

FRAUD AUDITING SMALL BUSINESSES WITH THE WHEEL

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Cash is the key to small businesses. Lou Mobley, founder and director of IBM’s Senior Management School, said it best: “A company can operate for years without a profit. It cannot operate a day without cash.” This statement is especially true for small businesses – those with \$10,000,000 or less. Our clients typically fall into the “or less” category.

Small businesses usually have deficient internal controls or the management or owner overrides those that are in existence. Therefore, we start any procedures by learning everything there is to know about cash in that business.

Cash is the hub of the small business wheel. The other accounts are the spokes connecting the hub to the rim of the wheel – representing the financial statements and operating reports.

After verifying the existence of all cash generated by the company, we then determine cash flow. A cash flow statement reconciles the difference between the cash and the accrual based financial statements. A year-to-year comparison of cash flow can be very instructive. If the accrual based statements show an increased profit, what does the cash flow look like? Over time, cash and profit should be the same. If there is a continuing divergence, look at the spokes.

The spokes that connect cash to the statements are: Accounts receivable, Accounts payable, Depreciation, Adjusting entries, and Accruals.

Accounts Receivable

If receivables are growing when the sales increase, what is happening in past due and

