Office of BUSINESS & ENTREPRENEURSHIP

FROM RISK TO RESILIENCE

Strengthening your business with effective internal controls.

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Drawing on her background as a CPA and experience as a small business owner and former university instructor, Wendy specializes in financial statement analysis, teaching financial acumen, and providing small business consulting. Wendy's goal is to tackle each task collaboratively and energetically, leveraging my extroverted nature. I thrive on teamwork and strive to foster a dynamic and engaging atmosphere for productive and enjoyable interactions.

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Jenifer Zurfluh is the Senior Vice President of Enterprise Risk Management at IncredibleBank, where she leads the strategic oversight of risk management practices. With over 30 years of experience in the financial industry, Jenifer has a proven track record of implementing effective risk management frameworks and fostering a culture of growth and innovation.

In addition to her role at IncredibleBank, Jenifer is passionate about equipping aspiring entrepreneurs with the knowledge and skills needed to navigate the complexities of starting and growing a successful business.

Jenifer holds a degree in accounting and a Commercial Lending diploma from the American Institute of Banking. She graduated in 2006 from the UW Madison Graduate School of Banking , completed the University of Maryland Robert H Smith School of Business Advanced Risk Management Program in 2017, and holds several advanced certifications in third-party risk management. She has been an instructor for the SBDC's Entrepreneurial Training Program for more than 15 years.

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WELCOME!!

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AGENDA

- What are Internal Controls?
- Why Internal Controls Matter
- Key Controls for Every Business
- Risk and Resilience
- Assessing Your Specific Business Risks
- Implementing a System of Controls

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WHAT ARE INTERNAL CONTROLS?

Definition: Internal controls are the policies, procedures, and Actions that help a business

1. safeguard assets.
2. prevent fraud.
3. ensure accurate financial reporting.

So this is a pretty big deal folks!!

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SAFEGUARDING ASSETS

Safeguarding assets means protecting a business's physical and financial resources from **theft, misuse, fraud, or accidental loss**. This includes:

- **Physical Protection**
  - Locking up cash, inventory, and equipment; restricting access to authorized personnel only.
- **Financial Security**
  - Using secure banking practices, reconciling accounts regularly, and monitoring transactions.
- **Data & Information Security**
  - Implementing cybersecurity measures, protecting sensitive business and customer data, and limiting access to confidential records.

By implementing strong internal controls, businesses can reduce the risk of loss and ensure that resources are used efficiently and for their intended purpose.

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PREVENTING FRAUD

Preventing fraud means implementing processes and controls to detect, deter, and minimize the risk of fraudulent activities within a business. This includes:

- **Segregation of Duties**
  - Ensuring that no single person controls all aspects of a financial transaction (e.g., the same person shouldn't authorize payments and reconcile bank statements).
- **Regular Monitoring & Audits**
  - Conducting routine financial reviews, surprise cash counts, and independent audits to detect irregularities.
- **Clear Policies & Training**
  - Establishing anti-fraud policies, setting ethical expectations, and training employees on recognizing and reporting fraud.
- **Secure Access & Approval**
  - Using strong passwords, dual authorization for payments, and limiting access to sensitive financial data.

By proactively preventing fraud, businesses can protect their assets, maintain financial integrity, and build trust with employees, customers, & stakeholders.

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ENSURING ACCURATE FINANCIAL REPORTING

Accurate financial reporting means **maintaining reliable, consistent, and error-free financial records** that reflect the true financial health of a business. This includes:

- **Recording Transactions Correctly**
  - Ensuring all income, expenses, and assets are properly documented in the accounting system.
- **Reconciling Accounts Regularly**
  - Matching bank statements, invoices, and financial records to identify discrepancies.
- **Implementing Internal Reviews**
  - Conducting periodic financial reviews or audits to catch mistakes or irregularities.

Accurate financial reporting helps businesses make informed decisions, meet compliance requirements, and build trust with stakeholders such as investors, lenders, & employees.

THE "THREE C'S" OF INTERNAL CONTROLS:

- **Clear Policies**
  - Define responsibilities, approvals, and procedures.
- **Checks & Balances**
  - Separate duties to prevent fraud **(*e.g., the person handling cash should not reconcile accounts)***
- **Consistent Monitoring**
  - Regularly review financials, audit processes, and spot-check transactions.

Example in Action:

- **Without Controls:** One person manages all cash, records sales, and reconciles the books → High fraud risk.
- **With Controls:** One employee records sales, another deposits cash, and a third reconciles the books → Lower fraud risk.

Takeaway: Small, consistent steps in internal controls can protect your business and build financial confidence!

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WHY DO INTERNAL CONTROLS MATTER?

- **Protects Your Business:**
  - Reduces the risk of fraud and errors.
- **Ensures Accuracy:**
  - Helps maintain reliable financial records.
- **Supports Compliance:**
  - Keeps you in line with tax and legal requirements.
- **Improves Efficiency:**
  - Streamlines operations and decision-making.

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KEY AREAS OF INTERNAL CONTROL:

1. **Financial Controls**
   - cash handling, expense approvals
2. **Operational Controls**
   - inventory tracking, workflow procedures
3. **Compliance Controls**
   - regulatory and tax compliance

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FINANCIAL CONTROLS

- **Cash Handling:**
  - Implement procedures for receiving, recording, and depositing cash to prevent theft or mismanagement.
  - **Example**: Require two people to count and verify cash at the end of the day.
- **Expense Approvals:**
  - Establish a clear process for approving expenses and purchases.
  - **Example**: Require manager approval for purchases over a certain amount and maintain receipts for record-keeping.
- **Bank Reconciliation:**
  - Regularly reconcile bank statements to catch errors or fraudulent transactions. Example: Review and compare bank statements with accounting records at least monthly.

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SCENARIO: A COSTLY CASH HANDLING MISTAKE

- **Background:**
  Sarah owns a small café and relies on her employees to handle cash transactions.
- To keep things simple, she allows all employees to access the cash register and deposit money into the bank at the end of the day.
- There is no structured process for counting or reconciling the cash at closing.

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SCENARIO:
A COSTLY CASH HANDLING MISTAKE

What Happened:

- One busy Saturday, the café was packed with customers.
- At the end of the night, Alex, a new employee, was responsible for closing the register and taking the deposit to the bank.
- However, since there was no official cash-handling procedure, Alex didn't count the cash in front of a second person, and there was no verification step.

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SCENARIO: A COSTLY CASH HANDLING MISTAKE

- The next morning, Sarah checked the café’s bank account and realized that the deposit was $250 short.
- When she asked Alex about it, he was unsure what happened—maybe he miscounted, maybe a customer was given too much change, or maybe the money was misplaced during his walk to the bank.
- With no oversight or documentation, there was no way to verify where the missing money went.

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Internal controls protect employees AND owners!

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SCENARIO:
A COSTLY CASH HANDLING MISTAKE

Lessons Learned:
This situation could have been avoided with stronger financial controls, such as:

- **Dual Cash Counting:** Require two employees to count the cash together and sign off before it is deposited.
- **Deposit Logs:** Keep a written record of all deposits, including the total amount and who handled the transaction.
- **Surprise Audits:** Conduct periodic spot-checks to ensure proper cash handling.
  - My donut shop story!!
- **Bank Drops by Owner or Manager:** Limit who is responsible for making deposits to trusted staff members.

By implementing these internal controls, Sarah could have reduced the risk of theft, mismanagement, or simple human error.

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OPERATIONAL CONTROLS

- **Inventory Tracking:**
  - Use inventory management systems or periodic physical counts to prevent loss or theft.
  - **Example**: Cameras provide an inexpensive control device.
- **Workflow Procedures:**
  - Standardize business operations to ensure consistency and efficiency.
  - **Example**: Use checklists for customer orders, production processes, or service delivery.
- **Segregation of Duties:**
  - Assign different employees to key tasks to prevent fraud or errors.
  - **Example**: The employee who approves a vendor payment should not be the one who processes it.

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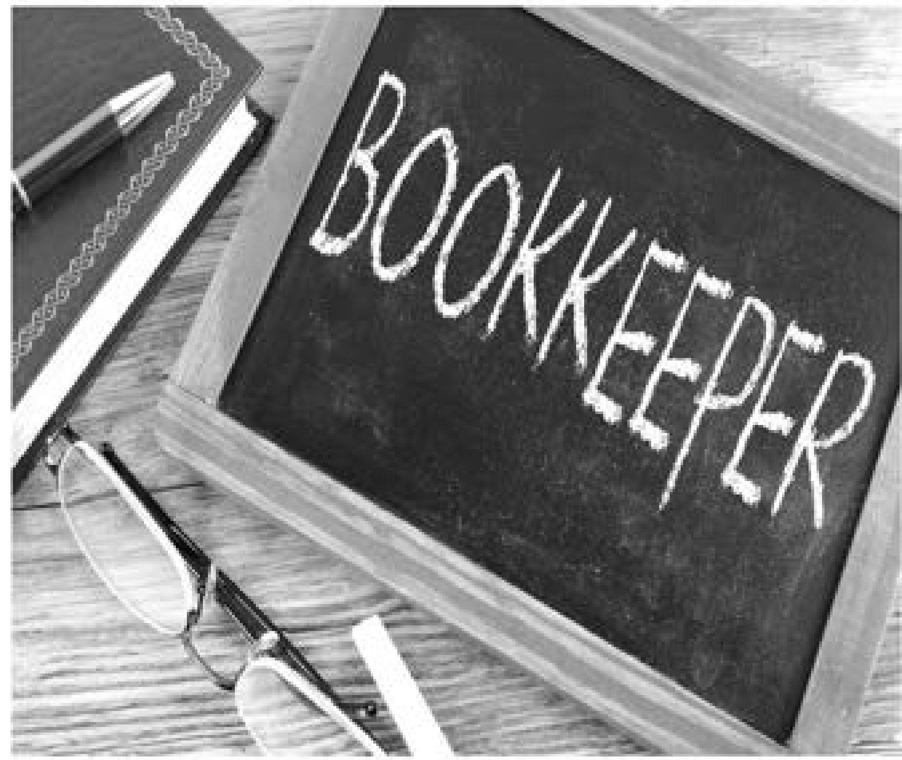
SCENARIO:
A COSTLY LACK OF SEGREGATION OF DUTIES

- **Background:**
  David owns a small retail business selling handmade home décor.
- To keep overhead low, he entrusts most financial tasks to his longtime employee, Lisa.
- Lisa is responsible for handling customer payments, recording transactions in the accounting system, preparing bank deposits, and reconciling the monthly bank statements.



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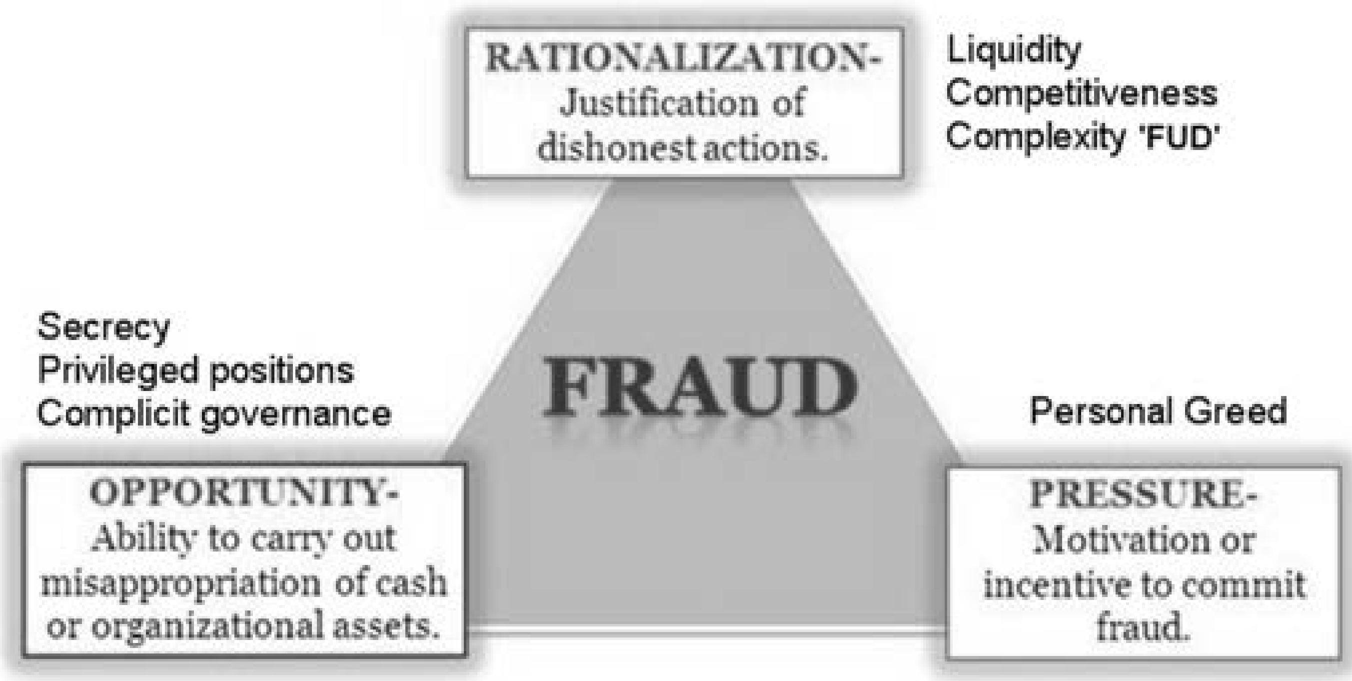
SCENARIO: A COSTLY LACK OF SEGREGATION OF DUTIES

What Happened:

- Over time, Lisa realized that there was no oversight of her work.
- Since she had access to both receiving payments and recording them, she started taking small amounts of cash from daily sales before depositing the rest in the bank.
- To cover her tracks, she altered the sales records in the accounting system to make it look like fewer sales had occurred.

THE FRAUD TRIANGLE



SCENARIO: A COSTLY LACK OF SEGREGATION OF DUTIES

- Because David trusted Lisa and never reviewed the bank statements or sales records himself, it took over a year before he noticed the discrepancy.
- When he finally looked into the numbers, he realized that his actual revenue was significantly lower than what he expected based on inventory sold.
- After hiring an outside accountant to investigate, David discovered that Lisa had embezzled nearly $20,000.

SCENARIO: A COSTLY LACK OF SEGREGATION OF DUTIES

Lessons Learned:

This situation could have been prevented with proper segregation of duties, such as:

- **Separate Cash Handling and Record-Keeping:** One person should collect payments, while another records them in the system.
- **Bank Deposits by a Different Employee:** The person preparing deposits should not be the same person who records them.
- **Owner or Manager Oversight:** Regularly reviewing financial statements, reconciling bank accounts, and checking deposits can deter fraud.
- **Rotating Duties:** Periodically switching roles or requiring employees to take vacations can expose discrepancies.

By implementing these controls, David could have safeguarded his business from fraud and financial loss.

COMPLIANCE CONTROLS

- **Regulatory Compliance:**
  - Ensure adherence to industry regulations, licenses, and business laws. Example: Maintain proper employment records and ensure adherence to labor laws.
- **Tax Compliance:**
  - Keep accurate financial records and file tax returns on time to avoid penalties. Example: Work with an accountant to ensure sales tax is collected and remitted correctly.
- **Data Security:**
  - Protect sensitive business and customer information. Example: Use encrypted passwords, limit access to financial data, and back up records regularly.

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RISK AND RESILIENCE

Risk
Possibility that something bad or unexpected could happen that might impact your business.

Resilience
Your business's ability to bounce back and recover quickly from difficulties or setbacks.

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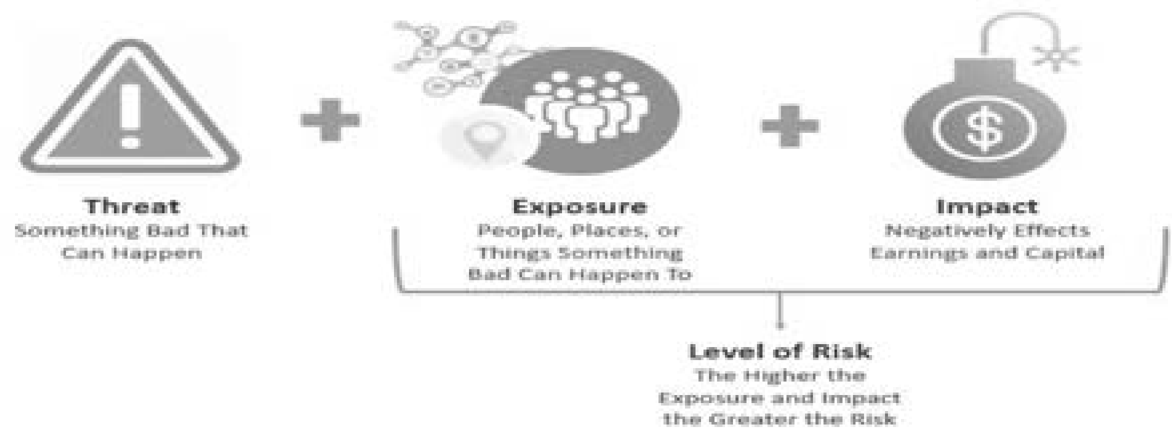
WHY RISK ASSESSMENT MATTERS

- Every business faces risks — from fraud and theft to cybersecurity threats and operational inefficiencies.
- Assessing risk is the first step in building strong internal controls.
- Helps prioritize where to allocate limited resources for the biggest impact.



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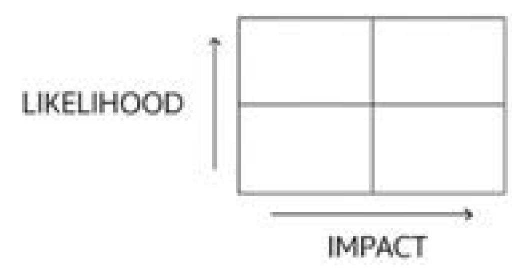
WHY RISK ASSESSMENT MATTERS

Key Questions to Ask:

- What could go wrong in my business?
- Where are we most vulnerable?
- How would those risks impact operations, finances, or reputation?

SIMPLE RISK ASSESSMENT STEPS

1. **Identify Risks**
   - Look at every area: cash handling, inventory, customer data, payroll, etc.
2. **Analyze Risks**
   - What's the likelihood? What's the potential impact?
3. **Rank Risks**
   - Focus first on those that are both likely and high-impact.
4. **Document & Monitor**
   - Keep a risk register and update it regularly.



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COMMON BUSINESS THREATS

- Cash Flow
- Access to Credit
- Competition
- Innovation
- Economic or Interest Rate Fluctuations
- Supply Chain Disruptions/Supplier Dependence
- People, Processes, or Technology Fail
- Law and Regulation Changes
- Tax Changes
- Employee Turnover
- Labor Market Challenges
- Product/Service Quality
- Pricing
- Customer Concentrations
- Changing Customer Behavior or Preferences
- Fraud or Theft
- Natural Disasters
- Data Breach
- Ransomware
- Geopolitical Tensions
- Market Demographic Changes
- Accessibility
- Technology Integration
- Lack of Management Succession
- Partner/Owner Disputes
- Insurance Gaps
- Intellectual Property Theft
- Location/Logistics
- Workplace Accidents
- Product Safety
- Negative Publicity/Social Media Backlash

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WHAT TO DO!?!?!

- How about an internal control checklist.............

Simple Internal Control Checklist for Small Business Owners

1. Financial Controls (Cash Handling & Expense Approvals)

- ☐ Separate cash handling and recording duties (e.g., one person collects cash, another records transactions).
- ☐ Require daily cash reconciliation by someone other than the cashier.
- ☐ Use pre-numbered invoices and receipts to track sales accurately.
- ☐ Set spending limits for employees and require approval for large purchases.
- ☐ Regularly review and approve expense reports and vendor payments.
  - *The simple act of periodically reviewing checks and supporting documentation*

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THANK YOU