

# Internal financial control and fraud preventative measures in that sector

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## Foreword

In this month's fraud newsletter edition 8 / 2021 we cover the subject at hand: internal financial control and fraud preventative measures in that sector.

In the next edition, newsletter edition 9 / 2021, in the third quarter of the year, we will discuss ***The importance of Fraud Risk Assessments.***

# Financial Control and its role in the business

A modern business cannot exist without extending control over its assets, and this includes using those assets to the best of their abilities to further the end goal that the business wishes to achieve. The financial controls in the business are the processes, policies and procedures that are implemented to manage the financial assets of the business. This includes the measures that the business takes to monitor a healthy and profitable existence.

## Why are financial controls important to the business?

For the business to function as a whole there needs to be a persistent air of diligence and proactivity in regard to how the business will manage its finances. Several aspects of this is essential for the correct management of a business' finance.

### Accuracy of Reporting

Accuracy of financial information should be at forefront of any business. The information must be free from fraud and error. Financial controls assist in identifying fraud and error in the underlying data and systems ensuring that business decisions are made on sound accurate information.

### Fraud Risk Management

Fraud risk management is not a one-time exercise but a continuous process. As businesses change and grow, so do their fraud risks. We therefore recommend a continuous improvement approach to the fraud risk management strategy that requires regular measurement of where the business is and where it wants to be in terms of effectively preventing, detecting, and deterring fraud. Persons tasked with handling the long-term sustainability of the business must regularly and diligently review financial documents to not only identify possible fraud but also to retain an overview of how the business is running.

### Protection of Assets

Any asset of a business holds value, whether tangible or intangible. A hacker might not be interested in stealing a company's vehicles, but that hacker would not turn aside sensitive information on the bank details of the company.

This last point ties in with both ensuring that the reporting was done correctly and that all possible instances of fraud could be eliminated to further the long-term sustainability of the company.

All aspects of the business must comply with judicial governance regarding the handling, gathering, and storing of all personal information of the business and persons affiliated with the business. Protocols must be in place to avoid major financial setbacks or ruin in case of a violation of these parameters. Without proper financial planning this will be a moot point that will only result in the doom of the business.



## Types of Financial Controls

Financial controls are the management systems and processes implemented by the organisation to help it ensure that its finances are being effectively managed. These financial controls are primarily intended to ensure that the financial resources of the organisation are effectively used, protected and recorded, and are only paid out to legitimately appointed personnel or business associates for legitimate work properly done.

Most organisations will already have in place financial controls which comply with independently established accounting standards and will be independently audited. Organisations which are listed on stock markets will also have to comply with the stock market's financial control requirements. The purpose of these controls is therefore much wider than fraud prevention. However, these controls can also have an anti-fraud effect, and, in designing and implementing these controls, the organisation should consider and take account of their effectiveness in reducing fraud risk. Risk is ever present for the business, in whichever form the demon decides to take whether it be innocent but costly mistakes, fraudulent manipulation, data leaks or theft; risk is lurking in the shadows waiting to pounce on the unwary and unprepared.

### **Detective Internal Controls**

These are controls that are used after the fact of a discretionary event. This means that management must question what had led up to these events to occur and what policies can be designed to prevent them from happening again. These detective controls include internal audits, reviews, financial reporting (reviewing financial statements) and doing physical inventories.

### **Preventative Internal Controls**

These are the controls a business puts in place to avert a negative event from occurring. Management can use both physical and administrative preventative controls in order to assert asset security. These preventative internal controls can include training programs to educate employees, drug testing to assert the competency of employees as well as protecting the information of the company with firewalls and information back-ups that are regularly updated.

### **Corrective Internal Controls**

This is the financial control that a company can only put in place after the detective internal controls discover that there is a problem. This should include disciplinary action, reports filed and the implementation of policies that prohibits the practices that had led up the to the detrimental event.

# How can the company effectually exercise financial control functions?

- Be proactive to how the business approaches risk that can become relevant in future. This includes the security measures that the business will have to implement to ascertain the necessary protection of their assets. Whether it is by duty-segregation or cyber-security risks (anti-viral software, firewalls, reviewing and updating passwords regularly).
- Regularly monitor the typical volume of the business and take score of whether business is showing a decline or growth. Using this on a regular basis allows the data to be interpretable easily to determine where a problem has arisen.
- Because most fraud is uncovered when the suspect is either “out of office” or has flown the coup, employee vacations afford a natural point for checks and taking assessment of an employees work without risking the validity of the end result.
- Be involved. Higher-level staff involvement is the best financial control to deter fraud. It is with this in mind that the highest-ranking person in the company would have to be able to review this input from the employees but still have the peace of mind to be audited within good faith, after all quis custodiet ipsos custodes, who guards the guards themselves?
- Monitor and account for the petty cash and change fund. Although currently there exists no fool proof way to prevent fraud within the business there are ways to minimize the exposure to such risks. It might be an innocent enough intention that an employee is “borrowing” money with the intention of returning it. Whether or not the problem was resolved is mutable at best because just by allowing this conduct the business had exposed itself to a risk that may have attributed to much more than a forgotten note that the loyal employee would have gladly returned. Loyalty is not a security in business and this principle must always be clearly understood that there must be no shades of grey in the relationship between employer and employee. There must always be policies in place in order to maintain the status quo surrounding funds such as the petty cash that many employees have access to, and harsh punishments must be carried out to make an example of those who abuse the privilege to be privy to that fund or information repository (e.g. gossiping about confidential information or relaying information to external sources).
- Prepare a budget. Smart budgeting, while limiting the scope of employees exposed to this information, is a smart way to provide a basis to compare actual performance with standard performance. The information that the business has attained the previous year can be used to determine its income and expenditure of the next 12 months or even longer if the correct mathematic projections are used. Realizing that you are out of budget is sometimes the first indication that your business is in trouble.
- Analyzing all possible operational scenarios, before implementing a strategy the business must first consider all possible outcomes of the scenario and have policies in place to proactively deal with teething or running problems as they arise. By reviewing previous information on how situations were handled by employees’ certain standards can be created to encapsulate the policies in place to stop detrimental events form occurring.



- Doing background checks on all persons affiliated with the business (with the persons consent of course to comply with the newly minted POPIA) in order to minimize risk. Obviously, a person with valid references and qualifications would have no qualms about a query over this subject but people can have different views on the use of their personal information. If there are hiring protocols in place, policy would eliminate those who would try to hide the validity of their qualifications.
- The business can also establish a periodic review policy with all existing customers, that will require stringent credit reporting however, by using this creditor-debtor relationship it will ensure the creditworthiness of customers and eliminates the ongoing probability of bad debts. Some customers may not like it if a business makes a change like this but if losing those possible risks to ensure the security of the business public visage it is a sacrifice that must be made to pave the way of progress.

## Active Fraud Prevention in the Business

Fraud can be broken down into 3 main categories: asset misappropriation, corruption and financial statement fraud. Although usually least costly asset misappropriation accounts for 90% of all fraud cases studied. Financial statement fraud are schemes that involve omitting or intentionally misstating information in the financial reports of the business. Corruption is the one of fastest growing forms of fraud in the workplace, whether it is in regard to bribery, extortion, or conflict of interest. Thus, it is vital for the modern business to have a fraud prevention plan in place as a deterrent to errant employees who wish to do harm to the business.

### The business can take the following simple steps towards fraud prevention

- Management can sometimes determine a guilty party or a party who is withholding information during an enquiry by picking up on changes in standard behavior of that person. Just by listening to the workers who fall under the scope of the business one can determine potential fraud risks. Any attitude change should cause the employer to look more closely at a specific employee not just for the sake of the business but also to intervene e.g., should the employee not feel appreciated by the business then a new compensation that is mutually beneficial can be negotiated.
- Set up a reporting system to be a detriment to those who would considering committing fraud. By setting up this system and spreading awareness about the risks that fraudulent behavior could bring to the company as well as the implications for the employee is especially important in order to have a work staff who are loyal with their ethics and to deter other less ethically correct employees.
- Implement internal controls that will ensure the security of the company's assets (e.g. log books for driver that can be verified with stamps, signatures from clients or other media) or even help ensure the integrity of the accounting and financial records of the company. These procedures that the company had set up must be consistently reviewed and revised according to technological or other advances. This includes setting up cyber-security platforms to help prevent possible risks from becoming imminent problems.
- Always remember to monitor vacation balances. It cannot be expressed enough that an employee that might never miss a day of work might have an agenda hidden behind their work. If there is proven to be no ulterior motive, then that employee deserves that vacation. But it allows the business to determine whether or not the employee in question is corrupting the rest of the information and has managed to hide their tracks for an extended period of time.
- Do not mix personal information and the information of the business. Keep separate accounts or create different memberships for the business. Fraudsters do not only target companies, but they will also go after only a few individuals who are of interest to them (CEO, Chairman etc.) who would have sufficient bank balances to



drain. This relationship works vice versa as well. It is important to remember that employees must also have to undertake policies to protect the information that is being given through to the business (e.g., an employee must have an official company email and cannot under normal circumstances use their private email)

- Purchase insurance as while there are many precautions one can take, by no means is there a foolproof way to deter or prevent fraud as of yet. Depending on the provisions detailed in the policies that were taken out in case of fraud, the business may report the problem to the creditors and may be reimbursed for the losses that have been suffered.
- The business must always try and create a way to put words into writing to ease out possible disputed. E.g., the business would be able to create a policy that refers to communication between employees to have any verbal communication be also referenced via an email so that the business has better track of “who said what” during dispute or investigation.

## What are the End Objectives of Financial Controls?

- To ensure that the business uses the resources at hand economically by doing regular reviews. Not only does this mean taking stock of the productivity of the business as a whole, but can also eliminate “dead weight” employees who are no longer a valid asset to the business.
- To ease the creation of a workable budget for a specific function by using both administrative functions that allows data to be verified (e.g., duty-segregation to allow mistakes to be spotted easily and verified accordingly) as well as projecting that data into a forecast that would take into account several different parameters and scenarios.
- Proper implementation of financial control verifies the adequacy of capital and thus allows the business to identify sectors within itself that require a larger expenditure or to determine where funds are being squandered or even where there are cases of fraud or theft within the company
- The end goal of any financial function, even security, is to accurately report the finances of the company. By utilizing financial controls effectively management within the business can take time to decide whether or not the current plan that they have set out within their budget must be adjusted or whether or not they have new arising problems that will affect the profits of the business and thus also affecting the dividends paid out to shareholders.
- The survival of the business and the growth of its profit margin is always the end goal towards the very nature of business. If a business does not retain internal capital, it will fail even after a surge of profits because that well might run out if there are dire economic circumstances. It is times like this that financial controls will allow the business to survive in times of distress.

## Conclusion

Financial Controls are the very foundation of the business’ first line of defense against fraud. Business must be sure that they are protected from the constantly evolving threats that the world is spews forth. Without proper codes of conduct and policies that are there to protect the interests of the business, there is no way to determine whether or not the business is having difficulties without having some measure of doubt. It is the responsibility of higher-level management to ensure that these measures are taken to extend the life span of the business.