

Ask the Expert: Internal Control Risk Assessment



Topics

- Audit concepts you need to know
- General Risks
- Fraud risk
- Risk assessment
- Risk management and internal control
- Tips for audit preparation and efficiency



Audit Concepts

- What is an audit?
- What does “reasonable assurance” mean?
- Material misstatement
- How recent standards affect your audits
- What is the cost of a benefit?



Basics of Risk Assessment

- Key concepts
- Your board’s role
- Concepts unique to libraries
- Internal control documentation guidelines
- Consideration of grant requirements



Risk from What?

- Mission failure
- Fraud and abuse
- Noncompliance with regulations
- Inaccurate financial information



Features of Risk Assessment

- Influencers
- Events
- Vulnerability
- Likelihood
- Impact
- Control



Fraud Risk

- Financial statement fraud
- Misappropriation of assets
- Risk factors
 - Incentives
 - Opportunity
 - Rationalization



Fraud Prevention Tips

- Know your expectations
- Red flags
- Prevention is the key

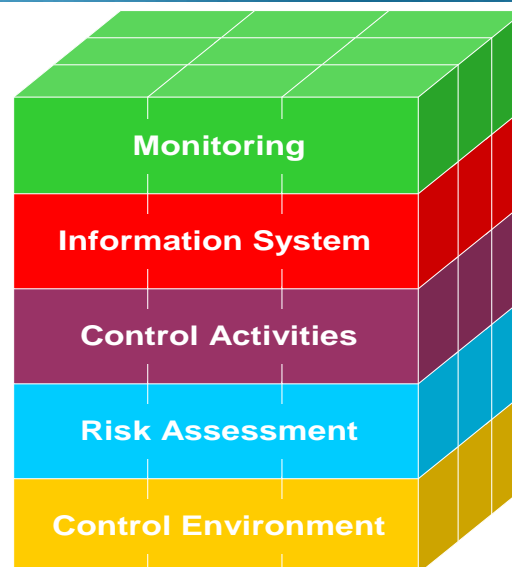


Internal Control Basics

- What is internal control . . . really?
- A framework so you can stay on course to:
 - Achieve your mission
 - Meet budget and financial goals
 - Comply with regulations
 - Minimize surprises along the way



Elements of Internal Control



Internal Control - Audit Focus

Focus:

- Financial-related controls
- Single Audit controls

Levels of Understanding:

- System design
- Policies and procedures used
- Effectiveness of policies and procedures



Internal Control - Audit Requests

- Understanding auditors' requests
 - Forms
 - Memos
 - Flowcharts
 - Questionnaires
- Examples of forms
- Efficient audit preparation
- Documentation guidelines



How to Assess Internal Control

- Understand:
 - Significant areas of operations
 - Flow of transactions
 - Who does what
- Look for policies or procedures that:
 - Prevent mistakes
 - Verify performance



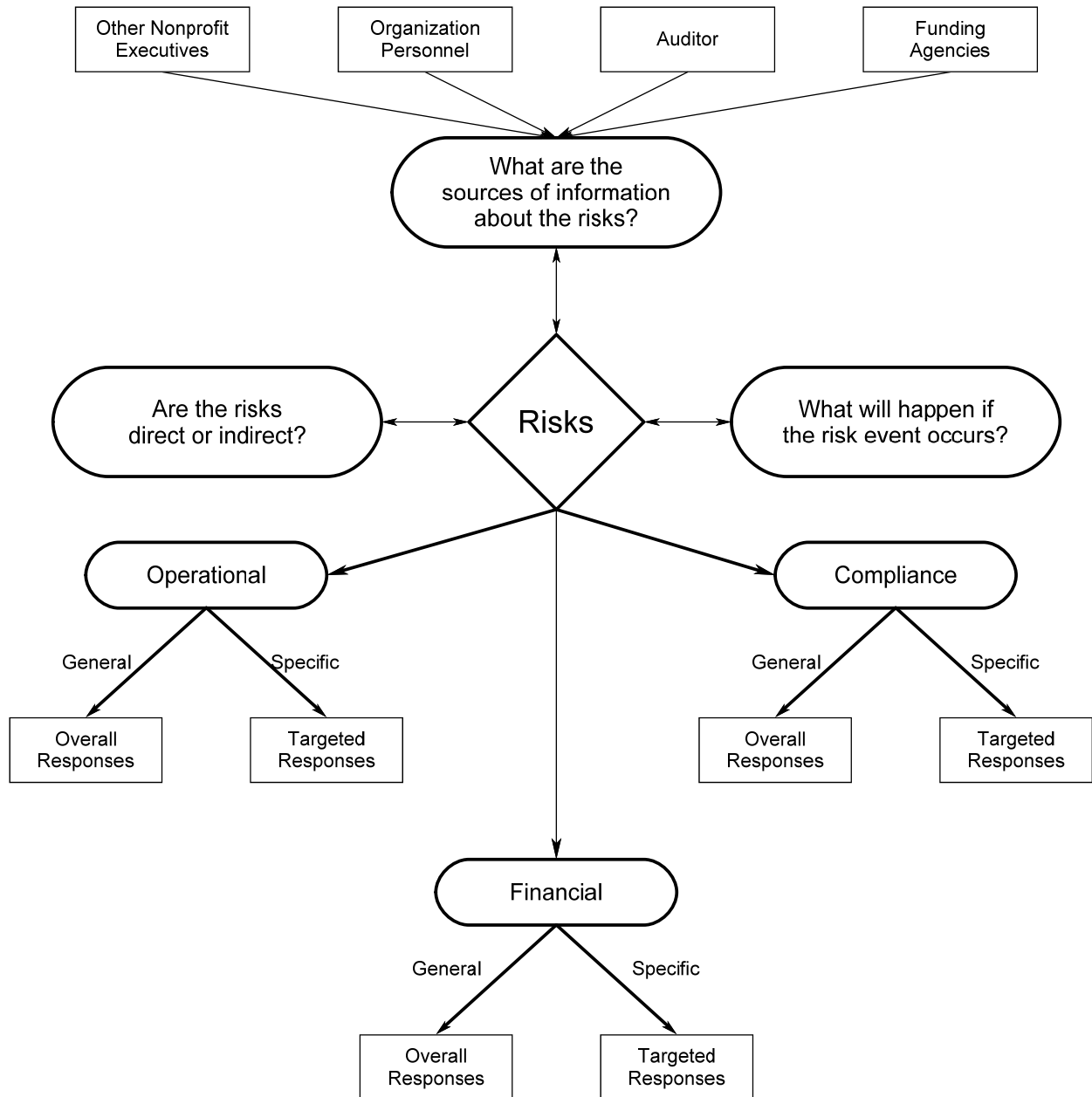
Audit Preparation

- How to prepare for your audit
- Audit efficiency tips

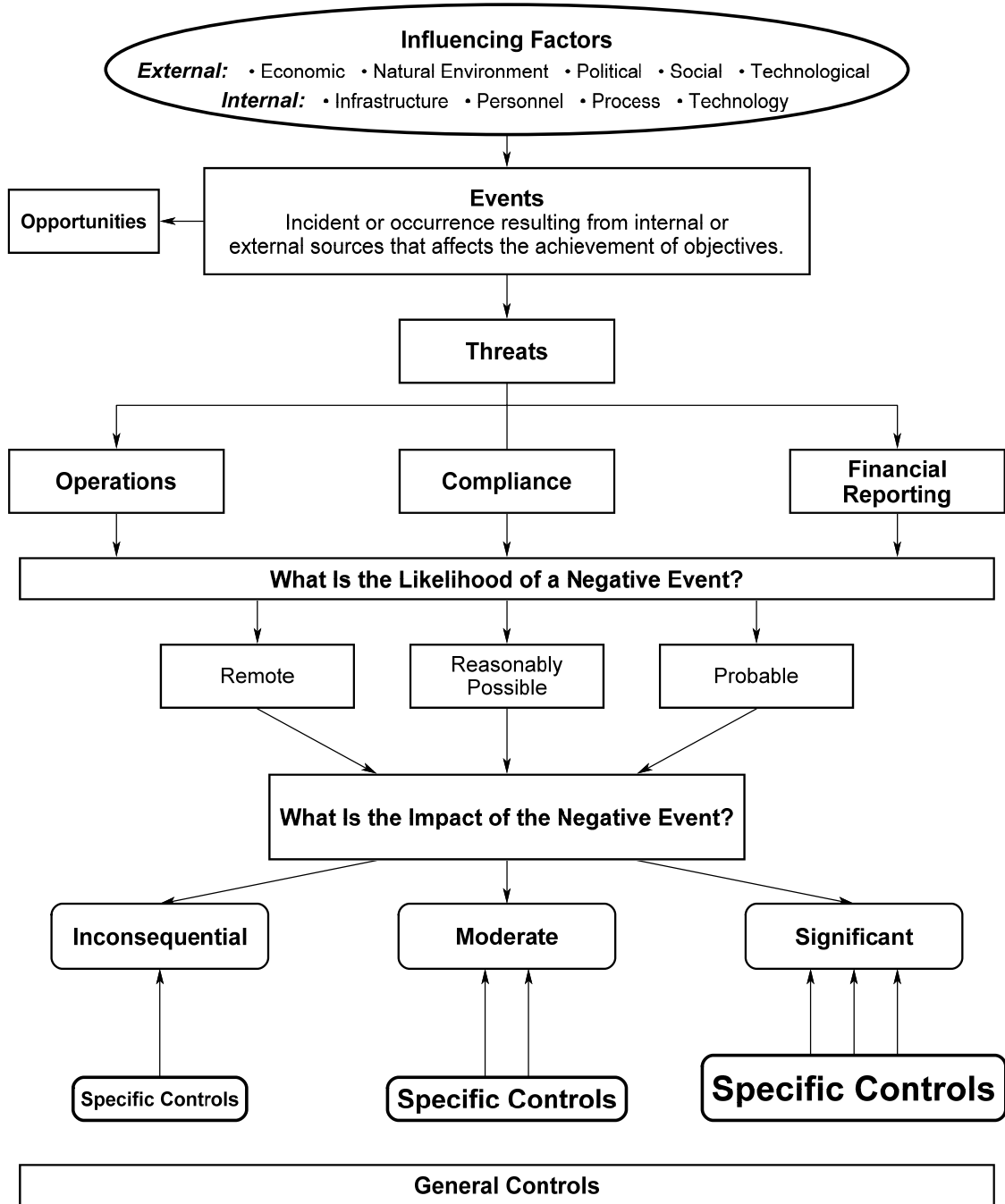


GENERAL RISKS

Elements of Risk Decisions



Events and Risk



External and internal events and circumstances can affect a library’s objectives to: 1) safeguard assets, 2) record accurate financial information, and 3) comply with regulations and grant requirements. When these objectives are hindered, the associated risk increases. The extent to which objectives are hindered represents likelihood. The magnitude of the effect (vulnerability) represents materiality. Here are examples of risks and the possible consequences of those changes.

<i>Examples of Risk Factor</i>	<i>Possible Effect of Risk Factor</i>
Changes in operating environment	<ul style="list-style-type: none"> • Pressure under which personnel perform which could lead to more mistakes • Lax attitudes toward internal control which could lead to circumvention of controls
New personnel	<ul style="list-style-type: none"> • Errors in performance • Uncertainty over communication procedures • Lack of awareness of deviation conditions
New or revamped information systems	<ul style="list-style-type: none"> • New reports might not show same information as old reports • New systems might process information differently • Changes in input processes
Rapid growth	<ul style="list-style-type: none"> • Accuracy in recording transactions due to increased pressures on existing staff
New technology	<ul style="list-style-type: none"> • Obsolescence of inventory • Impairment of assets
New organizational models, services, or activities	<ul style="list-style-type: none"> • Changes in the reporting entity • Changes in the composition of governance group could alter the collective expertise of that group
New grants or other sources of funding	<ul style="list-style-type: none"> • Changes in personnel responsible for monitoring • Changes in compliance reporting •
New accounting standards	<ul style="list-style-type: none"> • Implementation of new reporting requirements might require skills not present in the library

Management Survey – Internal and External Conditions

Use this survey to identify events, conditions, or other factors that influence the library, its financial statements, balances, transaction classes, grant compliance, or funding. Additional questions can be added as necessary.

Survey of Internal and External Conditions	
Questions	Response
What have been the 5 most significant non-financial events, changes, or conditions that affected the library during the past year?	
What do you expect to be the most significant non-financial events, conditions, or observations that will affect the library in the coming year?	
What do you consider to be the most important non-financial measures or benchmarks for your library?	
What competitive conditions affected the library the most during the year?	
What regulatory events or conditions had (or will have) the greatest impact on library?	
In what areas has risk increased the most during the past year for the library as a whole?	
In what financial statements areas has risk increased the most during the past year as compared to the prior year?	
What changes have occurred within the Board during the year?	
What changes have occurred within the accounting staff during the year?	
How has your IT hardware changed during the year?	
How has your IT software changed during the year?	
What trends have you monitored in the past year and what have been your observations?	

Survey of Internal and External Conditions	
Questions	Response
What events or conditions had the greatest effect on revenue this year?	
What events or conditions are expected to have the greatest effect on revenue next year?	
What events or conditions had the greatest effect on expenses this year?	
What events or conditions do you expect to have the greatest effect on expenses next year?	
How has the revenue mix changed this year compared to last year?	
What are the most predictable determinants of revenue?	
How is the budget prepared?	
What are the most predicable determinants of expense?	
Did you incur fixed costs in the current year that you did not have in the prior year?	
What new types of expenses did you incur in the current year that you did not incur in the prior year?	
For variable costs, what are the base components?	
If fraud were to occur, where to you believe you are most vulnerable?	
What new grants have you received during the year?	

Overall Risk Assessment

Use this worksheet to identify changes in overall risk factors since the previous evaluation.

Changes in Risk Affecting the Library as a Whole

Industry Conditions

Operational

Financial

Competitive

Regulatory

Other

Overall Risk Assessment (cont.)

Changes in Risk Affecting Operations, Account Balances, Specific Types of Transactions

Internal Factors

External Factors

Information Technology Factors - Risk Reducers

Information Technology Factors - Risks

Other

Changes in Risk Related to Decision-Makers

Other Risk Changes

FRAUD RISKS

Factors That Precipitate Misappropriation of Assets

The presence of adverse employee relationships with an entity or employee financial pressure can foster conditions that increase to risk of fraud. An auditor is not required to plan the audit to discover this information, but may become aware of it while performing other procedures.

- Personal financial stress.
- Greed.
- Substance abuse.
- Decreased job security.
- Revenge.

When these personal conditions are present, the opportunity for theft increases when the following *organizational* conditions are also present:

- Assets susceptible to misappropriation: The nature of the entity's assets and the degree to which they are subject to theft.
- Controls: The lack of controls designed to prevent or detect misappropriation of assets.

Risk Factors Relating to Misstatements Arising from Misappropriation of Assets

Risk factors that relate to misstatements arising from misappropriation of assets are also classified along the three conditions generally present when fraud exists: incentives/pressures, opportunity, and attitudes/rationalizations. Some of the risk factors related to misstatements arising from fraudulent financial reporting also may be present when misstatements arising from misappropriation of assets occur. For example, ineffective monitoring by management and weaknesses in internal control could be present when misstatements due to either fraudulent financial reporting or misappropriation of assets exist. The following are examples of risk factors related to misstatements arising from misappropriation of assets.

Incentives/Pressures

- a. Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.
- b. Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft could motivate those employees to misappropriate those assets. For example, the following could create adverse relationships:
 - Known or anticipated future employee layoffs.
 - Promotions, compensation, or other rewards inconsistent with expectations.

Opportunities

- a. Certain characteristics or circumstances can increase the susceptibility of assets to theft. For example, opportunities to misappropriate assets increase when:
 - Large amounts of cash are on hand or processed.
 - Inventory items are small in size, of high value, or in high demand.
 - Assets are easily convertible, such as bearer bonds, diamonds, or computer chips.
 - Fixed assets that are small in size, marketable, or lack observable identification of ownership.
- b. Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:
 - Inadequate segregation of duties or independent checks.
 - Inadequate management oversight of employees responsible for assets, e.g., inadequate supervision or monitoring of remote locations.
 - Inadequate job applicant screening of employees with access to assets.
 - Inadequate recordkeeping with respect to assets.
 - Weak system of authorizing and approving transactions e.g., in purchasing).
 - Poor physical safeguards over cash, investments, inventory, or fixed assets.
 - Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.
 - Lack of mandatory vacations for employees performing key control functions.
 - Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.
 - Inadequate access controls over automated records.

Attitudes/Rationalizations

Risk factors reflective of employee attitudes/rationalizations, that allow them to justify misappropriations of assets, are generally not susceptible to observation by the auditor. Nevertheless, the auditor who becomes aware of the existence of such information should consider it in identifying the risks of material misstatement arising from misappropriation of assets. For example, auditors may become aware of the following attitudes or behavior of employees who have access to assets susceptible to misappropriation:

- Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
- Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to correct known internal control deficiencies.
- Behavior indicating displeasure or dissatisfaction with the company or its treatment of the employee.
- Changes in behavior or lifestyle that may indicate assets have been misappropriated.

Consideration of Fraud Risk Factors

1. Factors are not easily ranked or combined into effective predictive models.
2. Presence of factors does not necessarily present a risk of material misstatement.
3. Specific controls can mitigate risks.
4. Assessment is an ongoing process. Conditions that change an assessment include:
 - a) Discrepancies in the accounting records.
 - b) Conflicting or missing evidential matter.
 - c) Problematic or unusual relationships between the auditor and client.

Behavioral Red Flags of Fraud

The 2008 Report to the Nation by the Association of Certified Fraud Examiners identified behavioral red flags present during asset misappropriation fraud schemes.

Behavioral Red Flag	Percentage of Time the Behavioral Red Flag Was Present		
	Less than 10%	Between 10-30%	Between 30-50%
Complained about lack of authority	X		
Excessive family / peer pressure for success	X		
Excessive pressure from within organization	X		
Instability in life circumstances	X		
Refusal to take vacations	X		
Complained about inadequate pay	X		
Past employment related problems	X		
Past legal problems	X		
Irritability, suspiciousness, or defensiveness		X	
Unusually close association with vendor / customer		X	
Addiction problems		X	
Divorce / family problems		X	
Control issues, unwillingness to share duties		X	
Wheeler-dealer attitude		X	
Financial difficulties			X
Living beyond means			X

RISK MANAGEMENT AND INTERNAL CONTROL

How to Design Accounting Functions and Procedures

The following discussion shows some ideas that a library can use to design its accounting procedures. The best design depends on number of variables, like the number of staff, participation by the board, and outside assistance. The central theme guiding any decision should be the separation of incompatible functions. How much separation? That depends on the level of risk a library is willing to accept. An acceptable level is one where the cost of reducing the risk justifies the benefit received. Separation of duties is important regardless of who performs them. In most cases where individuals handle cash or writes checks, it is advisable to obtain fidelity bonds for those individuals. Some libraries use a combination of internal staff, board members, and outside contractors to achieve the desired objectives.

Internal Controls and Segregation of Duties

As mentioned above, the key feature of strong internal control is adequate separation of critical accounting functions. As a general rule, one person should not have access to both physical assets (such as cash, checks or inventory) and the related accounting records or to all phases of a transaction. However, the cost/benefit principle recognizes that a limited number of staff in a library can prohibit an optimum, cost-effective separation of duties. This limitation, in libraries with small accounting staffs, requires the group assigned with financial oversight, such as a finance committee, to remain involved in the library's financial operations through preparation of budgets, oversight of operations, review and analysis of budget-to-actual variances, and the independent review of critical functions.

Payroll

Essential Duties: This function can be performed internally, externally, or using a combination of both. Payroll accounting generally include the following:

- Input of personnel master file information (initial information for new hires; pay rate, and similar changes for current employees)
- Receiving, verifying, and approving time records for accuracy
- Input of payroll information into payroll system
- Preparation and distribution of payroll checks

- Preparation and maintenance of employee payroll earnings records
- Preparation and payment of payroll tax deposits
- Posting of payroll expense, liabilities and tax payments to the general ledger
- Reconciliation of the payroll checking account
- Preparation of quarterly and annual payroll tax returns and W-2s
- Distribution of payroll checks

Here is an example of how a library could use an external payroll service to help separate payroll functions. The process starts with the individual who transmits basic payroll data to the payroll service—usually online. The payroll service then prepares checks or initiates direct deposits, transmits payroll tax deposits, produces payroll journals, returns checks for distribution, initiates employees’ electronic deposits, and prepares quarterly and annual tax returns, including W-2s. Other individuals can be assigned to the remaining functions.

Accounts Payable / Cash Disbursements

Essential Duties: This function can also be performed using the combination of services provided by internal staff (full or part-time) or an independent contractor. Accounts payable and cash disbursement functions generally include the following:

- Setup, maintenance and approval of new vendors in the accounts payable system
- Receipt of invoices
- Coding or verification of invoice coding
- Input of invoices into the accounts payable system
- Maintenance and monitoring of open invoices
- Custody of blank check stock and if applicable, signature plate or electronic signature
- Preparation of checks for signature
- Posting of accounts payable activity to the general ledger
- Signing of checks and review of attached documentation
- Mailing of checks
- Reconciliation of accounts payable control accounts to the general ledger

Department managers, using a standard chart of accounts, can code invoices to show which general ledger account a disbursement should be assigned to. On scheduled basis, the approved invoices should be recorded into the accounts payable system. Someone other than by the person who recorded the cash disbursements in the general ledger should sign the checks. The person who prepares checks should not be the same person who reconciles the bank statement.

Approval of checks together with supporting documentation is important. This procedure should be performed by someone other than the person who prepared the checks. After preparation, the check should not be returned to the person who prepared it. For example, the mailing function could be performed by the Executive Director's administrative assistant.

Cash Receipts / Accounts Receivable

Essential Duties: Internal staff is likely the best way to perform this function since receipt of cash or checks is generally a routine occurrence. Cash receipts and accounts receivable functions include the following:

- Receipt of mail or collection at special events
- Separation and logging of cash receipts
- Preparation of bank deposit
- Deposit of cash receipts
- Posting of accounts receivable activity
- Reconciliation of the monthly bank statement
- Monitoring the collection of accounts receivable

Since cash receipts should generally be deposited on a daily basis, it probably makes sense to use internal personnel to perform this function. The key responsibilities to separate are: 1) receiving and logging cash (or checks); 2) depositing the receipts; and 3) recording the cash receipts in the general ledger. An administrative person could perform the first procedure with a different person depositing receipts. An independent contractor or someone in controller position could perform the general ledger recording and reconciliation function.

General Accounting

Essential Duties: This role includes those functions performed by a controller, although not all functions require that level of expertise. In addition, individuals outside the accounting department could perform some functions. General accounting includes the following:

- Approval of invoices for payment
- Reconciliation of bank statements
- Recording and reconciliation of investment activity
- Preparation and recording of monthly accruals and adjusting entries
- Identify and develop estimates used in the financial reporting process
- Reconciliation of account balances against control accounts

- Recording fixed assets activity
- Preparation of monthly financial statements
- Preparation of annual operating budget
- Analysis of monthly variances between budget and actual amounts
- Oversight of general ledger software
- Preparation and recording of year-end adjusting entries
- Preparation of annual financial statements
- Monitoring the method of cost allocations

The person who performs these functions can be a member of the staff, a board member, treasurer, or an independent contractor. The level of expertise needed to perform these functions is generally higher than that required for the other functions. In addition, many of the functions are interrelated. As a result, the same person often performs these functions.

Internal Control – Separation of Duties Chart

Client:

Indicate the name and position of each individual responsible for a critical control function. Then place an "X" in the square representing the control activity performed by that individual.

	INDIVIDUAL/POSITION					
Separation of Duties Chart						
ACTIVITY						
<i>Purchase / Disbursement Activities</i>						
Authorize purchases of goods or services						
Access to / maintain vendor master file						
Match invoice quantities / prices to authorized amounts						
Assign account and program coding to invoices						
Record accounts payable						
Receive / record inventory received						
Review and approve invoices for payment						
Review and approve expense reports						
Prepare checks or authorization for electronic transfer						
Sign checks or initiate electronic transfers						
Custody of signed checks for mailing						
Establish new bank accounts						
Initiate wire transfers						
Receive bank statement						
Reconcile bank statement						
Reconcile outstanding payables to general ledger						
<i>Revenue / Cash Receipts Activities</i>						

INDIVIDUAL/POSITION

Separation of Duties Chart

ACTIVITY

Authorize sales / set credit limits						
Receive / record orders of goods or services						
Prepare invoices or equivalent record of sale						
Record invoices and related receivables						
Record pledges and contributions						
Prepare budgets for grants						
Reviews grant budgets						
Open mail						
Receive cash receipts (checks or cash)						
Prepare log of cash receipts						
Issue receipts for cash sales or services						
Prepare bank deposit slip						
Approve and make bank deposit						
Record cash receipts in accounting system						
Record receivable activity in A/R system						
Authorize pledge or account receivable adjustments						
Record pledge write-offs or credits						
Reconcile outstanding receivables to general ledger						
Payroll Activities						

INDIVIDUAL/POSITION

Separation of Duties Chart

ACTIVITY

Create / change personnel records						
Assign department and payroll account distribution						
Receive and record election for automatic deposit						
Approve pay rates or salary						
Input pay rate information into payroll system						
Approve pay period hours						
Input hours / salary information into payroll system						
Calculate payroll, withholdings, and adjustments						
Review preliminary payroll for errors						
Approve payroll for disbursement						
Record payroll in general ledger						
Prepare payroll checks						
Sign payroll checks						
Custody of signed payroll checks						
Distribute payroll						
Maintain / update employee benefit information						
General Ledger Activities						

INDIVIDUAL/POSITION

Separation of Duties Chart

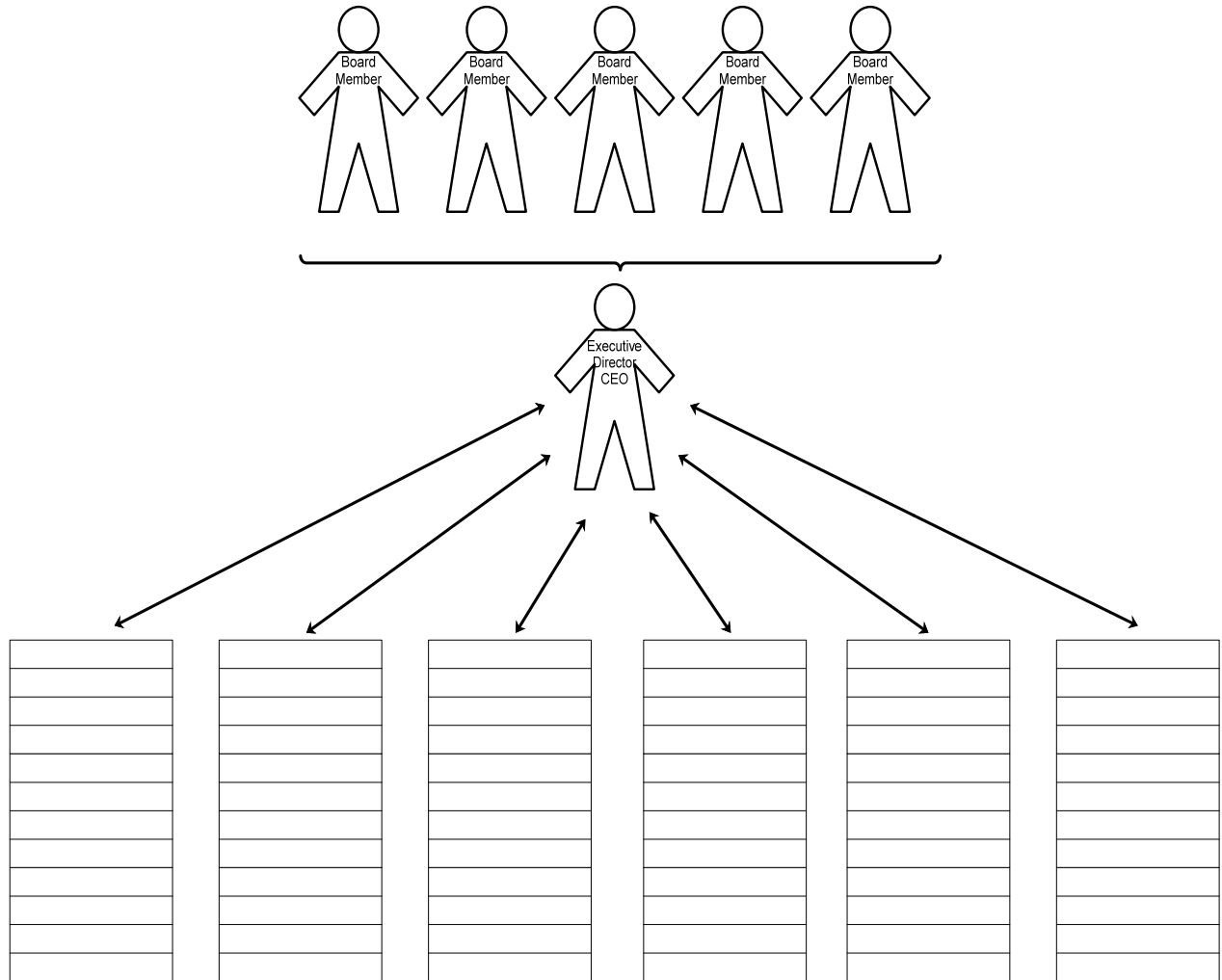
ACTIVITY						
Add / change chart of accounts						
Assign account grouping for financial statements						
Identify year-end adjustments, including cash-to- accrual entries						
Prepare general ledger adjustments						
Approve general ledger adjustments						
Record general ledger adjustments						
Reconcile subsidiary records to general ledger						
Prepare financial statements						
<i>Other Activities</i>						
Open mail						
Perform program expense allocations						
Identify and record pledges and discounts						
Reconcile grant requests to grants received						
Prepare or mail customer monthly statements						
Identify and record capital leases						
Allocate expenses among functional categories						
Maintain fixed asset records						
Approve issuance of debt						
Monitor accounting policies and procedures						
<i>Budgeting</i>						

Separation of Duties Chart	INDIVIDUAL/POSITION					
ACTIVITY						
Prepare the initial budget draft						
Review and approves budget inputs						
Prepare budget amendments						
Approve budget amendments						
Prepare budget variance reports						
Monitor and investigates budget variances						

Based on an assessment of the library’s separation of duties, determine where the design of the library’s separation of duties creates more than in remote possibility of not preventing or detecting:

- Fraud that is more than inconsequential.
- Material misstatement in financial reporting.

Nonprofit Organization Chart



Educational Information for Boards of Directors

This information is intended to help boards of directors refresh their understanding of a board's governance role, including oversight over financial reporting and internal control. While many board members are aware of this role, we believe ongoing communication adds value to the process.

Antifraud Programs and Controls

Libraries generally have certain controls in place designed to prevent material misstatements, whether caused by error or fraud, although separate controls related specifically to fraud may not have been formally implemented.

We recommend that libraries design and adopt a formal fraud policy in conjunction with fraud risk assessment procedures as a way to reduce the risk of incidences of fraud. The risk assessment process starts with consideration of the culture of honesty and high ethics within a library. Cultures of honesty and high ethics clearly communicate acceptable behavior and expectations of each employee. Such a culture is rooted in a strong set of core values that provide the foundation for employees as to how a library conducts its operations. It also allows a library to develop an ethical framework that covers (1) fraudulent financial reporting, (2) misappropriation of assets and (3) corruption, as well as other issues. Maintaining this culture requires that a library monitor the following segments of its internal control:

- Tone at the top
- Maintenance of a positive workplace environment.
- Hiring and promoting appropriate employees.
- Training about the library's values and its code of conduct.
- Confirmation that all employees will be held accountable to act within the library's code of conduct.
- System of discipline through which an organization communicates the way it reacts to incidents of alleged or suspected fraud, including expectations about the consequences of committing fraud.

Neither fraudulent financial reporting nor misappropriation of assets can occur without a perceived opportunity to commit and conceal the act. To reduce opportunity risk, a library should:

- Identify and measure fraud risks.
- Take steps to mitigate identified risks.
- Implement and monitor appropriate preventive and detective internal controls and other deterrent measures.

While a library's existing internal controls can contribute to antifraud objectives, establishing an ongoing, formal antifraud program, including the adoption of a formal fraud policy, can strengthen a library's existing internal control for preventing and detecting material misstatements on a timely basis.

Board of Directors' Normal Role in Fraud Risk Assessment

With the growing emphasis on the role that boards of directors and audit committees serve in fraud prevention, it is important to communicate developments that may be of interest to you. For libraries without a formal audit committee, the board as a whole assumes the role of an audit committee. The risk of management override of internal controls is present in every library. To help organizations address this issue, American Institute of Certified Public Accountants has issued the publication, *Management Override of Internal Controls: The Achilles Heel of Fraud Prevention*. This document is designed to facilitate an audit committee's consideration of this particular fraud risk. For organizations without a formal audit committee, the guidance is useful to those performing that function. By effectively overseeing management and addressing the risk of management override, audit committees increase the likelihood of preventing, deterring and detecting fraudulent financial reporting. The document discusses an audit committee's responsibilities related to the risk of management override of internal controls. In addition, it outlines the actions that an audit committee should take in conjunction with their risk assessment process. We are available to discuss this matter with you in greater detail or provide assistance with implementing the concepts outlined in the guidance in order to help your board carry out its oversight responsibilities.

Not-for-Profit Organization Governance

While the Sarbanes-Oxley Act of 2002 (SOX) does not apply generally to nonprofit organizations, some stakeholder groups have hinted that certain provisions of SOX might be desirable. As a result, boards of directors of nonprofit organizations continue to evaluate their governance responsibilities. Here are a few items related to governance that we consider to be sound practices to consider as you monitor your governance process.

Remind the board of directors of its overall responsibility for establishing and maintaining an adequate internal control structure. This includes the establishment of an audit committee function. In smaller libraries, a finance committee often performs this function. It also includes oversight of any internal audit function; however, a separate internal audit function is not typically common in smaller libraries.

Provide your board of directors with training in its fiduciary responsibilities. The fundamental responsibilities of a board of directors are generally considered to include:

- Determining the library's mission.
- Selecting and evaluating the library's top administrative staff.
- Ensuring the integrity of the financial reporting process.
- Providing program oversight.
- Raising the funds necessary to carry out the library's programs.

Develop an organizational code of ethics. This should cover not only employees, but also senior management and members of the board of directors. The term "code of ethics" generally means a set of standards that promote honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships; full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and compliance with applicable governmental rules and regulations.

Establish a conflict-of-interest policy. This policy should define the library's policy with respect to transactions or arrangements that either create a conflict-of-interest or the appearance of a conflict. This policy would apply to individuals (or their immediate families) who are board members, officers, management, major donors, or others with significant influence over the library. Examples of the topics that could be covered by a conflict-of-interest policy include, but are not necessarily limited to:

- Ownership or managerial interests in an organization with whom the library conducts transactions.
- Ownership interests in real estate, investments or assets that the library might acquire.
- Transactions between the library and employees or board members.
- Use of the library's assets or other resources, such as personnel or supplies, for purposes other than activities or programs sponsored by the library.
- Receipt of personal gifts or favorable transaction terms from a third party.
- Use of staff time during normal business hours for personal business or other activities not related to the library's mission.

The preceding guidance does not cover all aspects of organizational governance, but it shows some of the primary areas in which to focus.

Control Environment Relative Strength Chart

Use this chart to self-assess the primary features of the library’s control environment. Of particular importance in a smaller library is whether the control features are actively used (implemented.) Place an “X” in the box that corresponds to the control feature’s relative strength. An attribute with high strength is one that has been implemented in a way that contributes to the prevention or detection of material misstatements in the financial statements.

This approach can be useful in small libraries with limited separation of duties where management is also part of the governance group. For convenience, the term “board” is used to denote those on charge of governance.

Strength (1 = low; 7 = high)

Control Environment Attributes	1	2	3	4	5	6	7
<i>Integrity and Ethics</i>							
Management displays appropriate ethical values that are understood at all levels of the library							
Processes are in place to monitor adherence to the principles of sound integrity and ethical values and deviations are appropriately addressed							
<i>Governance</i>							
Board has identified the authorities it retained as compared to authorities delegated to management							
Board understands the library’s operational transactions and can evaluate whether the financial statements are presented fairly in conformity with the library’s basis of accounting							
Ability of board to evaluate the actions of management							
Independence of the governance group							
Board is large enough to function effectively							
Frequency of communication between board and management							
Governance group takes an active role in assessing risk and monitoring internal control							

Strength (1 = low; 7 = high)

Control Environment Attributes	1	2	3	4	5	6	7
<i>Management Philosophy and Style</i>							
Management actively communicates to employees their responsibilities for properly following internal control policies and procedures							
Management monitors internal control and adjusts its policies and procedures as necessary							
<i>Other Attributes</i>							
The organizational structure is appropriate for the library							
Accounting personnel have appropriate competencies for the financial reporting required							
Management and employee have appropriate levels of authority to facilitate effective internal control							

Comments and conclusions:

Internal Control Documentation: Accounts Payable / Cash Disbursements

Year Ending:	By:	Date:
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THIS DOCUMENT SHOWS SAMPLE CONTENT FOR AN INTERNAL CONTROL DOCUMENTATION MEMO.

We obtained our information about this area of internal control from:

_____	Title: _____
_____	Title: _____

Vendor Set-up/Maintenance

Describe the method for identifying and approving new vendors.

Describe the process for adding new vendors to the master vendor file.

Indicate the nature of information entered into the master vendor file.

Indicate the name of the computer application or modules used to input vendor information.

Indicate the name of the computer screen (perhaps get a copy of screen) used for data input.

Describe the process for initiating, approving and entering vendor master file changes, such as name and address changes, etc.

Indicate the names of the positions and individuals who enter vendor master file information.

Accounts Payable Access

Describe how the library grants and monitors access to its cash disbursements and accounts payable and related application programs. In addition, indicate who has permission to establish or change access rights. For example, access should only be granted to those with a logical need for the particular application.

Describe or reference the user ID and password policies for applications used in this area.

Purchasing

List the approval thresholds (e.g., no approval for routine items, dept. head only, board, etc.).

Indicate the types of items require purchase orders vs. bids vs. invoice approval only.

Describe the purchase order initiation, routing and approval process.

Indicate the filing locations for the various copies of the purchase order.

Describe the process for matching purchase order details to the quantities actually received and to the quantities and prices on the subsequent invoice.

Receipt and Approval of Vendor Invoices

Describe the process for receiving and distributing mail to the appropriate departments/individuals.

Describe the process and employee positions responsible for approving invoices for payment.

Describe the process, if applicable, for matching invoice terms to the associated purchase order.

Describe the routing process for invoices once they have been approved.

Account Coding

Indicate whether the library uses a standard chart of accounts.

Note: For libraries that receive federal funds, the assignment of an account number can affect the recording of costs to federally-funded programs. If applicable, describe the process of assigning accounts payable or cash disbursements to a federal program. This could be accomplished through the assignment of the account number. In addition, document the controls in place that help prevent an improper assignment of an expense to a federal program, i.e., how is the account coding is verified?

Describe the process for adding and approving new general ledger accounts.

Indicate the position(s) responsible for assigning account codes to invoices.

Accounts Payable Data Entry

Indicate the name of the software program used for accounts payable data entry.

Indicate the positions and names of individuals who receive approved invoices for data entry.

Indicate the name of computer screen (or obtain a copy of screen) used to input accounts payable data.

Describe the process for entering approved invoices into the accounts payable system.

Verification of Data Input

List the primary reports generated from the accounts payable data entry process.

Describe the process for reconciling data entry to output (e.g., what edit checks are used).

Describe the process for identifying and correcting data input errors.

Check Printing, Disbursement, and Distribution

Describe the process for approving accounts payable for disbursement.

Indicate who maintains security of check stock and custody of signature plate.

Is pre-numbered check stock used?

Describe how check stock numbers are accounted for.

Describe the process for preparing checks and recording in the accounting records.

Indicate who signs checks, mails them, and has custody of the checks after they are signed.

Bank Accounts

Describe the process by which a new bank account is authorized and established.

Describe the frequency with which authorized signatures are verified with financial institutions with which the library has accounts.

Electronic Transfers of Funds

Describe the controls in place to prevent transfers of funds or investments by anyone other than authorized personnel.

Describe the verification procedures in place at the financial institution initiating the transfer.

Describe the verification procedures, such as the use of personal identification numbers, in place at the library to safeguard against unauthorized attempts at fund transfers.

Accounts Payable Reconciliation and Adjustments

Describe the process for reconciling vendor balances to accounts payable control account.

Describe the process for initiating, approving, and recording adjustments to vendor accounts.

Open Accounts Payable

Describe the process for gathering and summarizing information for year-end accruals.

General Ledger Adjustments and Reconciliation

Describe the process for reconciling the accounts payable detail to the general ledger control account.

What are the expected type and number, and size of journal entries affecting the account.

Describe the process for initiating and approving journal entries.

Bank Reconciliation

Indicate the name and position of the individual who:

- Receives the unopened bank statements.
- Prepares and approves the bank reconciliation.
- Reviews the bank reconciliation.
- Reviews the cancelled checks or their electronic images

Is a “positive pay” process used with respect to the disbursement of funds?

Other Information

Based on your understanding of accounts payable and general disbursements, which controls do you perceive to be the strongest at preventing or detecting material misstatements in financial reporting?

Internal Control Documentation: Revenue / Accounts Receivable / Cash Receipts

Year Ending:	By:	Date:
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THIS DOCUMENT SHOWS SAMPLE CONTENT FOR AN INTERNAL CONTROL DOCUMENTATION MEMO.

We obtained our information about this area of internal control from:

_____	Title: _____
_____	Title: _____

Account Coding and Chart of Accounts

Indicate the primary accounts used to record revenue transactions.

Describe the mechanism used to verify the account coding used.

Describe the process for adding new accounts.

Indicate the position(s) responsible for assigning account codes to sales/revenue orders.

Customer/Client Set-up/Maintenance

Describe the method for identifying and approving new customers.

Describe the process for adding new customers to the master customer file.

Indicate the nature of information entered into the customer master file.

Indicate the name of the computer application used to input customer information.

Indicate the name of the computer screen (or obtain copy of screen) used for master file data input.

Indicate the names of the individuals (and their positions) who enter information into the customer master file.

Describe the process for initiating, approving and entering customer master file changes, such as name, address, payment terms, credit limits, etc.

Credit Approval

Describe the process and authorization thresholds for approving revenue terms (e.g., no approval for small items, dept. head only, board, etc.).

Identify the types of items that require sales orders.

Describe the sales order initiation, routing and approval process.

Identify the filing locations for the various copies of the sales order.

Describe the process for matching sales order details with subsequent shipping documents.

Sales/Revenue Invoice Processing

Describe how sales or revenue transactions are initiated and approved.

Describe the control policies and procedures that are in place to ensure that revenue prices and terms are determined and approved in accordance with the library's policies.

Indicate which programs are used to record and track open sales/revenue orders prior to delivery of the goods or services.

Indicate how the library initiates and approves its billings to customers/clients.

Indicate whether pre-numbered sales orders, shipping vouchers or invoices are used and how the numeric sequence is monitored.

If applicable, describe the process and documents used to assemble goods for shipment and how the quantity of goods is matched to the customer's sales order.

Describe the process by which checks are signed and mailed.

Open Sales Orders

Describe the process for monitoring open sales orders.

Receipt and Recording of Cash Receipts

Describe the process for receiving and distributing mail to departments/individuals.

Describe the process for opening mail and preparing a log of cash receipts.

Describe the process for preparing pre-numbered cash receipts vouchers.

Describe the process for preparing bank deposits and delivering the deposits to the bank.

Indicate who receives the bank statement and prepares the monthly bank reconciliation.

Indicate the process for recording cash receipt information into the customer accounts receivable records and for recording the control total into the general ledger.

Indicate the extent to which receipts are deposited directly to a financial institution through a lock box arrangement and whether daily deposits are reconciled by someone other than the individual who records receipts in the accounts receivable records.

Indicate whether fidelity bonds or equivalent theft insurance is carried for individuals with responsibility for handling cash.

Accounts Receivable Data Entry

Identify the name of the computer program used to enter sales/revenue data into the accounts receivable system.

Indicate the name of the computer screen used data entry (or obtain a copy of the screen.)

Identify the position and name of the person who receives approved sales/revenue invoices for entry into the accounts receivable system.

Describe the process for, if applicable, for matching invoice terms to the associated external purchase order and/or shipping documents.

Describe the process for entering approved billings into the sales and accounts receivable system.

Identify the reports generated from the accounts receivable entry process.

Describe the reconciliation process performed between data entry and output.

Verification of Data Input

Indicate the reports generated from the Revenue and accounts receivable data entry process.

Describe the reconciliation process performed between data entry and output (e.g., what edit checks are used).

Describe the process for identifying and correcting errors in the data input.

Accounts Receivable and Cash Receipts Access

Describe how the library grants and monitors access to its accounts receivable and cash receipts and related programs. In addition, indicate who has permission to establish or change access rights. For example, access should only be granted to those with a logical need for the particular application.

Describe or reference the user ID and password policies for applications used in this area.

Accounts Receivable Reconciliation

Describe the process for reconciling customer balances to accounts receivable control account.

Allowance for Doubtful Accounts and Bad Debts Write-Offs

Describe the process by which the library estimates its allowance for doubtful accounts.

Indicate who prepares the allowance for doubtful accounts and what information is used to support the underlying estimates.

Describe the process for identifying, initiating, approving, and recording adjustments to customer balances, including write-offs.

General Ledger Adjustments and Reconciliation

Describe the process for reconciling accounts receivable subsidiary ledger balances to the general ledger control account.

Describe the process used to estimate, monitor, and adjust the allowance for doubtful accounts.

Indicate the expected type, number, and size of journal entries for this account.

Bank Reconciliation

If not already described elsewhere, indicate who:

- Receives the unopened bank statements?

- Prepares and approves the bank reconciliation?
- Reviews the bank reconciliation?

Other Information

Based on your understanding of revenue, accounts receivable, and cash receipts, which controls do you perceive to be the strongest at preventing or detecting material misstatements in financial reporting?

Internal Control Documentation: Payroll

Year Ending:	By:	Date:
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THIS DOCUMENT SHOWS SAMPLE CONTENT FOR AN INTERNAL CONTROL DOCUMENTATION MEMO.

We obtained our information about this area of internal control from:

_____	Title: _____
_____	Title _____

Employee Set-up/Maintenance

Describe the method for identifying and approving new employees.

Describe the process for adding new employees to the master personnel/payroll file.

Describe the nature of information entered into the master payroll file.

Indicate the name of the computer application used to input and generate payroll.

Indicate the name of the computer screen (perhaps obtain a copy of screen) used for employee data input.

Describe the process for initiating, approving and entering personnel or payroll master file changes, such as changes for name, address, pay rate or salary changes, department assignments, withholdings, etc.

Indicate the names of the positions / individuals who enter personnel master file information.

Describe how employees are assigned to specific account numbers or department codes for payroll purposes.

Payroll Access

Describe how the library grants and monitors access to its payroll and related programs in this area. This could include Human Resource programs that interface with payroll. In addition, indicate who has permission to establish or change access rights. For example,

access rights should only be granted to those with a logical need for the particular application.

Describe or reference the user ID and password policies for the applications used in this area.

Receipt and Approval of Time Cards or Time Reports

Describe the process for preparing, approving and submitting employee time cards/reports.

Describe the process, if applicable, for reconciling reported hours to scheduled hours.

Describe the routing process for time cards/reports after they have been approved.

Payroll Expense Distribution and Account Coding

Describe how the library assigns general ledger account numbers for payroll expense.

Note: For libraries that receive federal funds, the assignment of an account number can affect the recording of costs of federally-funded programs. This memo should describe the methodology and process of assigning payroll expense to a federal program. The memo should also document our knowledge of the controls in place that help prevent an improper assignment of an expense to a federal program, i.e., how is the account coding is verified?

Describe the process for adding new payroll accounts.

Indicate the positions/individuals responsible for coding personnel to specific account codes or departments.

Describe how payroll expense is allocated to specific departments or general ledger accounts.

Payroll Data Entry

Indicate the name of the computer application used for Payroll data entry.

Indicate the position and name of person who receives approved time cards/reports for data entry.

Indicate the name of the computer screen (perhaps obtain a copy of screen) used for data entry of payroll hours, overtime, or salary, etc.

Describe the process for entering approved time cards/reports into the payroll system.

Verification of Data Input

List the primary reports generated from the payroll data entry process.

Describe how payroll data entry is reconciled to the output (e.g., what edit checks are used).

Describe the process for identifying and correcting errors in the data input.

Check Printing and Distribution

Describe the process for approving payroll for disbursement.

Indicate who maintains security of check stock and custody of signature plate.

Is pre-numbered check stock used?

Describe how check stock numbers are accounted for.

Describe the process for preparing checks and recording them in the accounting records.

Indicate who signs checks, mails checks, and has custody of checks after they are signed.

Indicate the percentage of employees who receive their payroll via direct deposit.

Compensated Absences

Describe the library's policy and process for accumulating and updating vacation, sick or other compensated absences.

Payroll Deposits

Is a separate payroll bank account used?

Describe how deposits for payroll taxes and other withholdings are determined and submitted to the appropriate organizations?

General Ledger Adjustments and Reconciliation

Describe the process for reconciling gross payroll to the payroll expense recorded in multiple general ledger accounts.

Indicate the expected type, number, and size of adjusting journal entries affecting payroll.

Bank Reconciliation

If not already described in another narrative, indicate who:

- Receives the unopened bank statements.
- Prepares and approves the bank reconciliation.
- Reviews the bank reconciliation.
- Reviews cancelled checks or their electronic images.

Is a “positive pay” process used with respect to the disbursement of payroll funds?

Other Information

Based on your understanding of payroll, which controls do you perceive to be the strongest at preventing or detecting material misstatements in financial reporting?

Internal Control Documentation: General Ledger Accounting and Journal Entries

Year Ending:	By:	Date:
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THIS DOCUMENT SHOWS SAMPLE CONTENT FOR AN INTERNAL CONTROL DOCUMENTATION MEMO.

We obtained our information about this area of internal control from:

_____	Title: _____
_____	Title _____

General

Indicate the name and version of the software used to record general ledger activity.

List the primary software modules that interface with the general ledger accounting system.

Indicate the names of other software used to generate accounting information.

Describe how the general ledger is updated with the information from the subsidiary modules, i.e., is the data updated automatically through direct integration with other modules, upon instruction from a user, or manually updated through a journal entry process.

Account Maintenance

Describe the process for creating and approving the use of new general ledger accounts.

Describe the process for updating existing general ledger accounts, such as changing names, account numbers, etc.

Describe the process for assigning or changing the coding used to summarize accounts for report writing purposes.

General Ledger Access

Describe how the library grants access to and monitors access to its general ledger program. In addition, indicate who has permission to establish or change access rights. For example, access should only be granted to those with a logical need for the particular application.

Describe or reference the user ID and password policies for the applications used in this area.

General Ledger Adjustments and Reconciliation

Describe the process for reconciling subsidiary records to the general ledger control accounts.

Describe the process for initiating and approving journal entries.

Describe the nature of the support that is required to accompany manual journal entries.

Identify the nature and frequency of standard, recurring journal entries and whether these are created automatically or manually. In addition, indicate how these journal entries are identified in the general ledger. For example, some automated systems assign specific codes to system-generated journal entries as distinguished from manual journal entries.

Reporting

Summarize the year-end general ledger closing process (e.g., how does the library identify the appropriate and necessary closing entries to prepare.)

Describe the reports used or generated in the year-end closing process.

Describe how the client identifies accounts to combine for financial reporting purposes. For example:

- Is the general ledger chart of accounts coded for specific account combinations?
- Who has the authority or ability to input or change those combination codes?

Describe the process used to reconcile the report totals to the underlying accounting records.

Describe the process used by the library to determine whether all disclosures have been included in its financial statements.

Describe the process for reviewing the financial statements after their initial preparation.

Other information

Based on your understanding of the general ledger, journal entry, and financial statement preparation process, which controls do you perceive to be the strongest at preventing or detecting material misstatements in financial reporting?

Internal Control Documentation: Other Areas

Year Ending:	By:	Date:
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THIS DOCUMENT SHOWS SAMPLE CONTENT FOR AN INTERNAL CONTROL DOCUMENTATION MEMO.

We obtained our information about this area of internal control from:

_____	Title: _____
_____	Title _____

Budgets

Describe the steps used to prepare the initial budget.

Describe the nature and source of financial and nonfinancial inputs used for budget line items.

Describe how the budget inputs are reviewed and approved. This process would normally include consideration of the underlying logic supporting the inputs used and a review of the documentation that supports the budget assumptions.

Describe how budget amendments are prepared and approved.

Describe the documentation maintained to support the development of the budget and its amendments.

Is the budget and its supporting documentation reviewed and approved by someone other than the individual who is responsible for handling cash receipts and cash disbursements?

Unconditional Promises to Give (Pledges)

Describe how promises to give are identified and monitored.

Describe the process for recording promises to give prior to their collection, including recognition of the applicable discount for long-term promises to give.

Other Areas Unique to the Library

Based on your understanding of the library's other areas, which controls do you perceive to be the strongest at preventing or detecting material misstatements in financial reporting?