

Dear Client:

As a continuing service to you, we want to remind you how important internal controls are. Internal controls are vital to the security and protection of your company's assets and should be considered a top priority. In light of this, we are sending this internal control letter to you, to aid you in your company's internal controls. Owners and management are responsible for establishing and assessing internal controls and then monitoring the effectiveness of the controls and safeguards that are put in place.

The following system of internal controls is being provided to you as a guide and should be considered for implementation in your business. This is a general list; it is not all inclusive and should be expanded and tailored as needed to meet your specific business needs.

1. Physical protection of assets such as cash, inventory, furniture and equipment.
  - a. Separate the physical control of cash receipts and disbursements from the record keeper.
  - b. Have adequate insurance: liability, disability, worker's compensation and fire.
  - c. Bond employees who handle negotiable property (including cash) and inventories.
  - d. Minimize employee access to company checks and keep them locked up. Minimize use of manual checks.
2. Separation of accountability and physical custodianship so no one person has control over a given asset or business function.
  - a. The employee posting cash receipts against accounts receivable should not prepare bank deposits and handle incoming receipts. Consider using a lock box for customer payments.
  - b. All adjustments and/or write-offs to accounts receivable should be reviewed by the owner.
  - c. Inventory- physical inventory should be in a locked storeroom separate from the person keeping inventory records.
  - d. Perform a physical inventory count at least once a month.
  - e. Perform a physical count of fixed assets at least once a year.
  - f. The employee posting accounts payable should not pay invoices or handle the checkbook.
  - g. The person who approves payments to vendors should be different from the person who approves the new vendors that are added to the payables system. Make sure W-9's are on file for all vendors before payment is issued.
3. Cash and checkbook separation of duties.
  - a. Keep small amounts of cash in an imprest petty cash fund.
  - b. Use double signatures on checks over a certain limit.
  - c. Bank statements and cancelled checks should go directly to the owner's home. This enables the owner to review the signatures on cancelled checks for forgeries. You should also compare payee on the front of the check with the endorsement on the back.
  - d. Check signing employees should be separate from the bank reconciliation employee. You should also consider having one of the owners (or a member of their family) reconcile the bank accounts as soon as the bank statement arrives. Pay attention to old reconciling items that have not cleared the bank.
  - e. Vendor invoices, not just statements, should be attached to all checks being presented for signatures.
  - f. Never accept photocopies of documents like invoices and delivery tickets.
  - g. Owner should sign and date invoices once they are approved for payment to avoid having them being submitted twice.
  - h. Avoid signature stamps whenever possible.
  - i. Use checks (and invoices) in sequential order and investigate missing or duplicate numbers.

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- j. No money should be taken out of a payroll checking account except to pay employees or to pay the taxing authorities.
  - k. When using wire transfers or other automatic payments, there should be adequate segregation of duties so that no one person is responsible for the initiation, processing and balancing of the transfer.
4. Talk with your bank regarding any anti-fraud tools that they may offer.
  5. Personnel should be rotated to prevent collusion between employees. Further, employees should be made to take vacations. Another employee should then handle the tasks normally handled by the employee on vacation.
  6. Perform background and credit checks on employees.
  7. Be suspicious of any employee with a sudden financial change (for example, someone who starts buying expensive clothes, gifts or cars).
  8. Implement the use of mechanical devices such as time clocks, check protectors, cash registers, etc.
  9. Periodically change locks on door and file cabinets. Change computer passwords regularly, particularly after someone leaves the company on bad terms.
  10. Internal audit and review systems should be reviewed and operations should be audited on a continuing basis with reports issued only to the top management.
  11. Conduct unscheduled audits. Pull purchase records from the company files and ask the person in charge if they compared prices and if not, why?
  12. Review internal reports constantly, looking for discrepancies, such as accounts receivable aging, accounts payable aging, inventory reports, financial statements, etc.
  13. Design expense reports for each employee to turn in with original receipts with proper coding.
  14. Externally prepared financial statements should only be mailed to the owner.
  15. Talk with your insurance agent regarding employee theft coverage.
  16. Prosecute offenders. It helps deter further crime. Articulate a zero tolerance policy in your employee handbook.
  17. Pay attention to backdated and/or altered entries in your accounting software.

**Controls can only work if they are implemented, maintained and monitored. Set the tone for the enforcement of internal controls at the top of the company. Remember: The person most trusted is often the one who can steal with the least effort.**

Sincerely,

ANDALORO, SMITH & KRUEGER, LLP