Checks and Balances
Internal Controls

West Virginia State Auditor’s Office
Chief Inspector Division
Internal Controls

• POP QUIZ
Internal Controls

• The auditor will test the effectiveness of your internal controls over safeguarding of assets.
Internal Controls

- Integrated set of policies and procedures designed to assist management to achieve its goals and objectives. (GFOA – GAAFR)
Internal Controls - Cash/Revenues

- Access to cash should be limited to certain employees
- Kept in a safe, if not deposited
- Daily deposits reconciled
- Employees bonded
- Monthly reconciliations of bank statements
Internal Controls - Cash/Revenues

- Security Camera for remote locations for collecting cash
- Written receipts journal for cash
- Deposit tickets separating cash collections from checks
- Payment stubs marked paid with cash
- Reconciling stubs to cash collections
Internal Controls - Cash/Revenues

- Maintain payment stubs – bundles per day
- Reconciling posting report to payment stubs
- Supervisory reviews over cash collections
- Comparing collections per month from bank statements to billings per month
Internal Controls - Fraud Prevention

- Adjustments of customer accounts approved by a Board member or Municipal official – prior to the adjustment
- Detail documentation of why adjustment was made
- Employee who posts to the customer accounts should not have the access or authority to adjust customer accounts
Internal Controls - Fraud Prevention

• Employee who posts to customer accounts should not prepare the deposit without supervisory review of the deposit
• Employee who posts to customer accounts should not take the deposits to the bank
• Do not allow records to be taken home
- Periodically check the type of meters assigned to customers
- Take notice of high amounts of customers complaints of incorrect billing or past due bills
Internal Controls – Disbursements

• Use of purchase orders
• Prior approval from Board members or Council for major disbursements
• Two signatures on checks – at least one actual signature
• Invoices marked paid with date and check number
• Support documentation for all expenditures including petty cash
Internal Controls – Disbursements

- Verify goods were actually received prior to payment
- Determine if vendors are legitimate and are certified with the State
- Credit card statements are not support documentation for expenditures – need actual invoices
- Travel policies and reimbursements – must have an accountable plan
Internal Controls – Disbursements

- Reimbursements to employees must be verified – require receipts prior to payment
- Under no circumstances should a governmental entity pay an individual’s personal credit card to reimburse expenses
- Gasoline purchases should be monitored and verified – mileage recorded
- Meals should not be provided to employees – must be open to the public
Internal Controls – Fraud Prevention

- Signature stamps should be maintained in a secured location
- Person who actually signs the check should never have access to the signature stamp
- Employee who prepares the checks should not have signature authority
- Employee who signs the checks should not complete bank reconciliations
Internal Controls – Fraud Prevention

• Only pay original invoices – No faxed copies or handwritten invoices
• Reimbursements for travel should require support documentation prior to the payment
• Verify the amount of goods received prior to payment
• Board Members or Council Members be actively involved – ask for invoices
Internal Controls – Fraud Prevention

- Do not allow cashing of personal checks through the governmental entity
- Do not make checks payable to “CASH” even for petty cash funds
- No pre-signing of checks
- Access to checks should be limited to authorized employees
- Signature authority should be limited and up-to-date
- Be watchful for circumventing controls
Internal Controls – Investments

- Adopt written policies in addition to State code regulations
- Monitoring of investment portfolios
- Most invested funds for Water and Sewer are with the Municipal Bond Commission for bond payments
Internal Controls – Fraud Prevention

- Ensure bond payments are made timely
- Review the annual statements from the MBC
- Take notice of any delinquency letters
Internal Controls – Capital Assets

- Adopt written capitalization policy
- Restricted access to tools and capital assets
- Inventory tags on all capitalized assets
- Periodic checks on assets
- Procurement of bids on construction projects
Internal Controls – Capital Assets

• Reasonable assigned life expectancy
• Depreciation consistency applied
• Recorded at historical cost
• Maintain capital asset schedule – including additions and deletions
Internal Controls – Fraud Prevention

• Periodically verify assets are where they should be – i.e. computers, flat screen TV’s, furniture
• Review invoices for any excess ordering
• Be certain all purchases meeting the capital assets policy are reported on the detailed listing
Internal Controls – Debt

- Written documentation of approval
- Maintain signed copies of bond issuances
- Repayment procedures
- Maintain amortization schedules
Internal Controls – Fraud Prevention

- Delinquency notices for payments due
- Review account balances for accuracy
- Do Not pay an individual’s debt obligation – credit card
Internal Controls – Payroll

- Certified time cards or time sheets by employee
- Approval of supervisor
- Prior approval of overtime
- Documentation of why overtime occurred
- Timely remittances for taxes
Internal Controls – Payroll

- Timecards should be reviewed and signed by a supervisor – even department supervisors’ time cards
- Have at least two people prepare and a third person review payroll records
- Employee access to payroll records should be restricted
- Periodically have the employees to certify leave balances
Internal Controls – Fraud Prevention

• Verify the number of checks an employee should receive – Multiple payments
• Verify leave balances periodically
• Do not accept faxed time cards, copies, or handwritten time cards
• Delinquency notices from IRS, State taxes
• Employees should not receive any 1099’s
Internal Controls – Fraud Prevention

• Buy-out of leave balances should be consistently applied in accordance with stated policies
• Never pre-pay or give payroll advances
• Supervisory review of payroll – someone watching
• Employee who prepares payroll should not reconcile bank statements
• Be watchful for circumventing controls
Internal Controls – Financial Reporting

- Financial statement preparation
- Documentation of general journal entries
- Documentation of adjusting entries
- PSC reports timely
Internal Controls – Computers

• Restricted access
• Password protected – do not share passwords
• Backups contained off-site
• Certified vendors
• Adequate computer software
Internal Controls – Segregation of Duties

• No one employee processes all aspects of a transaction
• Without it – elements do not reduce to a relatively low level the risk that errors and irregularities, in amounts that would be material in relation to the financial statements, may occur and not be detected in a timely manner
Internal Controls – Segregation of Duties

• Ideal World – segregation of duties occurs at all levels
• Economically feasible
Checks and Balances

Conclusion

- Review of work employees
- Segregation of duties
- If fraud occurs, have internal controls in place so that the guilty party can be identified
Preparing for An Audit

West Virginia State Auditor’s Office
Chief Inspector Division
Objective

- The primary objective of an audit is to express an opinion as to whether your financial statements are fairly presented in conformity with generally accepted accounting principles or GAAP.
Objective

• The audit will be planned and performed in order to obtain reasonable other than absolute assurance about whether your financial statements are free of material misstatements, whether caused by error or fraud.
Objective

• An audit is not designed to detect errors, fraud or other illegal acts that are immaterial to the financial statements.
Objective

• Financial statement audits are not the same as fraud audits
• Fraud audits are an extensive investigation of a particular area or areas as designated
• Agreed upon procedures
Audit Opinions

- Unqualified
- Qualified “except for”
- Disclaimer “do not express an opinion”
- Adverse “do not purport to”

- Best opinion is the unqualified opinion
• The auditor must follow Generally Accepted Government Auditing Standards (GAGAS) and Statements of Auditing Standards (SAS)
• Provides guidance and regulations for conducting an audit
Auditing Standards

- SAS 112 – Assessment of competency
- Financial statement preparation – Auditor should not prepare financial statements
- Material audit adjustments
- Material prior period adjustments
Auditing Standards

- SAS 99 – Assessment of fraud
- Conducting interviews with key management officials
- Assessment at all levels of auditing process: planning, testing, conclusion
Auditing Standards

• SAS 115 – Communication with those charged with governance
  • Council
  • Voting Board members
Documents for Audit

• Copies of all June 30 bank statements
• Copies of all June 30 MBC statements
• Trial balances – PSC reports
• Access to bond documents
• Access to board or council minutes up to the date of fieldwork
• Copies of written policies
• Copy of Charter or By-laws
Documents for Audit

- Detailed capital asset listing
- Amortization schedules
- Access to payment stubs
- Copy of the latest approved rate tariff
- Access to receipts journal and payment journal
- Check register
- Access to payroll records
Documents for Audit

- Access to grant documents
- Copies of grant agreements
- Explanation of “Miscellaneous” revenues and expenditures
- Access to significant contracts
- Any unusual items that may have occurred that impacted the financial statements
Audit Procedure

• The auditor will examine, on a test basis, evidence supporting the amounts and disclosures in your financial statements including the Notes to the Financial Statements.

• Management representations
Audit Procedure

- Internal controls are management’s policies and procedures implemented to safeguard municipal assets, ensure accuracy of the financial statements, and the protection of employees and property.
Audit Procedure

- The auditor will gain an understanding of internal controls and may test internal controls to determine their effectiveness as well as testing compliance with applicable State regulations.
Audit Procedure

• Examine the council and board minutes for significant municipal ordinances passed during the audit period
• Examine the minutes for significant construction projects, bond issuances, and grants awarded
• Also will determine if any subsequent events happened after the audit period
Audit Procedure

- Major sources of revenues will be tested.
- For Water and Sewerage funds, the billings of municipal officials will be reviewed plus sampling of billed customers and payments received.
- Important to keep stubs, copies of receipts for cash collections, adjustments to accounts, etc.
Audit Procedure

• Sampling of invoices – need to keep copies of cancelled checks; invoices; receipts for reimbursements (travel), receiving reports – support documentation verifying the purpose of the expenditure
• Credit card statements are not the same as invoices
Audit Procedure

• The auditor will test documentary evidence supporting the transactions recorded in your accounts such as the physical existence of inventories and capital assets.
• Need a detailed capital asset listing indicating additions and deletions
• Not just the PSC report
Audit Procedure

• Major projects for renovation of the existing Water and Sewerage system but no deletions are recorded in the capital asset listing

• Completion of construction projects should be included in the detailed capital asset listing – re-class from CIP
Audit Procedure

• The auditor will obtain direct confirmations of receivables and certain other assets and liabilities through correspondence with selected individuals, creditors, and financial institutions.
Audit Procedure

- Confirmations to third parties – Municipal Bond Commission yearly statements; bank accounts; collateralization; bond issuances; lease purchases
Audit Procedure

- Rate covenant testing
- Net revenues divided by the highest principle and interest in any given year
- Would include leases payable, and debt not yet forgiven
- Debt issued in parity – last bond issuance for rate covenant percentage
Audit Procedure

- Grant testing
- Federal expenditures over $500,000 requires a Single Audit
- Single Audit tests federal money for a specific program
- Compliance with federal regulations
- Construction projects
Audit Procedure

• Davis-Bacon Act – prevailing wage
• Procurement requirements
• Forgivable debt program – American Recovery Reinvestment Act – ARRA
• ARRA compliance provisions must be met for the debt to be forgiven – special items
Audit Procedure

• As part of the engagement, the auditor will request written representation from your attorneys.
Audit Results

- Auditor’s opinion on the financial statements
- Findings – internal control findings & noncompliance findings
- County prosecutor notified of any noncompliance
- Management letter comments – items discovered in the audit but not significant enough for findings
Conclusion

• Questions

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