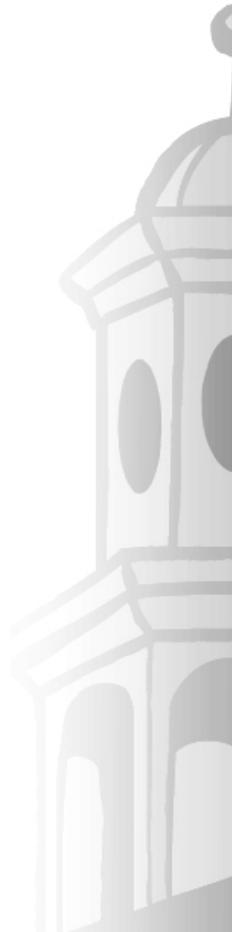


# Using Internal Controls to Improve Accounting and Reporting

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# Using Internal Controls

- **Overview of internal control**
- **COSO framework**
- **Control-related policies and procedures**
- **Best practices**



# Embezzlement/Fraud/Errors

- **Embezzlement**
  - To make away with, to steal, plunder
- **Fraud**
  - An act of deceiving or misrepresenting
- **Error**
  - An unintentional mistake that results in misleading financial reporting



# Internal Control Overview

- **Why do we need internal controls?**
  - **Safeguard resources**
  - **Maintain accurate financial data**
  - **Report financial information in a timely and accurate manner**
  - **Adhere to laws and regulations**



# Internal Control Overview

- **Inherent limitations of internal controls**
  - **Judgment**
  - **Breakdowns**
  - **Management override**
  - **Collusion**

**Cost versus benefit**



# Internal Control Overview

- **How are auditors impacted?**
  - **Understanding the internal control system and how it works will determine how you approach your audit**
  - **You may be an integral part of the internal control system**
  - **Part of your role as auditors is to make suggestions for improvements to financial operations**



# COSO Framework

- **Three components of fraud**
  - **Pressure**
  - **Rationalization**
  - **Opportunity**
- **Opportunity is the component we can have an impact on**



# COSO Framework

- **Committee of Sponsoring Organizations**
  - **American Accounting Association**
  - **American Institute of Certified Public Accountants**
  - **Financial Executives International**
  - **Institute of Management Accountants**
  - **Institute of Internal Auditors**
- **Initial framework released in 1992**
- **Updated framework released in 2012**



# COSO Framework

- **Framework consists of five essential components**
- **Seventeen principles support these five components**
- **Supporting each principle are points of focus to help management in designing and implementing internal controls**
- **<http://www.coso.org/ic.htm>**



# COSO Framework

- **Internal control is**
  - ***a process with ongoing tasks and activities***
  - ***effected by people at all levels of government***
  - ***designed to provide reasonable assurance, not absolute assurance***
  - ***regarding the achievement of objectives in reliability of reporting, compliance with laws and objectives, and effectiveness of operations***



# Five Essential Elements of Internal Control

- **Sound Control Environment**
- **Regular Ongoing Assessment of Risk**
- **Design and Implementation of Control-related Policies and Procedures**
- **Effective Communication**
- **Ongoing Monitoring of Control-related Policies and Procedures**



# Control Environment

- **Senior management establishes the “tone at the top” regarding importance of internal control and expected standards of conduct**
  - **Commitment to integrity and ethical values**
  - **Exercises oversight responsibility for development of controls**
  - **Establishes structure, authority and responsibility**
  - **Commitment to competence**
  - **Enforces accountability**



# Risk Assessment

- Process that *identifies and analyzes risks* to achieving the government's objectives, and *determines how to address those risks*
  - Specify relevant objectives
  - Identify and analyze risks
  - Assess fraud risk
  - Identify and analyze significant changes



# Fraud Risk Assessment

- **A seemingly overwhelming task**
  - **Start somewhere**
  - **Go where the money is**
  - **Get buy-in from elected and appointed officials**
  - **Involve as many employees as possible**
  - **Document everything**



# Fraud Risk Assessment

- **Five Step Plan**
  - **Step 1 – Gather information about the government and its environment**
  - **Step 2 – Analyze the information and consider whether fraud conditions exist**
  - **Step 3 – Identify the risks of material misstatement (likelihood and significance)**
  - **Step 4 – Assess fraud risks and develop control activities**
  - **Step 5 – Report on results**



# Control Activities

- **Actions established by policies and procedures to mitigate risks identified in the risk assessment**
  - **Select and develop control activities**
  - **Select and develop general controls over technology**
  - **Implement controls through policies and procedures**



# Control-related Policies and Procedures

- **Adopt financial policies**
  - **Documents the various responsibilities and lines of authority**
  - **Communicates expectations of how financial transactions will be reported**
  - **Enables a discussion of how the town would like its finances to be handled**



# Control-related Policies and Procedures

- **Document procedures**
  - **Spell out how each process is supposed to be handled, who does what and how**
- **Document control activities**
  - **Prevention controls**
  - **Detection controls**
  - **Avoidance controls**



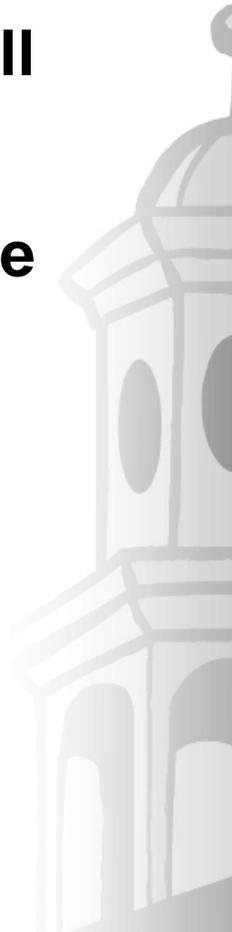
# Control-related Policies and Procedures

- **Compensating controls**
  - **Segregation of duties**
  - **Authorization of transactions**
  - **Periodic reconciliation and verification**
  - **Timely financial statements**
  - **Analytical review**
  - **Security of assets and records**
  - **Properly designed records**



# Information and Communication

- **Policies and procedures are communicated to all appropriate personnel**
- **Communication from staff of procedures that are no longer working or need to be improved**



# Monitoring

- **Policies and procedures need to be reviewed on a regular basis to make sure they function at optimal efficiency**
  - **On-going risk assessment**
  - **As risks change, policies and procedures should change**



# Best Practices - General

- **Demonstrate a commitment to competence**
- **Document policies, procedures and practices**
- **Take steps to reduce the opportunity to commit fraud**
  - **Annual vacations for accounting employees**
  - **Proper supervision and review of employees' work**
  - **Regular financial reporting and review of budgetary status**
  - **Bonding of all employees who handle municipal funds**



# Best Practices – Financial Records

- **Establish and maintain adequate systems and processes for accounting and reporting**
  - **Allow financial transactions to be recorded, easily retrieved for analysis, and provide for generation of timely financial reports**
  - **Approval of general journal entries by management**
- **Maintain proper separation of duties**
  - **Bank reconciliations should be performed by someone not involved in the receipt or disbursement process**
  - **Perform regular reconciliations of other accounts**
  - **All financial recording documents should be pre-numbered and all forms should be accounted for**
  - **Safeguard accounting records**



# Best Practices - Cash

- **Establish adequate processes for safeguarding receipts**
  - **Adopt a cash receipts policy**
  - **Restrictively endorse checks on receipt and deposit on a timely basis**
  - **Prepare duplicate receipts for all transactions**
- **Establish adequate processes for safeguarding disbursements**
  - **All disbursements by check or direct deposit**
  - **Select board orders must be prepared for all purchases and signed by a majority of the board**
  - **Petty cash funds (when needed) should be handled on an imprest, or fixed amount, basis**



# Best Practices – Accounts Receivable and Collections

- **Establish and maintain process that will ensure that account balances are correct**
  - **Maintain adequate separation of duties**
  - **Record all receivables in the general ledger (taxes, utilities, miscellaneous)**
- **Establish and maintain process that will ensure that outstanding amounts due are collected**
  - **All invoices for all departments should be forwarded to finance office for processing**
  - **Prepare regular aged listing of receivables**
  - **Send regular statements to all customers**
  - **Charge interest and penalties on all overdue accounts**



# Best Practices – Purchasing and Disbursements

- **Establish and maintain processes that ensure adequate oversight**
  - **Adopt a purchasing policy**
  - **Implement a purchase order system**
  - **Maintain adequate separation of duties**
  - **Ensure proper approval of all invoices**
  - **Install procedures to detect fictitious vendors and duplicate payment of invoices**



# Best Practices - Payroll

- **Establish and maintain adequate systems for ensuring accuracy and oversight**
  - **Maintain a personnel file that includes hiring and compensation information and authorization for all deductions**
  - **Salary and wage information must be adopted annually by the select board for all employees**
  - **All payroll changes should be authorized by someone who does not process payroll**
  - **Use direct deposit for payment of net pay**
  - **Adopt leave policies and properly document the accumulation and use of leave time**



# Best Practices – Grand List and Tax Records

- **Establish and maintain adequate process to ensure that records are accurate**
  - **Make certain all properties are included in the grand list (including improvements)**
  - **Changes to values should be maintained and reconciled on a regular basis**
  - **Reconciliation of tax receivables with tax receipts and tax adjustments on a monthly basis by someone other than the tax collector**
  - **Adopt policies concerning collection actions, and follow up on delinquencies**



# Best Practices – Property and Equipment

- **Establish and maintain adequate systems and processes to ensure that schedules are accurate and inventory is secure**
  - **Prepare and maintain fixed asset schedules and conduct periodic follow-up**
  - **Maintain proper security**
  - **Review insurance coverage to determine its adequacy**



# Best Practices – Information Systems

- **Establish and maintain adequate systems and processes to ensure that data is secure**
  - **Limit access to financial records to those who require specific access**
  - **Back up computer records regularly and store back-up copies off site**
  - **Use passwords to protect all financial information and change them on a regular basis**



# Internal Control Checklist

- **VLCT Internal Control Checklist**
  - [http://www.vlct.org/assets/MAC/vlct\\_municipal\\_internal\\_controls\\_checklist.pdf](http://www.vlct.org/assets/MAC/vlct_municipal_internal_controls_checklist.pdf)
  - **Designed to assist in reviewing internal controls**

