UNDERSTANDING CONTROLS IN BUSINESS

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In life there are always checks and balances to reduce the risk of loss, fraud and time management. We have checks and balances in our families, communities and the economy at large. Likewise businesses put in place checks and balances. In the business sense these are referred to as business controls.

The need to understand Business Controls for Treasury and Finance Departments

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INTRODUCTION

In life there are always checks and balances to reduce the risk of loss, fraud and time management. We have checks and balances in our families, communities and the economy at large. Likewise businesses put in place checks and balances. In the business sense these are referred to as **business controls**.

Before we proceed to look at the different forms of business controls, let us take a moment and ask ourselves some of the following questions:

1. What are business controls?
2. Why are business controls so important for treasury and finance departments?
3. When should we consider putting in place controls?
4. When do internal controls become effective?
5. How should the controls be managed?
6. Which controls should be in place?

Let us now briefly look at the questions above.

What are business controls?

Business controls are procedures adopted in a business to safeguard its assets; ensure financial information is accurate and reliable, ensure compliance with all financial and operational requirements; and generally assist in achieving the business's objectives.

Controls can as well be defined as methods put in place by a company to ensure the integrity of financial and accounting information, meet operational and profitability targets and transmit management policies throughout the organization.

Why are business controls so important for treasury and finance departments?

Business controls are so important for treasury and finance departments for the following reasons:

- Effective business controls ensure thorough reporting procedures and that the activities carried out by the business are in line with the business's objectives.
- They also ensure the business's physical and monetary assets are protected from fraud, theft and errors.

- Additionally, business controls minimize the chance of unexpected events.

When should we consider putting in place controls?

There is no specific time when controls should be put in place. As a matter of fact, controls should be in place at all times and in all sections of the organization.

When do internal controls become effective?

Internal controls become effective only when employees follow them. Thus, if you want your company's employees to carry out its internal control procedures, you must hire competent and trustworthy employees. Employees are the most important resource in a business but they are often taken for granted. When employees realize that they are not valued and their contribution in the company is not noticed, they can decide to sabotage the future of the company by intentionally refusing to adhere to the controls in place. When controls are not adhered to, loop holes are created and it is these loopholes that other parties take advantage of and siphon the company of its resources and as such it can no longer be a going concern.

I recall a time when we had just been hired, we were taken through training and the company policies were clearly communicated to us. Later on I found out that this was done to ensure that we get to know what is expected of us at the onset. For my case particularly, since I was part of the cash management team, we were strictly told never to make any cash disbursement before obtaining proper authorization from authorized managers. In fact, we were even furnished with a list of people meant to approve documents for each department. This made the internal controls in place very effective and highly adhered to.

How should the controls be managed?

It is the responsibility of every individual in the company to manage the controls that relate to that particular department. However, separate committee, for instance an Internal Audit department or an Internal Compliance section can be created to oversee the management of internal controls.

Which controls should be in place?

Different sections of Treasury and Finance Departments require different controls. For this reason, we shall look at the controls required in the following areas of finance and treasury department:

- Accounts payables
- Sales and Accounts Receivables

- Payroll
- Cash and bank accounts
- Non-current assets
- Stock

ACCOUNTS PAYABLES CONTROLS

Accounts payable controls are used to mitigate the risk of losses in the payables function. These controls can be for an entirely paper-based accounts payables system or a computerized accounts payables system as discussed below

Controls for an entirely paper-based accounts payables system

Though it may seem unlikely that some companies still use entirely paper-based systems to conduct their accounts payable processes, this is still the case for some smaller businesses. Even with a paper-based accounts payables system, there is a minimum set of controls needed to ensure that it operates properly. Some of the controls needed under an entirely paper-based accounts payables system are as below:

- **Manually review for duplicate invoices**. A non-computerized accounting system has no way to automatically verify a supplier's invoice number against the invoice number of invoices previously paid. Consequently, the payables staff must compare each newly received supplier invoice against invoices in two files: both those in the unpaid invoices file and those in the paid invoices file.
- **Conduct the three-way match**. The payables staff must compare the pricing and quantities listed on the supplier invoice to the quantities actually received, as per receiving documents, and the price originally agreed to, as noted in the company's purchase order. In summary, compare the invoice, Goods Received Note and Purchase Order t ensure accuracy.
- **Store payables by due date**. The company must pay its bills on time, which calls for proper filing of unpaid supplier invoices by payment due date. Otherwise, suppliers can give the company a lower credit score or charge late fees. This control assumes that unpaid invoices will be stored based on the dates when the company can take early-payment discounts.
- **Check/Cheque stock from locked cabinet**. Unused check/cheque stock should always be kept in a locked storage cabinet. In addition, the range of check/cheque numbers used should be stored in a separate location and cross-checked against the check/cheque numbers on the stored checks, to verify that no checks/cheques have been removed from the locked location.

- **Check signer compares voucher package to check/cheque**. The check/cheque signer must compare the backup information attached to each check/cheque to the check/cheque itself, verifying the payee name, amount to be paid, and the due date. This review is intended to spot unauthorized purchases, payments to the wrong parties, or payments being made either too early or too late. This is a major control point for companies not using purchase orders, since the check/cheque signer represents the only supervisory-level review of purchases.
- **Perforate voucher package (Stamp the payment vouchers)**. The voucher package can be reused as the basis for an additional payment unless the package is perforated with the word "Paid" or some other word that clearly indicates the status of the voucher package.
- **Pre-number receiving reports**. A key part of the three-way matching process is to ensure that the items being paid for have actually been received, and in the correct quantities. It is easier to ensure that all receiving reports are being transferred to the accounts payable department by pre-numbering the receiving reports and tracking down any reports whose numbers are missing.
- **Lock up blank receiving reports**. If three-way matching is used, then the receiving report is considered evidence that the quantity of an item contracted for has arrived at a company location. If someone were to steal a blank receiving report, he or she could take the goods and still submit a completed receiving report, resulting in undetected theft. Consequently, it may be useful to lock up unused receiving reports.
- **Pre-number purchase orders**. The purchase order is a key part of many accounts payable systems, since it provides the central authorization to pay. Consequently, if the purchasing system is paper-based, it makes sense to keep track of the stock of purchase orders by pre-numbering them.
- **Lock up blank purchase orders**. The purchase order represents a company's official authorization to acquire goods and services. If someone could obtain blank purchase orders and fraudulently affix a company officer's signature to it, that person could obligate the company to a variety of purchases with relative impunity. Consequently, in cases where purchase orders are printed in advance, they should be stored in a locked cabinet.
- **Maintain a register of unapproved supplier invoices**. If a company issues new supplier invoices to those empowered to authorize the invoices, then there is a significant chance that some invoices will be lost outside of the accounting department and will not be paid. To avoid this, update a register of unapproved supplier invoices on a daily basis, adding invoices to the

register as they are sent out for approval and crossing them off the list upon their return. Any items remaining on the list after a predetermined time limit must be located.

- **Conduct a daily review of unmatched documents**. The three-way matching process rarely results in a perfect match of all three documents (purchase order, receiving report, and supplier invoice), so these documents tend to pile up in a pending file. To keep the associated supplier payments from extending past early-payment discount dates or from incurring late-payment penalties, there should be a daily review of the pending file as well as ongoing, active measures taken to locate missing documents.
- **Reconcile supplier credit memos to shipping documentation**. If a company negotiates the return of goods to a supplier, then it should deduct the amount of this return from any obligation owed to the supplier. To do so, it should maintain a register of returned goods and match it against supplier credits. If no credits arrive, then use the register to continually remind suppliers to issue credit memos.
- **Only fund the checking account sufficiently to match outstanding checks.** If someone were to fraudulently issue a check/cheque or modify an existing check/cheque, a company could lose a large part of the funds in its bank account. To avoid this, only transfer into the checking account an amount sufficient to cover the total amount of all checks/cheques already issued.
- **Destroy or perforate and lock up cancelled checks/cheques**. Once a check/cheque is created, even if it is cancelled on the in-house accounting records, there is still a chance that someone can steal and cash it. To avoid this problem, either perforate it with the word "cancelled" and store it in a locked cabinet or shred it with a cross-cut shredder.
- **Add security features to check/cheque stock**. A wide array of security features are available for check/cheque stock, such as watermarks and "Void" pantographs, that make it exceedingly difficult for a forger to alter a check/cheque. Since the cost of these features is low, it makes sense to add as many security features as possible.
- **Verify that all check/cheque stock ordered has been received**. It is possible for both inside and outside parties to intercept an incoming delivery of check/cheque stock and to remove some checks/cheques for later, fraudulent use. To detect such activity, always compare the number of checks/cheques ordered to the number that has arrived. Also, verify that the first check/cheque number in the new delivery is in direct numerical sequence from the last check number in the last delivery. In addition, flip through the check/cheque stock delivery to see if any check/cheque numbers are missing. Further, if the check/cheque stock is of the continuous

feed variety, see if there are any breaks in the delivered set, indicating that some checks/cheques were removed.

- **Limit the number of check/cheque signers**. If there are many check/cheque signers, it is possible that unsigned checks/cheques will be routed to the person least likely to conduct a thorough review of the accompanying voucher package, thereby rendering this control point invalid. Consequently, it is best to have only two check/cheque signers—one designated as the primary signer to whom all checks/cheques are routed and a backup who is used only when the primary check/cheque signer is not available for a lengthy period of time.
- **Restrict check/cheque signer access to accounting records, cash receipts, and bank reconciliations**. The check/cheque signer is intended to be a reviewer of a nearly complete disbursement transaction, which requires independence from all the payables activities leading up to the check/cheque signing for which this person is responsible. Consequently, the check/cheque signer should not have access to cash receipts, should not perform bank reconciliations, and should not have access to any accounting records. It is best if the check/cheque signer is not even a member of the accounting department and is not associated with it in any way.
- **Never sign blank checks/cheques**. Though an obvious control, this should be set up as a standard corporate policy, and reiterated with all check/cheque signers.
- **Separate disbursement and bank account reconciliation duties**. If a person involved in the disbursement process were to have responsibility for bank reconciliations, that person could improperly issue checks/cheques and then hide the returned checks/cheques. Consequently, always separate the disbursement function from the reconciliation function.

Controls for a Computerized Accounts Payables Environment

Computerization of the accounts payable process results in a number of efficiencies, though the overall process bears numerous similarities to the original paper-based system. Some of the controls needed under a computerized accounts payables environment are described as follows:

- **Automatic duplicate invoice number search**. The accounting software automatically checks to see if a supplier's invoice number has already been entered and warns the user if this is the case, thereby avoiding the need for manual investigation of potentially duplicate invoices.

- **Conduct three-way match**. The payables staff must compare the pricing and quantities listed on the supplier invoice to the quantities actually received, as per receiving documents, and the price originally agreed to, as noted in the company's purchase order.
- **Print report showing payables by due date**. Since the computer system stores the invoice date and number of days allowed until payment, it can report to the user the exact date on which payment must be made for each invoice, thereby eliminating the need to manually monitor this information.
- **Check/cheque stock from locked storage**. Unused check/cheque stock should always be kept in a locked storage cabinet. In addition, the range of check/cheque numbers used should be stored in a separate location, and cross-checked against the check/cheque numbers on the stored checks/cheques, to verify that no checks/cheques have been removed from the locked location.
- **Check/cheque signer compares voucher package to check/cheque**. The check/cheque signer must compare the backup information attached to each check/cheque to the check/cheque itself, verifying the payee name, amount to be paid, and the due date. This review is intended to spot unauthorized purchases, payments to the wrong parties, or payments being made either too early or too late. This is a major control point for companies not using purchase orders, since the check/cheque signer represents the only supervisory-level review of purchases.
- **Restrict access to the vendor master file**. For a variety of reasons, it is unwise to allow unrestricted access to the vendor master file. Instead, use password access to restrict access to the smallest possible number of people, and only to those people who have no other responsibilities within the accounts payable and bank reconciliation areas.
- **Separate the supplier record creation and payment approval functions.** A strong risk of fraud arises when the same person can create a supplier record in the vendor master file and approve payments to the same suppliers, since this person is capable of creating a fake supplier and approving payments to it. Instead, split these two responsibilities among different employees.
- **Use a standard naming convention to create supplier names in the vendor master record.** Having multiple supplier records for the same supplier presents a problem when attempting to locate duplicate supplier invoices, since the same invoice may have been charged multiple times to different supplier records. One of the best ways to address this problem is to adopt a standard naming convention for all new supplier names, so that it will be readily apparent if a supplier

name already exists. For example, the file name might be the first seven letters of the supplier name, followed by a sequential number.

- **Review daily changes to the vendor master file**. An employee with access to the vendor master file could alter a supplier's remit-to address, process checks/cheques having a revised address that routes the checks/cheques to him or her, and then alter the vendor master record again, back to the supplier's remit-to address. If this person can also intercept the cashed check/cheque copy when it is returned by the bank, there is essentially no way to detect this type of fraud. The solution is to run a report listing all changes to the vendor master record, which includes the name of the person making changes. A second control that provides evidence of this type of fraud is to only use a bank that creates an electronic image of all checks/cheques processed, so there is no way for an employee to eliminate all traces of this type of crime.
- **Require independent review of additions to vendor master file**. To reduce the risk of having an employee create a shell/fake company to which payments are made by the company, have a person not associated with the payables process review all additions to the vendor master file and confirm that they are acceptable prior to any payments being made. Under this approach, only collusion that involves the reviewer will result in shell/fake company fraud.
- **Purge (clean up) the vendor master file**. The vendor master file within the accounting software can become clogged with multiple versions of the same supplier information, if not regularly reviewed and cleaned up. Having multiple supplier records presents a problem when attempting to locate duplicate supplier invoices, since the same invoice may have been charged multiple times to different supplier records. The solution is to conduct a regularly scheduled review and purge of the vendor master file.
- **Run a credit report on every new supplier added to the vendor master file**. A clear sign of fraud is when a shell/fake company is set up specifically to receive fraudulent payments from someone within the accounts payable department. By running a credit report on every new supplier, it is possible to see how long a supplier has been in business and investigate further as necessary.
- **Run a report listing identical remit-to addresses for multiple suppliers**. Sometimes even the best manual review of the vendor master file will not detect all instances of duplicate records, because the variety of names used for a single supplier may be widely separated within the vendor master file. A good way to spot this problem is to sort the vendor master file by

remit-to address, which tends to cluster multiple instances of the same supplier close together in the report.

- **Match supplier addresses to employee addresses**. Employees can create shell companies and fraudulently have checks/cheques sent to themselves. To detect this issue, create a computer report that matches supplier addresses in the vendor master file to employee addresses in the employee master file (assuming that the payroll function has also been computerized).
- **Reconcile supplier statements to payment detail**. When a supplier's monthly statement reveals that some payments are overdue, this can be evidence of a diverted payment by an employee. Consequently, the timely comparison of any supplier statements containing overdue payment notices to the vendor ledger in the computer system can be a good way to detect fraud. This control is also possible for a paper-based payables system, but requires considerably more review time, since payment records must be manually assembled for comparison purposes.
- **Access the vendor history file when paying from a copy**. There is a greatly increased chance of duplicate payment when paying from a document copy, since the document original may already have been processed for payment. To mitigate this risk, always review the vendor history file to see if the same invoice number or an identical dollar amount has already been paid. An additional control is to require more approval signatures whenever a document copy is used.
- **Match quantities ordered to MRP requirements**. When the purchasing department orders more materials than are required by the material requirements planning (MRP) system, this may represent fraud by the purchasing staff, which may be diverting the excess materials for their own uses. Using the computer to match quantities ordered to actual requirements needed will spot this problem.
- **Match purchase order records to actual quantities received**. If a company has a policy of paying the full amount of the purchase order if the delivered quantity is within a small percentage of the ordered amount, a canny supplier can continually short-ship deliveries by a small amount and never be caught. To detect this problem, run a computer report comparing the purchased amount to the delivered amount to see if there are any suppliers who have an ongoing pattern of delivering less than the ordered quantity.
- **Track changes in customer complaints related to suppliers**. A supplier can improve its profits by selling low-quality goods to the company. Though this problem is difficult to detect, an indication is a sudden increase in customer complaints related to the materials provided by

the supplier. Running a summary-level report itemizing customer complaints by supplier or type of complaint can spot this problem.

- **Track short-term price changes by suppliers**. There is a possibility that suppliers will offer a kickback to a person in the purchasing department in exchange for allowing price increases by the supplier. To detect at least the possibility of this type of fraud, run a report listing short-term price changes by suppliers. By screening the report to show only significant price increases, the probability of the report showing evidence of fraud will increase. However, if a canny supplier increases prices only by a small amount, such a report will still not detect the problem, unless the filter is set to report on price changes of any size.
- **Audit acquisitions made within authorized purchase levels**. Employees sometimes attempt to circumvent maximum purchase authorization levels by having suppliers split invoices into multiple smaller-shilling invoices. To detect this control circumvention, have the internal auditors run a report listing multiple small payments to suppliers within a short time period, and see if these payments are related to a single acquisition.
- **Investigate payments made for which there are no purchase orders.** If the purchase order is the primary control over the payables process, then it is critical to ensure that all payments made (above a minimum shilling threshold) are supported by an authorizing purchase order. To locate control failures in this area, run a report comparing the payables file to the purchase order file, and list all payments for which there is no authorizing purchase order record.
- **Use varying font sizes for each character in a check/cheque payment.** Using a computer to print checks/cheques has the advantage of allowing for a wide array of printing techniques that makes it more difficult for someone to alter a printed check/cheque. One approach is to have the computer use a different font size and type for each character of the written payment amount listed on the face of a check/cheque. This type of printing is extremely difficult to modify.
- **Restrict access to check/cheque-signing equipment**. If a company uses any form of computerized check/cheque-printing equipment, it may be necessary to lock down all access to it. This can include any printers in which check/cheque stock is maintained, signature plates, and signature stamps.
- **Require a manual signature on checks/cheques exceeding a predetermined amount**. This control is useful when signature plates are used for smaller check/cheque amounts. When signature plates are used, there is no longer a final review of payments before they are mailed.

Therefore, requiring a "real" signature for large checks/cheques adds a final review point to the payment process.

- **Implement positive pay**. A strong control that virtually eliminates the risk of an unauthorized check/cheque being cashed is "positive pay." Under this approach, a company sends a list of all checks/cheques issued to its bank, which only clears checks/cheques on this list, rejecting all others. However, this approach also calls for consistent use of the positive pay concept, since any manual checks/cheques issued that are not included on the daily payments list to the bank will be rejected by the bank.
- **Use electronic payments**. There are several types of fraud that employees can use when a company pays with checks/cheques, while outside parties can also modify issued checks/cheques or attempt to duplicate them. This problem disappears when electronic payments are made instead. In addition, the accounts payable staff no longer has to follow up with suppliers on uncashed checks/cheques.
- **Reconcile the checking account every day**. An excellent detective control, this approach ensures that any fraudulently modified checks/cheques or checks/cheques not processed through the standard accounting system will be spotted as soon as they clear the bank and are posted on the bank's Web site. This control is not available to companies not having Internet access.

As is readily apparent from the number of controls associated with the vendor master file, this is an area requiring restricted access and regular review in order to reduce the risk of multiple payments and fraudulent payments. Also, a computerized accounting environment allows for panoply/collection of additional controls that are not cost-effective in an entirely paper-based environment, allowing for cross-checking of accounting records against the purchasing, production planning, receiving, and customer complaints databases to unearth control problems.

Automated Check/cheque signing

The central problem with the accounts payable system is that the primary control point—supervisory review of the purchase—occurs after the service or product has already been delivered, so a company typically is obligated to pay for whatever was purchased, even if it has no need for it or management did not initially authorize it. In essence, a lack of up-front control over the purchasing process results in an excessively late approval process just before payment is due to be made to the supplier.

This problem is exacerbated if supervisors are not asked to approve supplier invoices, so that the sole control point becomes the check signer. This person is now obligated to sort through the voucher package that accompanies all unsigned checks and investigate any suspicious payments. In reality, this person is usually a senior-level manager who has many other activities to accomplish and so conducts no more than a cursory review of the accompanying voucher packages and then signs the checks. The result is the almost total lack of any real control over the purchases that a company makes.

Many larger companies have recognized the futility of the control represented by the check signer and have eliminated this control through the use of a signature stamp, signature plate, electronic signature image, or some similar device. However, by doing so, they must ensure that a sufficient level of control has been added earlier in the purchasing and payables process to compensate for this loss of control. The use of a purchase order is a better control point than a check signer, since purchases must now be approved in advance, rather than after receipt, thereby giving the company greater control over what materials are allowed to be received at the receiving dock.

The new controls noted that are specific to automated check signing are described as below.

- **Mandatory purchase order authorization**. The key control point for automated check signing is requiring the purchasing staff to issue a purchase order for every purchase made by the company. This means that the purchasing staff must also forward a copy of each purchase order to the receiving dock, where it is used to verify the purchasing authorization for each item received.
- **Rejection at receiving dock if no authorizing purchase order**. Requiring a purchase order for every purchase does not represent much of a control if the receiving department accepts all arriving deliveries. Instead, the receiving staff must ensure that an authorizing purchase order is on file for every item that arrives at the dock. If there is no purchase order for a delivery, the receiving staff must reject it. This control can be quite time-consuming for the receiving department, which must research purchase order information for every delivery. To ease the workload, suppliers should be asked to prominently tag their deliveries with the authorizing purchase order number.
- **Restrict access to signature stamp**. This control actually applies to any form of automated check-signing equipment, not just the signature stamp. This is a critical control, since anyone

gaining access to both check stock and the check-signing equipment could create authorized checks in any amount with impunity.

- **Restrict access to purchase order documents**. If the purchasing department uses paper-based purchase orders, then it must restrict access to the purchase orders by locking them in a storage cabinet when not in use. Otherwise, blank forms could be used by unauthorized parties to order goods.
- **Pre-number purchase orders and track missing documents**. If the purchasing department uses paper-based purchase orders, it can more easily determine if blank forms have been removed by pre-numbering all purchase orders, keeping track of the numbers used, and investigating any missing numbers. This approach makes it less likely that blank forms will be removed from the department.
- **Restrict access to the purchase order database**. If the purchasing department creates all of its purchase orders through a computer database, then it must restrict access to that database to guard against the unauthorized creation of purchase orders. Typical controls include password protection, regular password changes, and access being limited to a small number of purchasing staff, and a human resources check-off list for departing employees that calls for the immediate cancellation of their database access privileges.
- **Compare payments to authorizing purchase orders**. This detective control is used to spot payments made without a supporting purchase order, which constitutes evidence of a breach in the purchase order control requirement.
- **Review old open purchase orders**. This detective control is useful for determining which outstanding purchase orders are no longer needed and can be cancelled. Taking this step makes it less likely that someone could use old, open purchase order to order goods inappropriately.

Though the use of purchase orders can provide a very effective level of control over purchases, it also results in a great deal of "paper-pushing" labor by the purchasing staff, which must create a purchase order for every item that a company acquires. To reduce the amount of purchasing labor while still retaining a high level of control over purchases, it is logical to implement procurement cards.

SALES AND ACCOUNTS RECEIVABLES CONTROLS

Sales

- Make sales to customers that will be collected profitably.
- Develop realistic sales forecasts that result in real present or future customer orders.
- Sell company products or services to the right customers at the right time in the right quantities.
- Ensure that actual customer sales correlate directly with management's long- and short-term plans.
- Assure that sales efforts and corresponding compensation systems reinforce the goals of the company.
- Integrate customer sales with the other functions of the company, such as manufacturing, marketing, merchandising, engineering, purchasing, finance, and so on.

Accounts Receivable

Accounts receivable has a significant impact on cash flow. It represents the results of the company's sales effort, except the cash has not been collected yet. Goods or services have been delivered in exchange for the customers' promises to pay at a later date (usually after 30 days). Most businesses, because of competitive necessities, must operate on credit, and payment of receivables represents their major source of ongoing operating cash. If customers pay late or not at all (bad debts), the company can wind up with insufficient cash to meet its current obligations.

Accounts Receivable Collection Period

Collection period defines the time between setting up the account receivable and the ultimate cash collection from the customer. The longer the collection period, the higher the investment in accounts receivable and the shorter the collection period, the more readily available is the cash flow generated. If at all possible, accounts receivable should be eliminated entirely. The cash manager may be able to convince management that the costs of billing, accounts receivable processing, and collection efforts are sufficiently high that passing them on to the customer may be worth investigating. In exchange for lower prices, the customer may be willing to pay at time of delivery, preferably through an electronic transfer that will make the funds immediately available to the company. Such opportunities should be pursued to maximize cash inflows, reduce cash conversion gap time, and eliminate unnecessary functions that do not add value. It is important to know the average collection period for accounts receivable. and to take measures to continually work toward keeping it at a minimum, consistent with good customer relations and competitive necessities. The most commonly used process for calculating the average collection period is:

$$Average\ Daily\ Sales = \frac{\text{Total Annual Credit Sales}}{365}$$

$$\text{Average Collection Period, in days} = \frac{\text{Accounts Receivable Balance}}{\text{Average Daily Sales}}$$

However, for internal measurement purposes, it is better to use a shorter period of time to measure the collection period. Typically, the accounts receivable represent sales made in the last one to three months. Therefore, it would be more meaningful to determine the sales made in the last, say, two months, divide by 60 days, and divide that result into the accounts receivable balance. That will give a much more current look at the collection period relative to the actual sales that make up those receivables.

Accounts Receivable Aging

The accounts receivable aging schedule is a familiar tool, and someone in the company is likely to have prepared or reviewed one. It is another tool to help identify cash flow problem areas in the early stages as well as the specific source of a problem.

The first thing to look at in the aging schedule is the customers causing the collection period to extend beyond 30 days. They must be aggressively contacted, and if changes are not forthcoming, decisions need to be made regarding the benefits of ongoing sales to them - shipment holds, cash on delivery (COD) shipments, or even order cancellations in some instances may become necessary. Intelligent use of the aging schedule can also yield information about recent changes in paying habits - slower payments resulting in more outstanding and older balances, credit limit breaches, failure to take cash discounts if offered, and so on. These signals can be used as early warning indicators to help ward off future problems and as signs of a possible critical cash management problem.

An aging schedule is also necessary to avoid harassing customers whose accounts are not yet overdue. Persistent calls to customers who pay on time and are not yet late can create serious customer relations problems. Occasional calls regarding large payments to be sure that they will be remitted on time may be acceptable, but repeated calls when not justified should be avoided.

It would be ideal for businesses to be able to collect the cash due upon delivery of their goods and/or services. Even better would be to collect in advance of delivery. While a worthy goal of an effective cash management system, this is unlikely for most businesses. Therefore, the cash manager should concentrate on developing effective and efficient collection systems to increase cash flow and keep investment in accounts receivable at a manageable minimum level. Various factors have an impact on this goal, including:

- Credit policy
- Invoicing procedures
- Accounts receivable follow-up.
- Cash discounts.
- Finance charges.
- Holding delivery.

PAYROLL CONTROLS

Responsibilities for the preparation of the wage sheets should be delegated to a suitable person, and adequate staff appointed to assist him/her. The extent to which the staff could perform other duties should be specified clearly.

Other key controls under payroll include:

- Staffing and segregation of duties.
- Authorization of the following: Engagement and discharge of employees; changes in salaries; overtime; non-statutory deductions; advances of pay.
- Recording of changes in personnel and pay rates.
- Recording and review of hours worked.
- Recording of advances of pay.
- Holiday pay arrangement.

CASH CONTROLS

Of all the assets a company owns, cash is the most liquid and a business cannot survive and prosper if it does not have adequate control over its cash. But what is cash? In accounting, cash includes coins, currency, undeposited negotiable instruments such as checks/cheques, bank drafts and money orders.