



## MEMORANDUM

To: Board of School Directors  
From: Marilyn R. Frederick, Business Manager  
Date: January 10, 2015  
Re: Internal Control Process

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### **Introduction**

The Lamoille North Supervisory Union utilizes a variety of procedures and activities designed to minimize risks and provide reasonable assurance that financial and operational tasks will be achieved accurately and within risk tolerances. We accomplish this within the parameters of maintaining effectiveness and efficiency of operations, financial reliability and compliance with laws and regulations.

We support an environment of risk management through three important beliefs: 1. Management is responsible for ensuring that internal controls are established, properly documented, maintained and adhered to in each unit, department, school and central office; 2. All employees are responsible for compliance with internal controls; 3. An effective control system provides reasonable, but not absolute assurance for the safeguarding of assets, the reliability of financial information and the compliance with laws and regulations.

### **Internal Controls**

The purpose of internal controls is to provide proper fiscal accountability which, in turn, builds public trust and confidence. It is management's expectation that our attitude and control policies determine the control environment. We believe that a truly effective control environment lays down the expectation that policies and procedures surrounding controls are to be followed, but do not assume that they are followed. Therefore, we also maintain an internal output review process that helps to ensure that established policies and procedures are monitored and followed.

Our control environment includes independent oversight provided by our board of school directors, an independent external auditor, a separately elected or appointed treasurer, a defined organizational structure with competent employees, and the assignment of authority and responsibility.

To maintain the best protection possible, our control activities can be divided into six specific areas to achieve its objectives. The most important control activities involve: segregation of duties, proper authorization of transactions and activities, adequate documents and records, physical control over assets and records, independent checks on performance and monitoring. These, along with a process of communication for improvements in each area are essential. A short description of these control activities appears below.

- **Segregation of duties** requires that different individuals be assigned responsibility for different elements of related activities, particularly those involving authorization, custody, or recordkeeping. For example, the person who requisitions the purchase of goods or services should not be the person who approves the purchase; the person who approves the purchase of goods or services should not be the person who reconciles the monthly financial reports or obtain custody of checks; the person who opens the mail and prepares a listing of checks received should not be the person who makes the deposit; the person who is responsible for an asset's recordkeeping should not be responsible for physical control of that asset; and the person who sets up the employee to be paid should not be the person that pays the employee. Having different individuals perform these functions creates a system of checks and balances, or dual control.
- **Proper authorization** of transactions and activities helps ensure that all activities adhere to established guidelines. Responsible administrators must authorize or approve expenditures initiated by others within the parameters of budget, law and spending authority subject to Board approval and applicable bidding laws.
- **Adequate documents and records** provide evidence that financial statements are accurate. Our controls are designed to ensure adequate documentation. Our expectation is that there be timely preparation and submittal of documents. Receipts are to be original, dated and itemized documents. All recordkeeping, including journal entries, the creation of invoices, timesheets and other documents must be descriptive, detailed and sufficiently informative. Our system provides consecutive numbering of checks and purchase orders.
- **Physical control** over assets and records helps protect the district's assets. These control activities may include electronic or mechanical controls (such as a safe, ID cards, combinations, cash registers, fireproof files, and locks) or computer-related controls dealing with access privileges or established backup and recovery procedures.
- **Independent checks** on performances, which are carried out by employees who did not do the work being checked, help ensure the reliability of accounting information and the efficiency of operations. For example, the business manager at any time will compare a payroll detail with a districts employee list to do some spot checking. Output review personnel also verify work on both a routine and random basis.
- **Monitoring** beyond separate independent checks involves assessing the quality of performance over time and ensures that the findings of audits and other reviews are promptly resolved. Internal control should be designed to assure that ongoing monitoring occurs in the course of normal operations. We regularly check activities, do comparisons, evaluate controls for effectiveness, communicate findings through weekly Finance/HR meetings and plan for corrections. Staff is instructed to communicate problems to management and beyond if warranted. The monitoring function does not end until a resolution is found. When business controls are found to contain weakness, the need exists to weigh and mitigate the risk as appropriate.

In order to identify and establish effective controls, management must continually assess the risk, monitor control implementation and modify controls as needed. Maintaining a system of effective internal control requires appropriate separation of duty, or responsibilities. If internal control is to be effective, there needs to be an adequate division of responsibilities among those who perform accounting procedures or control activities and those who handle assets or initiate disbursements. In general, the flow of transactions, work processes and related activities should be designed so that

the work of one individual is either independent of, or serves to check on, the work of another. Even under the best circumstances however, while we can reduce the risk of error and limit opportunities to misappropriate assets or conceal intentional misstatements, we cannot guarantee all acts of fraud, concealment or collusion be avoided.

Bottom line...**No one person should:** Initiate a transaction, approve a transaction, record a transaction, reconcile balances, handle assets, and review reports. At least two sets of eyes are required for any transaction! To assist in reviewing and setting up checks-and-balances controls, the business manager uses charts such as the ones below to visualize tasks and determine whether adequate dual control exists in high risk areas.

<u>Accounts Payable</u>	Authorization	Custody of Assets	Recording	Control Procedure
Issuance of purchase requisition/orders			Staff Initiator	
Approval of purchase requisitions/orders	Administrator			
Approval of access to vendor master files	Accountants			
Approval of Grant purchase orders	Finance Manager			Business Manager
Approval of access to purchase-related data files	Finance Manager			Business Manager
Issuance of debit memos to vendors			A/R	
Issuance and signing of receiving reports		Staff		
Matching of invoices to purchase orders and receiving reports				Output Review/ School Board
Coding account distribution of vendor invoices			Staff Initiator	
Approval of voucher packages for payment	Board			
Preparation of checks			Accountant	
Signing of check	Treasurer			
Mailing of checks		Staff		
Maintenance of the purchases journals			Accountant	
Maintenance of accounts payable records			Accountant	
Reconciliation of the accounts payable records (or the total of unpaid vouchers) with the general ledger control account				Treasurer & Accountant
Control of the accuracy, completeness of, and access to purchasing and accounts payable programs and data files	Finance Manager			Business Manager

<u>Payroll</u>	Authorization	Custody of Assets	Recording	Control Procedure
Issuance of Employee Requisition			Administrator	
Contingent Approval of Employee Requisitions	HR Manager			
Issuance of Personnel File in System			HR Staff	
Approval of Employee Hire or Termination	Board/ Superintendent			
Approval of access to System-related data files	Finance Manager			Business Manager
Issuance of Payroll Checks in System			Accountant	
Signing of Checks		Treasurer		
Matching of Staff to Payroll Detail				Business Manager

The table is used to review individuals/positions listed in more than one column, and then determine whether that represents a potential lack of segregation of duties, or, whether individuals are performing incompatible duties (e.g. Initiator, Approver and Control) If an individual is identified as performing incompatible duties, all duties performed by that individual should be reviewed to determine the effectiveness of those duties and the risk of fraud due to the lack of segregation of duties.

In addition, while the first rule is to use the **PURCHASE ORDER SYSTEM or PROCUREMENT CARD SYSTEM** for all possible transactions, we recognize that there are times when this is not possible for emergencies, practicality and some co-curricular or student activity needs. Therefore, we recognize some activity exists at the building level and we have suggested controls in place for Activity Funds in the area of: Cash Receipts and Cash Disbursement.

### **Cash Receipts**

- Have someone other than the holder of the Imprest account open the mail and list all cash receipts.
- Have all checks endorsed "for deposit only" with a school stamp at the time the mail is opened.
- Count cash with a witness and keep the cash handling and record keeping separate.
- After all cash receipts have been listed by someone else, have the Imprest account holder immediately record them.
- Compare the listing of cash receipts with the cash receipts journal and deposit slips.
- Deposit cash receipts in the bank every day ideally, or as soon as possible within a week.
- Post cash receipts to accounts receivable ledgers promptly (to be set up in system).

## Cash Disbursements-Imprest Accounts

- Make all disbursements by check (other than when rare and documented petty cash-limits apply).
- Use pre-numbered checks and account for them.
- Sign checks only if adequate dated, original, itemized documentation is presented.
- Have only administrators/management sign checks (**never the holder of the account!**).
- **Prohibit checks payable to cash.**
- Mail checks independently of the accounts payable function.
- Prepare bank reconciliations.
- Keep petty cash in a safe place.
- **NO GRANT PURCHASES CAN GO THROUGH ANYTHING BUT THE NORMAL ACCOUNTS PAYABLE PROCESS UNDER RULES BY GRANTS MANAGER.**

## Control Activities for Information Technology

Finally, an area of vulnerability that we recognize as a prominent one to gain assurance in appropriate control is in the area of information systems technology. While some of the control activities relating to information technology (IT) are the responsibility of specialized IT personnel, other IT control activities are the responsibility of all employees who use computers in their work. For example: any employee may use strong password combinations that are alpha and numeric, private, and not obvious. Additionally, we use the following strategies in controls.

- Back-up and restore features of software applications that reduce the risk of lost data.
- Virus protection software and Filtering software are used at each location.
- IT Security passwords that restrict user access to networks, data and applications.
- IT General controls apply to all computerized information systems - mainframe, minicomputer, network and end user environments.
- Critical data secured and owned by the district should not be dependent on non-proprietary access.
- Application controls that apply to the processing of data within the application.
- Off-site nightly back-up.

## Conflict of Interest

Under no circumstance will any staff, board member or officer of the district conduct themselves in any manner of transaction that involves a possible conflict of interest. Individuals will not conduct themselves in a manner nor knowingly allow, behavior or action that promotes favoritism or nepotism in the influence of the decision making process for financial or any benefit or gain. If a staff or board member in the decision making process for procurement or other benefit finds themselves in a circumstance when contemplating entering into a transaction or arrangement that might benefit the private interests of an officer, director, or employee of the district, or might result in a possible excess benefit, then the following steps of action must transpire:

1. **Duty to Disclose** -- In connection with any actual or possible conflict of interest, an interested person must disclose the existence of the financial interest and be given the opportunity to disclose all material facts to the superintendent and ultimately to the Board or Executive Committee.

2. **Recusal of Self** – Any director may recuse himself or herself at any time from involvement in any decision or discussion in which the director believes he or she has or may have a conflict of interest, without going through the process for determining whether a conflict of interest exists.

3. **Determining Whether a Conflict of Interest Exists** -- After disclosure of the financial interest and all material facts, and after any discussion with the interested person, he/she shall leave the Board or Executive Committee meeting while the determination of a conflict of interest is discussed and voted upon by the remaining Board or Executive Committee members