

## Examples of Internal Control Procedures

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- New employees receive training on internal controls and employee policies.
  - New software requires a reevaluation of policies and procedures to determine if existing controls will continue to be effective and if new controls need to be designed and implemented. (Procedures that worked well under a manual or a previous software system may no longer be applicable under the new system).
  - A change in reporting requires a review of internal controls over the compilation of the report.
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### **Component Three: Control Activities**

Once risks are identified and assessed, management develops control activities to minimize the risks. Control activities detect, prevent, or reduce the identified risks that interfere with the achievement of objectives. Detection activities are designed to identify unfavorable events in a timely manner whereas prevention activities are designed to deter the occurrence of an unfavorable event. Examples of these activities include reconciliations, authorizations, approval processes, performance reviews, and verification processes.

An integral part of the control activity component is segregation of duties. However, in very small governmental units, such segregation may not be practical. In this case, compensating activities should be implemented which may include additional levels of review for key operational processes, random and/or periodic review of selected transactions. In smaller units, these reviews and testing of processes might be performed by governing boards or other elected officials.

#### **Principle 10. Management designs control activities to achieve objectives and respond to risks.**

Management tailors control activities to the functions of the political subdivision and documents the required procedures. The following examples of control activities are categorized by transaction type; the list is not all inclusive and would not necessarily comprise a complete internal control system.

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### A. Payroll Activities

1. Salaries and wage rates are verified by someone outside of the payroll process.
2. The responsibilities for hiring, terminating, and approving promotions are segregated from those preparing payroll transactions or inputting data.
3. The responsibilities for approving time sheets are segregated from those for preparing payroll transactions or inputting data.
4. Payroll adjustment reports are reviewed by someone outside of the payroll process.
5. Employees' time and attendance records are approved by their supervisors.
6. Corrections to recorded time and attendance records are approved by the employee's supervisor and authorized by management.
7. Procedures are in place to ensure that changes in employment status are promptly reported to the payroll processing unit.
8. Payroll disbursements are reviewed and approved by an authorized individual prior to payment.
9. Access to payroll applications is appropriately controlled by user logins and passwords.
10. Changes to a payroll disbursement are approved by an individual other than the ones authorized to make the changes.
11. Payroll checks are accounted for in numerical order and reconciled to the payroll check register.
12. Access to the signature stamp used to sign payroll checks is adequately controlled.
13. Payroll checks/stubs are periodically distributed by someone outside the normal payroll distribution function.

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14. Unclaimed payroll checks/stubs are returned to an individual other than those involved with the payroll process.
15. Employees are cross-trained on the payroll process; those assigned to payroll take mandatory vacations.

### **B. Disbursement Activities**

1. The responsibility for approving claims is segregated from those preparing the claims.
2. Checks are written by an individual other than the one approving the claim.
3. Checks are signed by an individual other than the one preparing them.
4. Claims for payment are reviewed and approved by the governing body prior to payment.
5. A reconciliation is completed between the claims for payment approved by the board and the actual disbursements posted to the ledger.
6. The responsibility for acknowledging the receipt of goods or services is segregated from those preparing claims and writing checks.
7. Vendor checks are accounted for in numerical order and reconciled to the disbursement ledger.
8. Invoices or other receipts are attached to each claim to support the disbursement.
9. A review is completed by an individual outside the disbursement process in which the claim amount is compared to the supporting documentation attached to the claim and the amount of the check.
10. Access to disbursement applications is appropriately controlled by user logins and passwords.

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### C. Receipting Activities

1. The responsibility for collecting money and issuing receipts is segregated from those preparing the bank deposit.
2. The responsibility for making bank deposits is segregated from those preparing the monthly bank reconciliation.
3. Pre-numbered receipts are issued for all money collected and the duplicate receipt is retained.
4. Receipts are reconciled to the cash receipts ledger by an individual other than the one collecting money and issuing receipts.
5. Posting of receipts to the ledger is completed by an individual other than the one who collects money and makes the deposit.
6. Receipts indicate the type of payment received (cash, check, etc.) and this is reconciled to the make-up of the bank deposit.
7. Accounts receivable records are maintained by an individual other than the one(s) involved in the billing process.
8. The billing process is completed by an individual other than the one who collects cash payments from customers.
9. Adjustments to customer accounts are approved by the governing body only after a thorough review.
10. A periodic review is completed of all adjustments made to customer accounts by an individual independent of the billing and accounts receivable processes to ensure that all adjustments made have proper approval from the governing body.

### D. Cash Activities

1. A reconciliation between the recorded cash balance and the bank balance is completed monthly by an individual separate from the receipting and disbursing processes.

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2. A reconciliation between the receipts ledger and the credits to the bank account is completed periodically by an individual separate of the receipting process.
3. A reconciliation between the disbursement ledger and the debits to the bank account is completed periodically by an individual separate of the disbursement process.
4. The monthly reconciliation between the cash balance and the bank balance is thoroughly reviewed and approved by the governing body.
5. Disbursements from and reimbursements to petty cash funds are periodically reviewed by an individual other than the one responsible for maintaining the petty cash fund.

### **E. Credit Cards Transactions**

1. A designated official or employee oversees the issuance and use of the credit cards.
2. An ordinance or resolution specifically states the purposes for which the credit card may be used.
3. The designated official or employee collects the credit card when the purpose for which the credit card has been issued has been accomplished.
4. The designated responsible official or employee maintains an accounting system or log which includes the names of individuals requesting usage of the cards, their position, estimated amounts to be charged, fund and account numbers to be charged, date the card is issued and returned, sufficient documentation provided, etc.
5. A designated person separate from disbursement process reviews transactions listed on the credit card statements for sufficient documentation and inclusion in claim to the Board.

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**Principle 11. Management designs the political subdivision's information system and related control activities to achieve objectives and respond to risks.**

Management may utilize Information technology (IT) systems as an integral part of the internal control system. In many cases, IT systems are used to record all financial information for a governmental entity. In these instances, the IT system may provide many different internal controls over the financial reporting process. For example:

- Permissions can be set that allow only certain users to perform certain tasks.
- Segregation of duties can occur by forcing duties to be completed by different users. For example, the system could be set to only allow User A the ability to generate receipts when money is received and only allow User B to post the receipts generated to the ledger. User B could check the receipts issued against the bank deposit to ensure that all receipts collected were deposited. Then, User B could post all the receipts to the ledger.
- The automation of processes and calculations enhances the internal control system by preventing errors. For example, posting receipt and disbursement amounts to the ledger and calculating fund balances and total receipts and disbursements may be completed automatically by the IT system. Once management verifies that the IT system has been set to ensure these procedures and calculations are completed correctly, reliance may be placed on the processes as a part of the internal control structure.

It must be noted that the use of an IT system can also create risks to the internal control structure. The procedures and calculations performed by the IT system must be checked to ensure they are functioning properly. Reliance on the IT system to perform these functions without verification of the accuracy can result in inaccurate reports and information. In addition, the IT system must also be adequately protected from

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unauthorized use to avoid the recording of unauthorized transactions or unauthorized changes to existing data. Also, safeguards must be established to prevent loss of data in the event of a failure of the IT system. In view of these risks, the following steps may be considered as part of the internal control system:

- Limiting the authority to access different components of the software to employees with duties specifically related to that component.
- Prohibiting User ID and password sharing between employees.
- Restricting the authority to correct or make adjustments to the records on the system to key employees or management.
- Requiring the use of prescribed forms or the approval of alternative forms.

All of these considerations, both the benefits and risks, must be weighed by the governmental entity when deciding whether or not to make the IT system a part of the internal control structure.

### **Principle 12. Management implements control activities through policies.**

Management establishes policies in sufficient detail to address all identified risks. Procedures are communicated in writing to all employees that are part of the financial or reporting process. Policies set out the expectations of the oversight body and management and procedures specify the specific actions needed to comply with the policy. For example, a travel policy may require out-of-state travel to be approved in advance. The procedures outline the steps to obtain and document the approval for the claim process. In addition, management may consider the following:

- The employee handbook is provided online or in hard copy and includes internal control.
- Internal control procedures are written and available to all employees.

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- Variances from established procedures are brought to management's attention.
  - The legislative body formalizes procedures by review and adoption during a public meeting.
  - Policies and procedures are provided to other departments that are part of the financial or reporting process.
  - Templates are provided for frequent procedures that document the required procedures and adherence to the procedures such as travel, credit card purchases, employee reimbursements, etc.
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### **Component Four: Information and Communication**

An internal control structure must provide for the identification, capture, and exchange of information within the government and with external parties. Internal communication allows supervisors to convey responsibilities and issues to their staff. In turn, staff and middle management alert upper management to potential problems; administration and program staff communicate requirements and expectations to each other. Effective communication also encourages employee involvement. In regard to external communication, management relies on the information system, including the accounting system, to accurately report activities to the Legislature, oversight agencies, and federal grantors.

### **Principle 13. Management uses quality information to achieve the political subdivision's objectives.**

Information must be relevant and of high quality. The appropriate statutes, regulations, grant requirements, local ordinances, and internal reports must be the most current information available. Management determines the information needed to evaluate the internal controls established. Those needs for information are communicated to the employees so that only the most relevant and reliable information is used in the internal control procedure evaluations. The oversight body also implements policies to facilitate the flow of communication between offices or departments. The oversight body is made aware of any changes to reporting or compliance requirements that would require adjustments to the internal controls over information and communication.