

Internal Controls

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Making the Case for Checks and Balances

As a busy small business owner, with rarely a moment to sit and think, it probably seems unimportant or, worse, counterproductive, to set up a system of checks and balances to ensure the quality of decisions and transactions taking place within your company. “Unnecessary bureaucracy”, you might think. “I sign all the cheques and negotiate all the deals anyway”. Nothing could get past you, right? Wrong.

Appreciating Human Nature

As long as there is another human involved in your business besides you, there will exist the classic problem of an “agent” (an employee), with his/her own motivations and ideas, acting on behalf of a “principal” (you). It is not a question of the agent’s character or your level of trust in him/her. Some fundamental facts of human nature are that 1) we frequently make mistakes and 2) we tend to get lazy and lax in our behavior when no one is watching. Even the world’s greatest athletes train under the intense and watchful eye of professional coaches. Why? Left to their own devices, these athletes would be unable to force themselves to perform to an elite level.

The Best Offense

While the above argument is about constructing a good defense, in reality, implementing internal controls is about setting up your business for a good offense and growth. If you can arrange for a scheme whereby the making of good decisions is reinforced, and poor decisions are regularly exposed, it actually makes it possible to bring new people on board and decentralize decision-making. And, frankly that’s the only way for your business to grow. There are only 24 hours in the day. How much can one person accomplish alone?

Sustainability

When was the last time you went on leave? When was the last time 48 hours passed without your having to answer a work-related phone call? If you need to be personally involved in every decision in order for those decisions to be well-taken, one wonders if you have really built a company.

Understanding Internal Controls

Internal controls are a system of self-reinforcing rules, policies, procedures, duties, and positive tensions (yes, conflict!) that encourage every agent in your business to make quality decisions, lest they be caught by another agent or you, the principal. Control activities include:

- Record retention;
- Authorization process and/or levels,
- Segregation of duties,
- Reporting to enable monitoring and review,
- IT controls,
- Application controls,
- Creation of client/supplier standards, and
- Auditing.

The concepts are easier to understand when you put them in practice, so let's get started!

Six Simple Measures to Get in Control

STEP 1: Write Simple Policies

Write 1-page policies on company letterhead: This measure is about setting standards with respect to your customers, suppliers, employees, or other stakeholders. As disarmingly easy as it sounds, having, for example, standard payment terms on company letterhead can accelerate negotiations with potential customers and simplify the work of your salespeople. Oftentimes, customers simply want to be assured that they aren't receiving discriminatory treatment or getting a bad deal. Once something is on letterhead, it is official and assumed to be applied across the board to everyone.

STEP 2: Meet Regularly with True Figures

Meet regularly with true figures: This activity encompasses two very important ideas. The first is that you should be meeting frequently – monthly is adequate – to ensure that not too much time has passed for lots of bad decisions to be made unchecked. The second important idea is that, at

these meetings, the discussion should center on the cold, hard truth. While it may be difficult to produce monthly financial statements, at the very least, your agent should be able to account for and explain all the inflows and outflows from the bank. If not, something is terribly amiss!

STEP 3: Segregate Duties

Segregate duties (Best Case Scenario): If your business has enough staff such that one person is dedicated to sales or procurement, it is essential that another staff be tasked with confirming/ratifying the price.

STEP 4: Compare 'Actuals' to 'Budget'

Compare actuals to budget (All Cases Scenario): Budgeting can be one of the most powerful and easiest ways to audit, but it must be implemented properly in order to work.

- Step 1.** Let the agent set the budget (with your input, of course). This is a critical step, as it then transfers accountability of the results onto him/her.
- Step 2.** Review the actual results (true figures) as compared to the budget on a regular basis.
- Step 3.** Focus your inquiries on the large discrepancies. You may miss small anomalies here and there, but it will be difficult for gross fraud to happen if you regularly comparing actual outcomes with self-professed budgets

STEP 5: Multiple Quotations

Require and keep file of multiple quotations: If you have delegated responsibility for the procurement of key services or supplies to an agent, require that he/she seek at least two quotations and keep those quotations on file. While not 100% fraud-proof, this will minimize the opportunity for your agent to cut a side deal with a 'preferred service provider'.

STEP 6: Leverage Accounting Software

Leverage IT to secure your financial information: In the year 2014, all business owners, no matter the size, should be encouraged to use accounting software. There are many simple solutions out there, as easy to use these days as Microsoft Excel. And all of available solutions have security features – a key one being the ability to “close the books”, making it impossible to adjust historical accounting entries except with the administrator’s password. This is critical if you have an agent preparing your financial statements.

Popular accounting packages in Ghana include:

- Tally ([link](#))
- QuickBooks ([link](#) or [link](#))
- MYOB ([link](#))
- Sage ([link](#))

Thank you for reading!



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