

# Financial Controls: What Are They, Best Practices, and How to Enforce Them



For successful businesses, part of managing risk effectively lies in developing and enforcing effective financial controls.

These internal controls not only help protect a company's financial assets, but ensure staff are complying with policy, procedure, and the law.

Understanding what financial controls actually are, and investing in tools that can help you create and implement them, will give your company a powerful advantage in reducing risk, ensuring financial responsibility, and making smart, strategic spending decisions.

## What Are Financial Controls?

Organizations need ways to monitor and manage their financial resources, using a core trio of financial statements that includes the cash flow statement, the balance sheet, and the income statement (also called the profit and loss statement or P&L statement). In analyzing the data from these core financials, companies can identify new opportunities, refine their processes to improve performance,

and ensure they're complying with industry and legal requirements.

Supporting these efforts, financial controls provide a framework for managing cash flow, allocating resources via budgeting, and guarding against potential threats such as fraud and theft.

Properly constructed financial controls:

## 1. **Improve operational efficiency**

Full visibility into financial data and an internal control system help teams optimize resource allocation, cash flow, and strategic sourcing to provide powerful support for overall operational efficiency. On-budget, on-target spend by team members who follow internal control procedures makes it easier to hit production goals, reduce waste and inefficiencies, and guard against rogue spend, embezzlement, and invoice fraud.

## 2. **Enhance profitability**

Increased efficiency, speed, and accuracy from optimized processes improves productivity and profitability in all areas of your business.

## 3. **Simplify resource management**

Finance and procurement are at the heart of your organization, providing all other areas of your business with the resources necessary to function. Proper financial controls give small business owners, chief financial officers (CFOs), and financial experts the flexibility to allocate (or reallocate) resources where and when they're needed most. This improves both performance and profitability in the short term, but also provides long-term security and value by increasing business agility and resilience.

## 4. **Improve accountability and engagement at all levels**

By providing clear procedural guidance and defining the roles and responsibilities of all stakeholders from senior management on down,

financial controls help to ensure everyone is aware of the obligations they must meet, helps everyone understand the importance of doing so, and improve engagement by eliminating confusion and miscommunication.

## 5. **Streamline the reporting and auditing processes**

Full data transparency, full context for all transactions, and policy mandates that support compliance improve the quality and timeliness of financial reporting. They also make auditing much easier and more comprehensive, as all financial data is readily available and accessible to authorized parties.

*The ideal financial controls policy acknowledges the complexity of the modern economy and workplace, and strives to achieve accountability, compliance, transparency, and risk assessment and management supported by continuous improvement.*

## **Financial Controls: Examples**

While every organization will have its own specific goals for financial management, risk assessment and mitigation, budgeting, etc., it's important to make sure you're covering the most critical areas with the most common financial controls.

Establishing internal controls like these will, over time, help your business create lasting value through high-quality data, continuous improvement, and reduced risk.

## **General Financial Management Controls**

- Strict qualifications and role assignments for creating, approving, and implementing financial management policies and practices.
  - Perform in-depth reference and background checks on all potential financial team members.
- A clear and concise chain of command, from the CFO down through

senior management, finance managers, department/project managers, and accounting staff.

- Delegation and segregation of financial duties so as to maintain the chains of command and operation, maximize efficiency and accuracy, and minimize risk to financial and operational health.
  - All cash-related functions should be segregated. Ensuring no one individual is responsible for payroll, accounts receivable and payable, general ledger maintenance, bank reconciliation, etc. will curtail the risk of fraud—a critical concern, given the Association of Certified Fraud Examiners' (ACFE) 2020 *Report to the Nations* found nearly 33% of fraud can be directly contributed to a lack of internal controls.
- Frequent, regularly scheduled training and education sessions to keep all stakeholders up to date on the latest industry, legal, and internal requirements for compliance.
- Regularly scheduled financial analyses and review of all internal controls, with additional analyses and reviews whenever significant discrepancies are found.
  - Tracking the typical daily, weekly, monthly, and annual volume and aggressively investigating deviations is instrumental in driving compliance and engagement while reducing fraud.
- Effective cross-training for all staff, ensuring complete coverage of essential workflows while maintaining both accountability *and* segregation of duties.

## **Incoming Cash Flow Controls**

- Comprehensive credit checks on all potential customers before credit is extended.
- Regular reconciliation of bank statements with the company's general ledger, as well as comprehensive annual reporting to meet compliance requirements and provide strategic insights necessary to financial and operational planning.
- Regular policy reviews with all customers who have been extended credit in order to confirm their creditworthiness and reduce the chances of acquiring or increasing bad debt.
- A secure, centralized, and regularly backed-up database of all financial

data, protected by role-appropriate, leveled access.

## **Outgoing Cash Flow Controls**

- Proactive and comprehensive vendor management, including a secure database of all transactions protected by role-appropriate, leveled access.
- Implementation of controls such as guided buying, full integration of vendor catalogs and contract data, and detailed, context-sensitive approval workflows to minimize the risk of maverick spend, invoice fraud, embezzlement, etc.
- Regular reconciliation of the company's bank statements with its general ledger.
- Clear and comprehensive expense management policies, including detailed guidelines on reimbursement, expense reports, and spending practices to curtail waste and fraud.
- Clear standards and policies for petty cash management, including assignment of a specific "petty cash monitor" to audit, reconcile, and replenish the petty cash account as needed.

## **Financial Controls Policy**

While they've always been important, the lingering impact of the COVID-19 coronavirus pandemic on global commerce—including more remote workers collaborating and communicating across not just time zones but potentially different platforms and applications—has made understanding and enforcing financial controls more important than ever.

The ideal financial controls policy acknowledges the complexity of the modern economy and workplace, and strives to achieve accountability, compliance, transparency, and risk assessment and management supported by continuous improvement.

It is written to be clearly understood, regularly updated as appropriate, and distributed to all stakeholders, who are asked to affirm their understanding of, and compliance with, the policy.

For optimal effectiveness, make sure your policy covers five key areas:

1. A clear chain of command and hierarchy of accountability. This should include monitored delegation where appropriate, and multiple contingencies for separation of duties while ensuring coverage of all essential processes.
2. A clear, regularly reviewed policy regarding issues such as corporate governance, insider transactions, conflicts of interest, embezzlement, fraud, etc.
3. Clear spend authority standards and practices related to all financial transactions. This includes approvals, check signing, payroll, credit cards, borrowing of funds, etc.
4. Detailed standards for, and description of, those positions approved to enter into contracts, and under which conditions.
5. Detailed information on the positions responsible for maintaining accurate, complete, and transparent financial records.

## **Financial Controls Best Practices**

There's no one single "right" way to create and implement effective financial controls. However, you can follow a few basic best practices to ensure you're on the right track.

### **1. Invest in comprehensive procure-to-pay (P2P) software.**

The best thing you can do to ensure your financial control activities are a ringing success is to make sure you have total visibility into and secure control over your financial data.

Add in process automation, deep data analytics, full integration with your accounting system, and powerful reporting, auditing, and budgeting tools, and you've got everything you need to craft internal control procedures that will help you reach your financial performance goals.

A cloud-based software solution like PLANERGY gives you all of those features, along with best-in-class service and support—including training and education

before, during, and after implementation to ensure your team understands why the controls matter and how to fulfill their role within the hierarchy.

## 2. Start with risk assessment.

Risks both internal and external need to be identified and prioritized as you develop your financial controls.

One very effective way to do so is with a risk assessment matrix, which helps you prioritize a risk based on both the likelihood it will occur and the potential impact on your organization if it does.

	<b>Low Impact</b>	<b>Medium Impact</b>	<b>High Impact</b>
<b>Likely</b>	Medium Risk	High Risk	<b>Very High Risk</b>
<b>Unlikely</b>	Low Risk	Medium Risk	High Risk
<b>Very Unlikely</b>	<b>Very Low Risk</b>	Low Risk	Medium Risk

An internal risk assessment like this makes it easy to identify those areas that need your attention most quickly.

If, for example, your accounting team has switched to working remotely, but you don't have a standard virtual private network (VPN) in place to ensure secure, encrypted connections to your server and software applications, the financial data team members are accessing is at risk of being stolen by hackers.

In addition, if you don't have standardized hardware and applications, it can be difficult to manage access and track what's going on with business-critical data at any given point.

Given their potential impact and the high likelihood of occurrence, both of these risks would likely fall into the "Very High Risk" category, and therefore require immediate development and deployment of policies and practices to curtail them effectively.

## 3. Prioritize Segregation of Duties

Keeping critical responsibilities in the hands of multiple parties isn't just smart—it's essential to protecting your business from financial loss and potential legal action.

The ACFE's *Report to the Nations* found 86% of fraud cases were related to asset misappropriation, and on average, went undetected for 14 months.

So in addition to carefully vetting members of your accounting team during the hiring process, it's critical to ensure you have controls in place to make sure payroll, the general ledger, check writing, credit cards, accounts payable and receivable, and bank reconciliation are distributed across your accounts team.

Cross-training and process audit controls will ensure your team members can still get the job done when someone's out due to illness or vacation, while maintaining accountability and minimizing the risk of fraud.

## Financial Controls Checklist

- Perform risk assessments before developing and implementing controls to ensure you're targeting the highest priorities first.
- Review your financial controls policy and practices at least twice a year—and be ready to adjust both based on changing circumstances (e.g., new requirements, evolving threats, etc.).
- Invest in comprehensive procure-to-pay software to ensure you have:
  - Clean, complete and secure financial data management (with integration of other data sources).
  - Automation and process optimization tools that make it easier to develop, implement, and enforce financial controls.
  - Analysis tools that improve risk assessment and mitigation, along with auditing.
  - Contract management, vendor relationship management, and supply chain optimization tools to support guided buying and minimize the risk of fraud, embezzlement, and rogue spend.
  - Ongoing continuous improvement for all business processes to continue reducing risk while increasing savings, profits, and value for your organization.
- Secure all data and limit access based on roles and responsibilities.
- Aggressively monitor and enforce segregation of duties while prioritizing business continuity at the same time.
- Invest in stakeholder education and training to ensure compliance and secure buy-in.

- Guard against internal and external risk by performing credit checks on all potential credit customers and background checks on potential members of accounting staff.
- Tightly monitor cash flow, both as a bellwether of overall financial health and to help your organization react with agility to potential threats and disruptions.

# **Financial Controls Improve Your Company's Health and Performance**

Your company's financial health is in your hands. Take the time to develop detailed, clear, and enforceable internal control procedures, and enjoy the peace of mind that comes with knowing your data is secure, your entire staff is on the same page working toward shared success, and your company's profits, performance, and competitive strength are insulated against needless risk.

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