Analyzing the Relationship Between Internal Control Principles and Fraud

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**Memo**

**To:** All Staff  
**From:** Kelsey Thomspon, Business Accountant  
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**Subject:** Analysis of Fraud and Internal Controls

Understanding the relationship between fraud and internal controls is required for protecting our organization's assets, ensuring accurate financial reporting, and maintaining compliance with regulations. (Wild, 2022).

**Relationship Between Fraud and Internal Controls**

Fraud involves deliberate misrepresentation for personal gain, and internal controls are designed to prevent and detect such activities. Assigning specific tasks to individuals ensures accountability, making it easier to trace errors or fraudulent actions. Proper recordkeeping protects assets and provides a reliable audit trail. Insuring assets and bonding employees who handle valuable assets add layers of protection against fraud and dishonesty. (Wild, 2022).

**Principles of Internal Control**

1. **Establish Responsibilities:** Assigning duties clearly ensures accountability, which is critical for identifying and addressing discrepancies.
2. **Maintain Adequate Records:** Comprehensive records protect assets and provide a basis for verifying transactions.
3. **Ensure Assets and Bond Key Employees:** Insuring assets and bonding employees reduce the risk of loss from theft or fraud.
4. **Separate Recordkeeping from Custody of Assets:** Ensuring that individuals who handle assets do not also maintain their records helps prevent and detect errors and fraud.
5. **Divide Responsibility for Related Transactions:** Distributing transaction responsibilities creates checks and balances, minimizing the risk of errors and fraud.
6. **Apply Technological Controls:** Using technology, such as access controls and ID scanners, enhances internal control effectiveness by reducing errors and improving transaction accuracy.
7. **Perform Regular and Independent Reviews:** Regular external audits ensure internal controls' effectiveness and identify areas for improvement. (Wild, 2022).

**Limitations of Internal Controls**

Internal controls have inherent limitations. Human error can still occur, and collusion between employees can circumvent controls. Management may override controls, highlighting the need for strong ethical standards and governance. Implementing and maintaining controls can be costly, and our organization must balance these costs against our benefits. (Wild, 2022).

The Committee of Sponsoring Organizations (COSO) framework outlines five key components for effective internal controls: control environment, risk assessment, control activities, information and communication, and monitoring. These components ensure a comprehensive approach to risk management and internal control. (Wild, 2022).

In conclusion, robust internal controls are essential for preventing and detecting fraud, significantly reducing its likelihood, and ensuring more reliable financial reporting. Our continuous assessment and improvement of these controls are necessary to address emerging threats and maintain organizational integrity. A new initiative will be implemented shortly.

References

Wild, J. (2022). Financial Accounting Fundamentals (8th ed.). McGraw Hill.