



## The Mini-Audit: Self-Defense for Your Assets

As more and more companies bring their accounting systems in house, the opportunities for errors and/or fraud increase correspondingly. Here are some fairly simple steps you can take in the comfort of your office to help protect your company from both of these unpleasant and regrettable circumstances,...

### The Nature of Accounting Reports

There are many company owners who never take the time to **really** look at their accounting reports. Besides missing out on the opportunity to improve operations by taking action on the data, they could be losing money to an unscrupulous employee. Fortunately, by a careful perusal of reports and underlying data, you can help to prevent that from happening in **your** company.

Good business practice dictates staying in touch with your daily and monthly financial activity. If one of your employees handles your financial transactions and has access to your assets, it becomes even more critical to receive and carefully review accounting reports every month.

Become familiar with the following report formats and the information they contain:

- **Summary reports.** Standard balance sheets and income statements are good examples of summary-style reports. They consolidate the results of a number of transactions for a given period of time into specific, detailed accounts (e.g., workers' compensation insurance) or more generalized account groups (e.g., compensation and fringe benefits).

Summary reports can be prepared at the account level. Even if you're primarily interested in the most summarized version of the document, ask for the "account-level" report. You can quickly see what accounts make up the total. Summary reports can be very useful for "big picture" purposes and trend spotting. However, if you only look at the most summarized versions, you may miss or overlook vital information.

- **Detailed transaction reports.** These documents list the individual entries that compose specific accounts' (e.g., bills, credit card charges, journal entries, invoices, etc.) total balances. Transaction reports are useful when resolving questions about what makes up the balance in a particular account. In addition to the transaction date and the vendor, you may find it helpful to include a column that shows who made each entry and the date and time they did so.
- **Supporting schedules.** A supporting schedule is simply a list of what makes up an account balance. These are generally prepared for balance sheet accounts. Typical supporting schedules show a detailed listing of accounts payable or accounts receivable (both of these should be shown in an "aging" format; i.e., analyzed by the length of time they have been unpaid).

You should also periodically ask to see supporting schedules to show what is included in accounts such as "employee loans receivable," "work in progress," "suspense" (let's hope you don't have one of those!) and other accounts that contain entries that "come and go."

- **"Change" reports.** What's changed since last month? Last quarter? Last year? These reports typically show the most recent month's balances, another column showing the prior month's (or prior quarter's or prior year's) balances and remaining column(s) that show the dollar and/or percentage change since the previous report period. Change reports are especially useful for balance sheet reports.

As you review the report, confirm that the account balances listed for the previous month, quarter or year agree with prior change reports you've reviewed. (Note: Accountants usually ask if the balances "roll forward"; i.e., if you start with the prior beginning balance and account for the increases and decreases, the result must agree with the ending balance.)

Many accounting systems allow users to change balances for prior reporting periods. That is why it's especially crucial to reconcile the current change report's prior balances with historic balances that you have reviewed for a given period. If you are focused on current balances and activity, but the prior balance has been altered, you won't see accurate results.

- **Variance reports.** These documents show how actual results differ from expected or estimated results. One column shows planned results, another column the actual results and the remaining columns show the difference (variance) in dollars and/or percentages. Examples of variance reports include budget vs. actual reports (generally account-based reports) and estimated vs. actual job cost reports (usually structured to show estimated and actual costs by job stage for individual jobs).

Variance reports are especially useful for fraud prevention; it's hard to conceal large dollar variances when a business owner continually monitors actual vs. planned results.

Remember, however, that you may be seeing only a portion of the financial activity entered into the books. For example, materials costs may be on target for jobs A, B and C, yet other costs may be included on the books that have not been assigned to any of those jobs.

## Crosscheck Your Data

It is important to periodically crosscheck variance reports with backup data to make sure the sum of the parts equals the total. I typically suggest to clients that they prepare an account-based "profit & loss by job" report and check the account totals against a "company account totals" report.

A clever embezzler could also alter the budget or estimate to cover up unusual activity, but an astute owner who is in touch with the numbers would likely spot that subterfuge.

## Filtered and Modified Reports

Accounting systems such as QuickBooks® allow the report preparer to filter reports to show only certain transactions or to export reports into a spreadsheet that can be modified before being printed. Both of these features can be very helpful when analyzing or extracting information for legitimate purposes, but it's easy to see the downside.

If you don't adopt a "hands on" approach to your accounting system and regularly confirm the accuracy of your reports, it can be fairly easy for someone to carefully select, or modify, the information that you see.

## Recommendations

- Ask and expect to see accounting reports in a variety of formats: summary, detailed, supporting schedules, change and variance. You must draw on the different information each format provides to get a complete picture of your financials.

- Take the time to review your reports for reasonableness and accuracy. For example:
  - Does the total equal the sum of the parts?
  - Do the planned amounts agree with your recall?
  - Do beginning balances agree with prior-period closing balances?
- Satisfy yourself that the reports you are reviewing have not been altered or modified between what is currently in the accounting system.
- If you find that, in spite of your best efforts, you just don't have the time to do the review yourself, try to find another trusted and reliable "set of eyes" to periodically take an objective look at your data (e.g., your CPA).

Your internal financial statements have a story to share. If you consistently review them and take just a little extra time to confirm the accuracy of the data they contain, you'll be in a good position to discover any significant unusual financial activity. That goes a long way toward preventing inside jobs.