R 1570 <u>INTERNAL CONTROLS</u>

OVERVIEW:

Internal controls are not separate systems of the school district. Controls are not an isolated activity but integral part of each activity used to guide the district.

Establishment, maintenance and evaluation of the internal controls are the responsibility of the administration. The evaluation of internal controls includes identifying the framework used by the administration to determine the effectiveness of the internal controls.

Controls are in place to detect or prevent errors and fraud. An error is an unintentional mistake that has the potential to affect the financial statements and fraud is the intentional misuse or misappropriation of district's assets.

OBJECTIVES OF INTERNAL CONTROL:

The three objectives of internal control are to ensure the effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. The safeguarding of assets is a subset of all of these objectives.

Continuous monitoring and testing is needed to help to identify poorly designed or ineffective controls. The administration is also responsible for communicating the objectives of internal control and ensuring the organization is committed to sustaining an effective internal control environment.

COMPONENTS OF INTERNAL CONTROLS:

The five components of internal controls include the control environment, administration's risk assessment, administration's communication of the controls, control activities and monitoring of the controls.

CONTROL ENVIRONMENT:

The control environment includes the organizational structure, the control framework, the district's policies and procedures and internal and external influences. The tone set by the school district's board and administration determines the attitude toward the controls of the district.

ORGANIZATIONAL STRUCTURE:

The organizational structure determines the administration's responsibilities and the sets the relationship with the board, which sets the policies.

CONTROL FRAMEWORK:

Elements of a control framework include the following:

Segregation of duties to help ensure the reliability of the organization's internal controls, one person should not have access to all stages of a process. If there is not proper segregation situations could arise where errors or irregularities occur and go undetected.

Integrity and competence of the personnel performing the duties are key to achieving the desired controls. This includes hiring the proper people and continually training personnel. It is important to ensure that employees who perform financial tasks have the knowledge and skill to perform their duties.

Communication by the administration of the controls and the employee's responsibilities are as important as ensuring that employees know how to communicate irregularities that may arise. Proper supervision of employees is needed to ensure proper execution of control activities.

DISTRICT'S POLICIES AND PROCEDURES:

The district's policies set the overall direction of the district. Procedures for all areas of financial preparation, reporting, operations, transportation, maintenance, personnel and payroll are needed. These policies and procedures will become the basis for the determination of compliance.

ADMINISTRATION'S RISK ASSESSMENT:

The administration has to conduct an assessment of risks relevant to the financial statements. This includes the identification of potential risks, the analysis of the potential impact of those risks on the ability to properly report the financial statements and the overall management of risks. Items to consider in the risk assessment of the district include, but are not limited to:

1. New personnel or new duties for existing personnel
2. How a change in accounting information system impacts controls and how effectively the training of personnel on new system was conducted
3. Changes in the regulations and laws that may affect the control environment
4. Record storage is appropriate and secure (proper passwords and access limitations for electronic information)
5. District limits access to computers and data files
6. Segregation of duties
7. Transactions are recorded timely
8. Cash is deposited timely
9. Assets are physically safeguarded
10. Transactions are performed by only authorized personnel
11. Reconciliations are properly and promptly completed
12. Occurrences of management override

INFORMATION AND COMMUNICATION:

The administration needs to determine if the information systems utilized in the district are adequate and relevant for their intended purpose.

The district's administration is responsible for communicating the controls of the district and the responsibilities of each employee in the control system.

The administration is also charged with reviewing information that may indicate a flaw in the controls that would not allow the control to detect an error in a timely fashion.

CONTROL ACTIVITIES:

Control activities include the policies and procedures that are in place to achieve the controls desired. Documentation of the control activities is vital to the overall control environment. These activities include, but are not limited to:
1. Segregation of duties
2. Transactions are recorded timely
3. Cash is deposited timely
4. Assets are physically safeguarded
5. Transactions are performed by only authorized personnel
6. Reconciliations are properly and promptly completed

CONTROL ASSERTIONS:

Control activities can be categorized into one or more assertions. All assertions should be addressed for each process (payroll, cash disbursements, etc).
1. Existence (E) /Occurrence (O) – Existence is whether the assets or liabilities of the district exist at any given point in time (cash, state aid receivable). Occurrence is the whether the transaction took place (goods were received before the PO was moved to accounts payable from encumbrances)
2. Valuation (V) or Allocation (A) – Valuation is whether the asset or liability is included on the board secretary's report at the proper value (the amount of cash or state aid receivable). Allocation is whether the revenue and expenditures were recorded in the proper amounts.
3. Accuracy/Classification (NCL) – transactions are recorded accurately and the classification of the transactions are proper.
4. Completeness (CO) – is whether all transactions are included (unrecorded purchase orders).
5. Cutoff (C) – Transactions are recorded at the proper time (purchase orders written in the proper year).

MONITORING:

The administration is charged with reviewing internal controls on an ongoing basis. Monitoring can include responding to the recommendation of the auditor in changes in the controls. Reviewing correspondence from outside sources such as banks and vendors for unusual items is part of monitoring.

Employees should be required to "sign off' on their understanding of the control activities and their responsibilities in those activities.

AFTER THE CONTROLS ARE ESTABLISHED:

Once the district establishes controls, those controls need to be evaluated at least annually and anytime circumstances dictate. Changes in personnel or regulations are examples of these.

As controls are evaluated they will either be effective or ineffective at achieving the proposed control. Controls are effective when there would be no material weaknesses in internal controls involved in financial reporting. Ineffective controls would be those where at least one material weakness exists. If a control is determined to be ineffective, then the control deficiency needs to be evaluated.

CONTROL DEFICIENCIES:

A control deficiency exists when the design or operation of a control does not allow the administration to prevent or detect misstatements on a timely basis. A design deficiency exists when a necessary control is missing or is not designed to enable the control objective to be met. An operational deficiency exists when control is designed properly, but does not operate as designed or the person performing the control is not qualified to perform the control.

A deficiency may exist that is unavoidable (segregation of duties in a small office). For these, compensating procedures should be put in place. These compensating procedures do not correct the deficiency.

REASONABLE ASSURANCE AND LIMITATIONS ON CONTOLS:

Reasonable assurance is a high level of assurance, but is not absolute. The district should understand that potential fraud could exist and not be detected timely in the following circumstances: when the district has poorly designed or operated internal controls, or when there are too many overrides of controls, when there is collusion between employees or between an employee and a third party.

REVIEW OF DISTRICT PROCESSES:

When reviewing processes in the district, it may help to consider incorporating the "5 Ws".

1. Who performs each activity? Who receives the outcome of the activities?
2. What activities are performed? What forms and reports are used? What computer systems and files are used?
3. When are activities performed? What is the sequence of activities? What is the timing of the activities? What is the frequency of the activities?
4. Where are activities performed (i.e., board office, school, etc.)?
5. Why are activities performed (i.e., what risks are controlled, what control assertion does process step serve, etc.)

One final consideration should be whether any changes to the process will increase the efficiency of the process or firm up the controls.

CONTROLS LISTED:

The controls listed here are not intended to be a complete list of controls, as each district will have different processes, controls and concerns. These items should be used as a beginning for the review of controls.

1. Segregation of duties is unachievable in the Green Township School Board office because of its small size.
2. The controls in place insure that either the business administrator, treasurer, or the Superintendent review the work produced by the administrative assistant to the Business Administrator in the purchasing, accounts payable, payroll or human resources functions.

    A. Purchasing: A requisition is generated and the signatures of the Superintendent and BA are required. A purchase order is generated and the signatures of Superintendent and BA are required. All purchase orders over $1000 are listed and approved by the board.
    B. Accounts Payable: All checks require the signatures of the treasurer, board president and board secretary . The chairman of the finance committee reviews all checks and signs the checks list provided to the board at the regular meeting.
    C. Human Resources: All enrollment forms are certified by the BA and Superintendent.
    D. Payroll: Prepared by the Assistant to the Business Administrator. It is reviewed by the BA for processing. The payroll register requires the signatures of the Superintendent, Board President and Board Secretary. The checks are signed by the treasurer or BA.

TITLE: **EVALUATING INTERNAL CONTROLS**

Subtitle: Internal Control

                  Evaluation of Internal Controls

Purpose: To ensure that controls are evaluated on as periodic basis to ensure the controls continue to be effective.

Procedure:

1. The business administrator will establish a process to evaluate internal controls over all areas of financial and operational procedures in the district.

2. These internal controls should be evaluated at least annually and every time one of the following conditions exists:

   a. Change in personnel performing a control function

   b. Change in accounting system

   c. Change in regulations

3. As the controls are evaluated, a determination should be made that designates the control as either effective or ineffective. Ineffective controls should be changed to achieve the proper level of effectiveness required.

4. Written documentation of the review of the controls in place should be kept.

Title: COMMUNICATING STAFF MEMBERS' ROLES

Subtitle: Communicating staff members role in the Internal Controls

Purpose: To ensure that everyone in the district who performs or should perform a control function understands the control.

Procedure:

1. The business administrator will establish a procedure to ensure the all employees and board members who are charged with a control understand the importance of the control and their role in the control environment.

   a. Controls that are not performed with an understanding of the control will not be effective.

   b. A review of the controls and the staff members' role in the controls should be conducted at least annually and anytime there is a change in the control, the personnel or the laws and regulations affecting the control.

   c. Documentation of these reviews should be maintained.

CASH CONTROLS

Title: Internal Control

Subtitle: Cash controls

Purpose: To identify the controls over cash and the personnel responsible Cash Receipt activities:

Procedure:

1. Administrative Assistant to the Business Administrator opens mail.

2. Checks are held in the safe until deposited within 24-48 hours.

3. The deposit slip, along with copy of check, along with supporting documentation is made for the BA.

4. Business Administrator records deposit in accounting system.

Title: **Internal Controls**
Subtitle **Payroll Controls**
Purpose: To identify the controls which exist over payroll related items

Procedure:

1. The business administrator will establish controls that help ensure that the errors and fraud in payroll would be detected in a timely manner. These controls may be some or all of the following: With respect to payroll:

2. The Green Township Board of Education approves any new hire, renewal, retirement and termination.

3. The Assistant to the Business Administrator collects all proper payroll forms and sets up employment file.

4. The Business Administrator prepares employment contracts and forwards the salary for each staff member to Assistant to the Business Administrator to be set up in payroll.

5. The preparation of the payroll:

    A. Staff attendance and input of substitutes is maintained by Superintendent's secretary in Frontline and/or CDK.

    B. The Assistant to the Business Administrator verifies attendance and substitute report.

    C. Maintenance supervisor approves time cards for custodial staff and forwards to Assistant to the Business Administrator.

    D. The Principal or Superintendent approves timesheets for all other extracurricular activities.

    E. Business Administrator reviews documentation before the Assistant to the Business Administrator transmits payroll to R&L (party third payroll processor)

6. The payroll checks are reviewed by Treasurer of School Monies or BA and signed.

7. The Payroll Register is reviewed and signed by Superintendent, BA, IDEA Person, and Board President.

Adopted: