



<b>Policy:</b> Risk Assessment & Internal Control Policy	<b>Effective Date:</b> 09/01/09
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**TOWN OF SUMMERFIELD**  
**Risk Assessment and Internal Control**  
**Policy**

**Adopted**

August 11, 2009

**Effective**

Revised November 12, 2013

**NOTE: Replaces in its entirety Policy 2008-004 Risk Assessment and Internal Control Policy**

## **Town of Summerfield Risk Assessment and Internal Control Policy**

**I. Purpose:** The core of any business is its people – their individual attributes including integrity, ethical values, and competence – and the environment in which they operate. The people are the engine that drives the entity and the foundation on which everything else rests.

The purpose of the Risk Assessment and Internal Control Policy is to document how the management of the Town of Summerfield has assessed risk and fulfilled their responsibility for implementing and maintaining a sound and comprehensive framework of internal control. Internal controls are vital for identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement.

The Town of Summerfield’s Risk Assessment and Internal Control Policy establishes proper procedures to safeguard the Town of Summerfield’s assets. This policy applies to all assets whether monetary or physical.

**II. Definition:** An Internal Control is a process which is designed by an entity’s management to provide reasonable, but not absolute, assurance regarding the achievement of organizational objectives in the categories of: (1) reliability of financial reporting; (2) effectiveness and efficiency of operations; and (3) compliance with applicable laws and regulations.

### **III. Descriptions:**

<u>Fraud Triangle</u>	Consists of opportunity, motivation/pressure, and rationalization. All factors must be considered when attempting to prevent fraud.
<u>Deficiency</u>	Exists when the design or operation of a control does not allow management to prevent or detect misstatement in a timely manner.
<u>Stakeholders</u>	Includes citizens, customers, and taxpayers.
<u>Contributing Factors</u>	May include financial stress, addiction, disaffection, pathologies, and opportunity.
<u>Cost of Fraud</u>	Includes a loss of assets (monetary or physical), a loss of confidence in the Town’s operations, and a loss of reputation for innocent third parties. In addition, there are costs of litigation and the costs to the perpetrator. Fraud is expensive, not just monetarily.

Types of Fraud Include the common types of kiting, lapping, bid rigging, payroll fraud, healthcare beneficiary fraud, false claims, double payments, charge-offs, and disposal fraud; however, there are many types of fraud.

**IV. Components of Internal Control:** An understanding of the five components of the process is vital in order to properly structure, implement, and maintain cost-effective internal controls.

1. *Control environment* provides the cultural atmosphere for human behavior within an organization. Several key factors impact the control environment:
  - a. *Integrity and ethical values* of management play a key role in providing standards of behavior, removing temptations for unethical behavior, and providing discipline when required.
  - b. *Commitment to competence* provides that all personnel receive the training, counseling, and performance evaluations required to perform their duties and understand the importance of maintaining good internal controls.
  - c. *Management's philosophy and operating style* impact the amount of risk tolerated and what behavior is rewarded or disciplined.
  - d. *Organizational structure* impacts how internal control functions are communicated, respected, and reported.
  - e. *Assignment of authority and responsibilities* for operations and control functions establishes accountability for results.
  - f. *Human resource policies and practices* establish proper hiring, training, evaluation, counseling, promotion, compensation, and disciplinary guidelines.
2. *Risk Assessment* is necessary after management establishes certain objectives in order to anticipate and compensate for factors which may prevent management from fulfilling their responsibilities and goals.
3. *Control activities* are those procedures, actions, or activities that help ensure that management's directives are executed. Control activities may consist of policies, physical actions, software processes, or procedures such as segregation of duties.
4. *Information on and communication* of internal control features focus on the entity's human and technological systems to ensure that the right information is presented to the right individuals at the right time and in the right format.
5. *Monitoring* internal controls on an ongoing basis is essential to ensure the controls are functioning as intended, and if not, to ensure effective corrective action is implemented.

**V. Limitations of Internal Controls:** In this imperfect world, there are several factors that can reduce the effectiveness of internal controls:

1. *Cost* of a control in dollars or staff time should not outweigh the potential benefit.
2. *Management override* can easily circumvent control procedures, whether for expediency or personal benefit.
3. *Unintended situations* such as employee errors, mistakes in judgment, carelessness, or misunderstanding of instructions can be impediments.

4. *Collusion* is the intentional act of two or more employees to circumvent existing controls. Collusion is usually hard to detect and the difficulty increases with the authority level of the employee.

**VI. Management Objectives:** The purpose of internal controls is to help ensure the following management objectives are met:

1. *Safeguarding of assets*-The Town of Summerfield is responsible for prudent stewardship of cash and all items acquired with public funds including infrastructure, buildings, software, equipment, and supplies, and for protecting other intangible items necessary for Town functioning such as employee information.
2. *Integrity of financial information*-Management is responsible for ensuring that financial information is accurate, complete, properly authorized, and produced in a timely manner.
3. *Compliance with laws and regulations*-The Town of Summerfield must ensure financial operations comply with all state and federal requirements, current Generally Accepted Accounting Principles (GAAP), the Local Government Budget and Fiscal Control Act, provisions of financing obligations, and any applicable grant or other funding source requirements.
4. *Operational efficiency*-Management must ensure that Controls are cost-effective, easy to maintain, and working as intended according to approved policy.

**VII. Town of Summerfield Internal Controls:**

1. *Control Environment*
  - a. Keeping core values of trust, honesty, integrity, and accountability at the heart of management decisions and personnel evaluations
  - b. Using credit checks as part of the contracting/hiring process to avoid a Finance Officer with personal financial issues, conducting background and reference checks for all employees, and requiring driving records when applicable
  - c. Hiring qualified financial personnel, providing continuing training and educational opportunities, and encouraging appropriate certifications
  - d. Ensuring the Financial Officer takes an annual CPE class in ethics as required for CPA's
  - e. Hiring a well-qualified external CPA firm to conduct an annual audit
  - f. Requiring responsible authorization for all accounting transactions
  - g. Communicating the organizational structure, internal control policy, and the importance of controls
  - h. Creating realistic performance goals and well-defined job descriptions and job qualifications

2. *Risk Assessment and Control Procedures*

Area	Risk	Control Procedures
Cash	Employee could pocket cash received from others	<ul style="list-style-type: none"> <li>Separate functions of receiving payments and making bank deposits <i>from</i> posting payments and bank reconciliation</li> </ul>
Cash	Employee could pocket cash using false invoice	<ul style="list-style-type: none"> <li>Separate functions of ordering and approving invoices</li> <li>Invoices/checks reviewed during accounts payable process by the Finance Officer, Town Manager, Mayor, and Designated Town Council member</li> </ul>
Cash	Employee could pocket cash from petty cash box	<ul style="list-style-type: none"> <li>Petty cash custodian has locked box and original receipts must be signed by individual receiving cash</li> <li>Reconciliation to replenish the petty cash fund reviewed by Finance Officer and check signers/approvers</li> <li>Annual review by external auditors</li> </ul>
Cash	Criminals could try to steal cash by altering or counterfeiting Town of Summerfield check	Monthly reconciliation of bank accounts performed by Finance Officer and reviewed by Town Manager and Town Council
Cash	Criminals could try to steal cash by forging ACH draft	Monthly reconciliation of bank accounts performed by Finance Officer and reviewed by Town Manager and Town Council
Cash	Employee could try to steal cash using blank check	<ul style="list-style-type: none"> <li>Check stock locked in Town Clerk's office</li> <li>Check stock is sequentially numbered and verified by Finance Officer upon check printing</li> <li>Sequential numbering verified by Town Clerk before presentation to check signers</li> <li>All checks require two signatures</li> </ul>

Area	Risk	Control Procedures
Cash	Cash transaction could be recorded improperly, such as typographical error or NSF check notification not received from bank	<ul style="list-style-type: none"> <li>• Finance Officer who does not process daily transactions performs monthly bank reconciliations that are reviewed by Town Manager and Council</li> <li>• Town Manager and Council review monthly budget-to-actual expenditure reports and detail transaction reports</li> </ul>
Investments	Investment could be susceptible to theft	<ul style="list-style-type: none"> <li>• All investment transactions reviewed and approved by Finance Officer and Mayor</li> <li>• Monthly investment reports reviewed by Town Manager and Council</li> <li>• Finance Officer only has approval to move funds between accounts and cannot execute withdrawals</li> </ul>
Investments	Investments and/or related income could be improperly recorded	<ul style="list-style-type: none"> <li>• Financial records are reconciled with statements prepared by financial institutions</li> <li>• Balances are confirmed annually by Finance Officer and external auditors</li> <li>• Monthly investment reports reviewed by Town Manager and Council</li> <li>• Accounting staff comply with GASB 40 guidance</li> </ul>
Investments	Investments not allowed under NC law could be purchased	<ul style="list-style-type: none"> <li>• Adopted Investment Policy clearly identifies allowable investments</li> <li>• Semi-annual report of deposits and investments submitted to LGC</li> <li>• Monthly investment reports reviewed by Town Manager and Council</li> </ul>

Area	Risk	Control Procedures
Revenues	Revenues could be improperly recorded or not received in their entirety	<ul style="list-style-type: none"> <li>• Separated duties of receiving and recording payments</li> <li>• Bank deposits are prepared daily if funds are received</li> <li>• All deposit transactions reviewed and approved by Finance Officer and Mayor</li> <li>• Monthly review of budgets to actual results by Town Manager and Council</li> </ul>
Debt	Debt could be issued improperly	<ul style="list-style-type: none"> <li>• All debt authorized by Council under auspices of LGC</li> </ul>
Debt	Debt service could be underpaid or inadvertently missed	<ul style="list-style-type: none"> <li>• Annual schedule of debt service corroborated with LGC and Trustee</li> <li>• Monthly review of budget to actual results by Town Manager and Council</li> </ul>
Debt	Outstanding Debt could be misreported in financial statements	<ul style="list-style-type: none"> <li>• Annual schedule of debt service corroborated with LGC and Trustee</li> <li>• Finance Officer aware of disclosure checklists and requirements</li> <li>• Monthly review of budget to actual results by Town Manager and Council</li> <li>• Annual reconciliation by Finance Officer and external auditor</li> </ul>
Debt	Violation of debt covenants	<ul style="list-style-type: none"> <li>• Management aware of provisions of financing agreements</li> <li>• Annual review of provisions by Finance Officer and external auditor</li> </ul>
Expenditures	Unauthorized or unavailable funds could be expended	<ul style="list-style-type: none"> <li>• Council-approved budget entered into accounting software</li> <li>• Invoices/checks reviewed during accounts payable process by the Finance Officer, Town Manager, Mayor, and Designated Town Council</li> </ul>

Area	Risk	Control Procedures
		<p>member</p> <ul style="list-style-type: none"> <li>• Password required to approve accounts payable transactions in accounting software</li> <li>• Purchase Order (PO) required for expenditures greater than \$500 with pre-audit by Finance Officer</li> <li>• All invoices, packing lists, and purchase orders matched by Town Clerk according to policy</li> <li>• Contracts are pre-audited by Finance Officer</li> <li>• Monthly review by Town Manager and Council of budget to actual expenditures by department and line item</li> </ul>
Expenditures	Incorrect amounts could be recorded or correct amounts omitted	<ul style="list-style-type: none"> <li>• Town Manager and Council review monthly budget-to-actual expenditure reports and detail transaction reports</li> <li>• Password required to post accounts payable transactions in accounting software</li> </ul>
Fixed Assets	Fixed Assets purchased could be incorrectly omitted from financial records	<ul style="list-style-type: none"> <li>• Town Manager and Council review monthly budget-to-actual expenditure and detail transaction reports</li> <li>• Finance Officer and external auditors carefully examine expenditures posted</li> <li>• Physical inventories taken every year with unique asset identifier reconciling general ledger with subsidiary fixed asset schedule Note: Separate physical inventory performed annually on non-capitalized small tools, furniture, and equipment.</li> </ul>
Fixed Assets	Fixed Assets no longer in service inadvertently left on financial records and/or impairment not properly disclosed	<ul style="list-style-type: none"> <li>• Physical inventories performed every year</li> <li>• Annual review of fixed asset records in software against automobile and property</li> </ul>

Area	Risk	Control Procedures
Fixed Assets	Assets could be lost due to theft, employee error, or casualty	<p>insurance schedules</p> <ul style="list-style-type: none"> <li>• Adequate property and liability coverage maintained</li> <li>• Moveable assets tagged with Town of Summerfield name and unique identifier</li> <li>• Buildings and storage areas locked after hours</li> </ul>
Purchasing	Possible violation of state procurement laws or Town policies and procedures	<ul style="list-style-type: none"> <li>• Town staff must follow an adopted Town of Summerfield Purchasing Policy and Procedures Manual</li> <li>• Policy and Procedures Manual incorporates legal mandates</li> </ul>
Purchasing	Risk of not getting best value for taxpayer dollars	<ul style="list-style-type: none"> <li>• Formal and informal bid procedures followed in accordance with Town policy based on state law and best practices</li> <li>• Frequent RFPs and bidding for repeat or continuing contracts</li> <li>• Use Cooperative Purchasing groups and discount programs such as U.S. Communities</li> </ul>
Payroll	Pay persons who are not employed by Town of Summerfield	<ul style="list-style-type: none"> <li>• New hire and termination forms are authorized by Town Manager prior to receipt by Finance Officer</li> <li>• Timesheet submission required for all employees</li> <li>• Each individual's timesheet approved by Town Manager, Finance Officer, and Mayor.</li> <li>• Town of Summerfield too small to hide "phantom" employees</li> <li>• Checks reviewed by the Finance Officer, Town Manager, Mayor, and Designated Town Council member</li> <li>• Budget to actual monthly expenditures report reviewed by Town Manager and Council</li> </ul>
Payroll	Amounts paid and/or deducted are incorrect	<ul style="list-style-type: none"> <li>• Personnel file is maintained to document current pay rates and</li> </ul>

Area	Risk	Control Procedures
		all deductions <ul style="list-style-type: none"> <li>• Pay stubs distributed with detail for employee verification</li> <li>• Checks reviewed by the Finance Officer, Town Manager, Mayor, and Designated Town Council member</li> </ul>
Information Technology	Data becomes corrupted or available for manipulation by outside parties	<ul style="list-style-type: none"> <li>• Daily offsite backups performed</li> <li>• The security of all data and information protected by anti-virus software and firewalls</li> <li>• Computer specialist assigned to review system performance periodically</li> <li>• Password protected accounting software</li> </ul>
Information Technology	Physical destruction of information technology equipment	<ul style="list-style-type: none"> <li>• Daily offsite backups performed</li> </ul>

3. *Monitoring Internal Controls*-On a periodic basis, the Town Manager or designee will monitor the effectiveness of these controls and propose any modifications as appropriate. In addition, any internal control deficiencies noted by the external auditors will be immediately investigated by the Town Manager, and appropriate remedial action will be taken and documented.
4. *Misuse of Town of Summerfield Assets*-Any employee who suspects or becomes aware of the misuse or potential misuse of Town of Summerfield assets shall immediately notify the Town Manager. If the Town Manager is involved in the misuse or potential misuse, the employee shall immediately notify the Council. The Town Manager and/or Council, as appropriate, shall investigate and document the personnel file as to additional action.

**VIII. Authority:** North Carolina General Statutes 159-25(a)(1) charges the Finance Officer with keeping the books of the government “in accordance with generally accepted principles of governmental accounting and the rules and regulations of the [Local Government] Commission. Statements on Auditing Standards (SAS) Numbers 55, 94, and 112 provide authoritative guidance for establishing and managing internal controls, and the North Carolina State Treasurer’s Manual prescribes internal control functions.

**Reference Materials:**

*Town of Summerfield Purchasing Policy and Procedure Manual*

*Miller 2002 GAAS Guide*

*Standards for Internal Control in the Federal Government* issued by the United States General Accounting Office

*Evaluating Internal Controls: A Local Government Manager's Guide* by Stephen J. Gauthier, published by GFOA

*NC Department of State Treasurer Policies Manual—Internal Controls Chapter*  
*GFOA Recommended Practice—Enhancing Management Involvement with Internal Control* (2004)