

## INTERNAL CONTROLS

### Real Life Horror Stories and How to Prevent Them in Your Practice

CVC West 2010  
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## WHAT ARE INTERNAL CONTROLS?

- Mechanisms and safeguards put into place to protect the assets of your veterinary practice – mainly cash!
- **Theft!!**
- **Embezzlement!!**

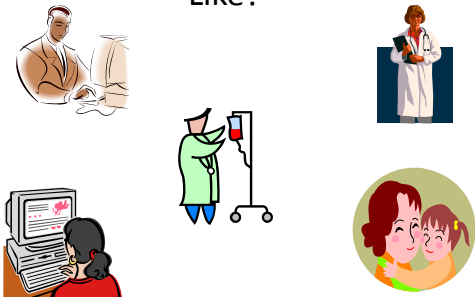
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## Embezzlement

- The Association of Certified Fraud Examiners estimates the cost of occupational fraud to U.S. organizations at **\$400 billion** annually
- Small business are the most vulnerable

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## What Does An Embezzler Look Like?



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## INTERNAL CONTROLS

Our experience has shown that small businesses run an inherently greater risk of employee theft because of a lack of checks and balances.

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## SMALL BUSINESSES MOST VULNERABLE

- **Why?**
  - *Overlapping duties.*
  - *Employees wear many hats*
  - *Usually a close-knit group, so trust is high*
  - *Single owner – relies on others*
  - *Internal controls not in place*

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## RECENT AAHA SURVEY

- AAHA NEWStat and Trends magazine surveyed a sampling of AAHA members to see how bad this problem is, what kinds of issues people are having, and what measures they have taken to respond to this threat.
- **Suggests most practices are susceptible to embezzlement**
- About 86 percent of respondents said their practice had been a victim of embezzlement
- Less than 30 % said they had won a criminal or civil case against the thief.

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## RECENT AAHA SURVEY

- Most respondents (83 %) reported that money was the thing that was stolen.
- Drugs and supplies each accounted for about 32 % of stolen goods
- Services, 13 %

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## RECENT AAHA SURVEY

- Of those who responded:
  - Roughly 33% reported that the approximate dollar amount of the theft or embezzlement was less than \$1,000
  - 25% lost between \$1,000 and \$5,000
  - About 6 % said they were embezzled out of more than \$100,000.

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## RECENT AAHA SURVEY

- Of those who responded:
  - Close to 90 percent of practices were general practices
  - 28 percent reported annual revenues of more than \$2 million.
  - 42 percent had between 10 and 20 staff members working at the practice.

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## RECENT AAHA SURVEY

- Of those who responded:
  - 55 % said the front office staff was responsible for the theft
  - 35% veterinary assistants were responsible for the theft
  - 14% practice managers/hospital administrators were responsible for the theft

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## FACTS

- ***Most thefts will only involve one person***
  - *Collusion is rarely the case*
  - *Very difficult to catch if two or more team up*
- ***Generally, only the people you trust will steal from you***
- ***Most embezzlements continue for months before being discovered***

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## SOME HORROR STORIES

- All True
- All Veterinary Practices
- Owners were shocked...SHOCKED...that this could happen to them
- Owners were fortunate to stumble on theft
- All were not clients of ours at time...whew!

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## HORROR STORY #1

- Theft committed by veterinary practice's most trusted and adored employee...
- ...who happened, by the way, to have a criminal record with multiple felonies
- She had several financial duties:
  - Controlled computer system
  - Prepared daily deposit slips
  - Made daily deposit

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## HORROR STORY #1

- Pocketed cash received, changed payment method on computer
- Credit Card Payments were reconciled at end of month by this employee
- Consistently stole about \$2,000 a month for a year and a half
- Got greedy. Forged a business check made payable to cash, and was caught
- Evidence: handwriting analysis, her on video at check cashing place, eventual confession.
- 24 months in slammer
- Total stolen: \$40,000

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## HORROR STORY #1

- What was learned by this owner?
  - Division of responsibilities a must
  - Always check employee references
  - Don't hire ex-felons
  - Timely bank reconciliations a must

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## HORROR STORY #2

- Employee "reversed" charges on her own and friend's credit card, using merchant machine
- Also did "reverse" debits on her own bank card
- Able to put money into own bank account, and credit onto own credit card
- No safeguards in place for merchant machine, no owner approval

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## HORROR STORY #2

- Same person reconciled bank accounts and credit card statements
- Went on for over a year
- Eventually caught when she pulled up for work in new BMW convertible
- That was a joke.
- Employee needed emergency surgery. Temp employee stumbled onto theft
- Total stolen: Almost \$65,000

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## HORROR STORY #2

- What was learned by this owner?
  - Division of duties
  - Reconcile credit card statements
  - Make sure employees take vacations
  - Make it at least appear that you're watching!

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## HORROR STORY #3

- Employee wrote out checks and prepared bills to be paid.
- Owner was the only one who could sign checks (supposedly)
- Same employee opened bank statement and did reconciliation
- Owner only looked at Quicken register, which was manipulated to balance

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## HORROR STORY #3

- Employee got sick and missed work, bank statement arrived in mail (two days early)
- Theft had gone on for over eighteen months
- Amount stolen: \$82,000

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## HORROR STORY #3

- What was learned by this owner?
  - Bank statements and cancelled checks go to owner
  - Owner thumbs through cancelled checks
  - Make employees take vacations

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## HORROR STORY #4

- Employee was responsible for drugs and supply orders.
- Employee was also responsible for reviewing shipment and stocking shelves
- Five boxes came in, four hit the shelves, one hit the street

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## HORROR STORY #4

- Another employee saw something suspicious and reported it to owner.
- Had gone on for almost twenty months
- Amount stolen: about \$50,000

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## HORROR STORY #4

- What was learned by this owner?
  - Separate people order, receive and pay for drugs and medical supplies
  - If not feasible, two people verify shipment received.
  - Take periodic inventory

## THINGS I'VE SEEN THAT HAVE GIVEN ME GREY HAIR...

- **Signed**, blank checks in owner's office (with six figures in checking account)
- No bank reconciliation done for entire year
- Voided transactions allowed in computer system
- No inventory count
- Deposits made whenever
- A/R balances allowed to be written off in computer system – no authorization

## IMPORTANT

- Division of responsibilities – cannot be overemphasized
- Bank Statements opened by owner only
- Bank Statements mailed to owner's home
- Thumb through cancelled checks. Look at payee and endorsement.
- Watch for behavioral changes in employees
- Make deposits daily. Only bad things can happen otherwise
- Check references of employees
- Let everyone know that you're watching
- A small amount of diligence can go a long way

## AGAIN, INTERNAL CONTROLS ARE...

- Methods and procedures concerned with the authorization of transactions, safeguarding of assets, and the accuracy of the financial records
- Areas of most importance in veterinary practices
  - Cash
  - Inventory

Let's get to it...

## Cash Payments

1. Cash Payments by Clients
  - a. Receipt clearly states cash payment.
  - b. Recorded as cash payment in computer.
  - c. Cash is counted by two employees at end of day.
  - d. Total cash is compared to total on daily report by same two employees.

## Cash Payments

### 1. Cash Payments by Clients

- e. If cash matches the daily report, enter cash amount on daily deposit slip.
- f. If cash does not match the daily report, list discrepancy, then enter on daily deposit slip.
- g. Put cash in envelope. Envelope dated, labeled and sealed. Signed off by same two employees.

## Check Payments

### 2. Check Payments by Clients

- Receipt clearly states check payment.
- Recorded as a check payment in computer.
- Check is immediately endorsed – For Deposit Only – Name – Acct #.
- No post dated checks accepted.
- No held checks accepted.

## Check Payments

### 2. Check Payments by Clients

- Checks are counted and totaled by two employees at end of day.
- Total of checks is compared to daily report from computer by same two employees.
- If checks match daily report, enter checks amount on daily deposit slip.
- If checks do not match daily report, find and correct discrepancy. Enter checks on daily deposit slip.
- Put checks in separate envelope. Envelope should be different color than cash envelope. Envelope dated, labeled and sealed. Signed off by same two employees.

## Deposit of Cash and Checks

### 3. Deposit

- a. Deposit slip prepared daily.
- b. Copy of deposit slip, and daily report, with cash and check totals highlighted, given to office manager and signed off by same two employees.
- c. Actual deposit slip, with envelopes, also given to office manager. Office manager verifies envelopes are sealed.
- d. Deposit slip and envelopes stored in safe or under lock and key until courier arrives.
- e. When courier arrives, office manager again verifies envelopes sealed.
- f. Deposit receipt from bank goes directly to owner. Owner agrees deposit receipt to daily report. Owner staples deposit receipt to daily report
- g. Any adjustments, NSF checks or notices regarding deposit goes directly to owner.

## Credit Cards

### 1. Credit Card Payments by Clients

- a. Receipt clearly states credit card payment.
- b. Recorded as credit card payment in computer.
- c. Batch report is run by two employees at end of day.
- d. Total from batch report is compared to total daily report from computer by same two employees.
- e. If total matches, give both batch report and computer daily total report to office manager. Same two employees sign off on reports.
- f. If total does not match, find discrepancy, then give both batch report and computer daily total report to office manager. Same two employees sign off on reports.

## Checking Account

- Bank statements go to owner unopened.
- NSF, debit or credit memos or any other bank correspondence also go to owner unopened.
- Owner peruses all check payees and endorsees for irregularities.
- Owner reviews all adjustments (NSF, debit or credit memos) on bank statement.
- All cash and check deposits are verified on bank statement.

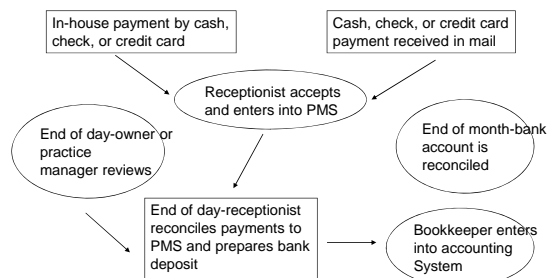
## Checking Account

- All credit card deposits are tracked from merchant account to bank statement.
- Office manager/bookkeeper prepares bank reconciliation.
- Owner reviews bank reconciliation.

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## What Can Be Done to Prevent Embezzlement?



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## Questions to ask yourself...

- Is there a segregation of duties?
  - Does the same person do all financial tasks?
  - Rotation of personnel
  - Control of assets and related records
- Checks
  - Are checks signed in advance?
  - Who is allowed to sign checks?
  - Are checks kept locked up?
  - Are checks pre-numbered and sequence maintained?
  - Is a signature stamp used?

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## Questions to ask yourself...

- Drawer and petty cash
  - Is cash locked up when not in use?
  - Who has access to cash?
- Bank reconciliations
  - Who prepares the bank reconciliations?
  - Who reviews them?
  - Are they prepared promptly?

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## Practice Management System

2. A/R, Invoices
  - a. Accounts receivable authorized by office manager and owner.
  - b. Any client receivable write-offs are authorized by office manager and owner.
  - c. Any “change of payments”, discounts or “voids” in system are authorized by office manager and owner.

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## Questions to ask yourself...

- Practice management system (PMS)
  - Is the end-of-day payment/PMS reconciliation reviewed by a practice owner or manager?
  - Are the PMS audit reports reviewed regularly by a practice owner or manager?
  - Are invoices given to all clients?
  - Is there a sign at the reception desk encouraging clients to ask for invoices?

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### Petty Cash

- a. Maintain separate petty cash drawer.
- a. No cash from daily activity to be used towards petty cash.
- b. Petty cash reimbursements for invoiced expenditures.
- c. Check written to cash to office manager for petty cash reimbursement

### Check Signing

Do your accountant a favor...

- a. Only the owner signs checks.
- b. No exceptions.
- c. No signature stamp

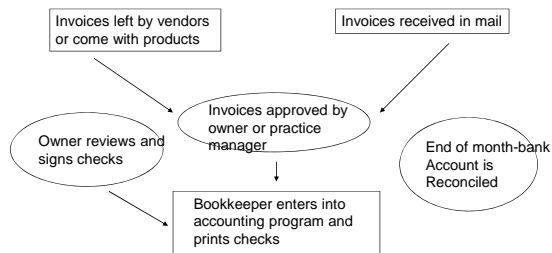
### Payroll

- a. Office manager to continuously review employee rates and salaries.
- b. Recommend direct deposits.
- c. Overtime authorized by supervisor, signed off on by owner
- d. Owner periodically reviews employee rates and salaries.

### Vendors/Ordering

- a. Orders made by appropriate supervisor. Approved by office manager.
- b. Shipment arrives. Packing slip matched to order, then matched to contents. Given to office manager
- c. Office manager agrees packing slips to vendor invoice.
- d. Payment is prepared.
- e. Office manager matches check to invoice due to vendor.
- f. Owner matches check to invoice to vendor. Owner signs check.

### What Can Be Done to Prevent Embezzlement?



### Questions to ask yourself...

- Credit cards
  - Who is allowed to use credit cards?
  - Who reconciles statements?
  - Are they reconciled promptly?
- Vendor payments
  - Are products received compared to a list of what was ordered and the packing slip?
  - Are invoices approved prior to payment?
  - Does check signer review all supporting documentation?



## Other Issues to Consider

- Inventory on shelves
- Alarm system/cameras
- Computer back up procedures
  - how often?
- Record-keeping and older files
  - Where stored?
- Computer security
  - Passwords
- Employee vacation time/sick time
  - recording & monitoring
- Employee handbooks
  - updating

Copy of slides and internal controls checklist by email?

Questions?



Answers