be downloaded at no charge from the ACFE's website. [www.acfe.com](http://www.acfe.com)

- Occupational frauds were most commonly committed by management or the accounting department.

Based upon the staggering numbers, it is apparent that there needs to be a fraud-prevention method provided to the small business owner who can't afford the high accounting fees that a public company can pay. Although there has been an increase in anti-fraud controls, they tend to focus on public companies, government agencies and non-profit companies.



***The small business owner tends to fall victim to occupational fraud more often, due to several factors. The owner . . .***

- Cannot afford to hire additional staff to implement segregation of duties.
- Does not put an appropriate pay scale value on bookkeeping and accounting work and tries to fit it into their budget, which gives them under-qualified employees.
- Does not have the time AND does not make the time to review records.
- Does not think that a fraudster could possibly look like their bookkeeper.
- Has bad work ethics themselves.
- Avoids the warning signs.
- In addition, employees know there is too much freedom and feel confident that they can get away with fraud.

## Owner Involvement

This workbook was created to outline a simple system of internal controls that you can implement in your own small business. Not all employees are thieves, and not all perfect bookkeepers are perfect. I have researched and interviewed highly qualified Certified Fraud Examiners and Accountants on additional internal control procedures that the small business owner can utilize; yet I am constantly coming to the same conclusion.

My conclusion is that **YOU are the missing link in the segregation of duties.** Every article I read that has to do with small business fraud, and every new small business fraud case that is opened, has the same ingredients: missing internal controls; no segregation of duties; and employees with too much accounting authority who can take advantage of the weakness within their company. It's time

# Internal Control Program

01/01/2011

TYPE YOUR COMPANY NAME HERE

# Internal Control Program TEMPLATE

---

---

# Table of Contents

Payroll and HR .....	68
Computer / Email / Voicemail / Filing Cabinets.....	69
Accounts Payable and Purchasing.....	69
Accounts Receivable and Sales.....	70
Bank Accounts and Reconciliation.....	71
Expense Reimbursements.....	72
Inventory and Equipment.....	73
Financial Reports and Tax Returns.....	73

The following template can be modified to fit your business. The procedures presented in this template are based upon control standards and are not mandatory but are highly suggested.

## Payroll and HR

**Type your company name here** has implemented the following internal control procedures in the Payroll and Human Resources Department.

- Background checks are required on all new employees.
  - References must be contacted before hiring.
  - Written job description per job classification.
  - Employee handbook must be written and up-to-date and should include:
    - Probation policy
    - Job rotation requirements
    - Privacy and access to company assets
    - Employee cooperation regarding procedures
    - Open-ended authorization to pull credit and background check
    - Consequences of fraud or theft
    - Employee must sign document stating that they have read and understand company procedures and requirements.
  - Employee / Vendor / Customer hotline – or a confidential e-mail address for complaints or tips.
  - Mandatory vacations
  - Reward and positive feedback program
  - Friends or family member working with company is by approval with the owner only.
  - Conflicts of interest must be brought to the attention of the owner immediately.
  - Payroll hours must be authorized by a supervisor and reviewed by the owner.
  - Payroll checks must be signed by the owner – if outside payroll service is used do not authorize a signature stamp.
  - Owner must approve all raises and overtime.
  - Employee register must be reviewed for new hires, addresses and changes monthly.
  - Owner must periodically review employee files.
  - Owner must get to know all employees.
  - Timecards must be verified for accuracy.
  - Commissions must be compared to sales reports before payroll is issued
  - Delivery of payroll checks must be watched closely.
  - Checklists and forms must be complete including name of preparer, authorized signature and owner signature verifying accuracy.
-

# Index for Forms and Checklists on CD

## **Accounts Payable**

- Approved Vendor List
- Automatic Payment Form
- Automatic Payment List
- Automatic Payment Update
- Change in Vendor Form
- Checklist
- Checklist (12 Mo)
- Check Request Form
- Check Run Form
- Credit Card Rec Checklist
- Credit Card Rec Checklist (12 Mo)
- Current Vendor Review Checklist
- Current Vendor Review Checklist (12 Mo)
- Employee Credit Card Request Form
- Expense Reimb Checklist
- Expense Reimb Checklist (12 Mo)
- Expense Reimb Form
- Manual Check Payment Checklist
- Manual Check Payment Checklist (12 Mo)
- Manual Check Payment List
- Missing Receipt Form
- Month End Checklist
- Month End Checklist (12 mo)
- Reconciliation Form
- New Vendor Checklist
- New Vendor Checklist (12 Mo)
- New Vendor Request Form
- Receipt of Vendor Refund
- Rejection of Exp Reimb Form
- Rejection of Vendor Invoice
- Vendor Application
- Vendor Black List
- Vendor Overpayment Notice
- Wire Transfer Request Form

## **Accounts Receivable**

- Bad Debt Request Form
- Checklist
- Checklist (12 Mo)
- Credit Application
- Credit Card Payment Form
- Change in Customer info Form
- Current Customer Review Checklist
- Current Customer Review Cklist (12 Mo)
- Customer Blacklist

- Customer Collection List
- Customer Lost Payment Form
- Deposit Form
- New Customer Checklist
- New Customer Checklist (12 Mo)
- New Customer Form
- Personal Guarantee Form
- Reconciliation Form
- Returned Customer Payment Form
- Sales Commission Request
- Weekly Sales Form

## **Assets**

- Asset Checklist
- Asset Checklist (12 Mo)
- Asset Reconciliation Form
- Disposition of Fixed Asset Form
- Fixed Asset Listing
- Fixed Asset Payment Request Form
- Fixed Asset Transfer of Location Form
- Lost or Stolen Asset Form
- Sale of Fixed Asset Form

## **Cash**

- Bank Deposit Checklist
- Bank Reconciliation Form
- Cash Drawer Reconciliation Form
- Cash Sale Checklist
- Petty Cash Checklist
- Petty Cash Checklist (12 Mo)
- Petty Cash Journal
- Petty Cash Reconciliation Form

## **Financial Reporting**

- Bank Reconciliation Checklist
- Bank Reconciliation Checklist (12 Mo)
- Cash Flow Reconciliation Form
- Journal Entry Checklist (12 Mo)
- Journal Entry Form
- Month End Checklist
- Owner Checklist
- P&L Horizontal Analysis
- Password File
- Ratio Analysis Template
- Year End Checklist

## **Human Resources**

- Employee Handbook
- Fraud Policy
- HR Checklist
- HR Checklist (12 Mo)
- Job Description Form

## **Payroll**

- Employee Advance Request Form
- Employee Roster Form
- Payroll Checklist
- Payroll Checklist (12 Mo)
- Payroll Disbursement Form
- Payroll Manual Reconciliation Form
- Payroll Month End Reconciliation Form

## **Purchasing & Inventory**

- Disposition of Inventory Form
- Inventory Access by Personnel Form
- Inventory Checklist
- Inventory Reconciliation Form
- Inventory Transfer of Location Form
- Inventory Valuation Listing Form
- Lost or Stolen Inventory Form
- Physical Inventory Count Form
- Purchase Order Checklist
- Purchase Order Reconciliation

## **Resources**

- Contact Numbers and Websites

# Accounts Receivable / Sales Deposit Form

TYPE COMPANY NAME HERE

- 
- Instructions:**
1. Complete Part A of the AR Payments Received Form
  2. Attach form with copies of AR Payments and Deposit Slip
  3. Forward to Supervisor / Owner for approval and signatures
  4. Supervisor / Owner to make deposit or confirm deposit to ticket
- 

## Part A: Accounts Receivable Deposit Form

Date	_____	Total Cash	\$ _____
Cash requested by	_____	Total Checks	\$ _____
New Customers	_____	Less Cash Received	\$ _____
Verified Funds	_____	Total	\$ _____

---

Checks Copied	<input type="checkbox"/>	Total Number of Checks	_____
Deposit Slip Created	<input type="checkbox"/>	Total Deposit Amount	\$ _____
Deposited to Bank	<input type="checkbox"/>	Actual Deposit Date	_____
Cash taken from Deposit	<input type="checkbox"/>	Total Cash Taken	_____
Payments Posted to Accounting	<input type="checkbox"/>	Posted by	_____
Payment Journal Printed	<input type="checkbox"/>	Total amount Posted	\$ _____
Cash Disbursed	<input type="checkbox"/>	Cash Received by	_____

**Comments** \_\_\_\_\_

---



---

## Part B: Approval

Completed By	_____	Date	_____
Reviewed By	_____	Date	_____
Approved By	_____	Date	_____

## Part C: Accounting / Owner

Deposited By \_\_\_\_\_ Deposit Ticket Total \$ \_\_\_\_\_



# Inventory Transfer Form

COMPANY NAME

- 
- Instructions:**
1. Complete Part A of the Request Form
  3. Forward to Supervisor / Owner for approval
  4. Supervisor / Owner forward to Bookkeeping for processing
- 

## Part A: Inventory Transfer Location Request Form

Request Date	_____	Requestor	_____
Current Location	_____	New Location	_____
	_____		_____
Phone Number	_____	Phone Number	_____
		Signature of Requestor	_____

---

Transfer Info \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

### Verification Information

Responsible Employee	_____	Beg Quantity on hand	_____
Inventory Type	_____	Quantity Requested	_____
Tag Number	_____	Quantity Transferred	_____
Transfer Date	_____	End Quantity on hand	_____

---

## Part B: Approval

Completed By	_____	Date	_____
Reviewed By	_____	Date	_____
Approved By	_____	Date	_____

## Part C: Accounting

Processed by \_\_\_\_\_ Date \_\_\_\_\_