



Internal Control

We issue a “management letter” along with each of our audit reports. Our management letters make recommendations for improving operations, saving money, upgrading management information, and improving “internal controls.” Most letters address internal controls by reviewing their purpose and making specific suggestions for tightening them. A typical letter might look like this:

This letter includes observations from our recently completed audit. Our audit was designed and intended to help you:

- safeguard your assets,
- report your financial activity and account balances accurately and properly, and
- operate more efficiently.

Your responsibilities

It is your responsibility to be sure that proper standards of business practice have been set, that policies and procedures exist to ensure that your directives are carried out, that you have an appropriate system for recording and reporting financial transactions, that you have appropriate controls, and that transactions are properly documented.

Our responsibilities to you

We have a responsibility to advise you about what CPAs refer to as “**reportable conditions**”. These are situations where your accounting systems or internal control procedures are not designed or operating in a way that would alert you to the risk of loss of assets.

We also have a responsibility to advise you about what we refer to as “**material weaknesses**”. These are similar but more serious conditions that could allow large errors or irregularities to exist and not be detected by your employees in the normal course of their duties.

The role of internal controls

Internal controls include proper standards of business practice and separation of the duties of custody of assets from recordkeeping for those assets. They are designed to improve accuracy, reliability and consistency, to reduce errors, and to help assure that assets are used according to your mission.

Segregation of duties is the most common internal control. Making payments by writing and sending checks is segregated from approval of the payment so that one person is prevented from causing a payment to be made to an improper payee without some crosscheck to reduce or eliminate that possibility. Another related internal control is to have the bank statements opened and reviewed by someone other than the person who wrote and sent the checks to ensure that they got to the correct payee. Here is one of our typical observations:

Monthly bank statement are currently reviewed by the Supervisor *after* reconciliations are prepared by the bookkeeper. For some assurance that the checks are proper, the statements and checks must be examined by someone other than the bookkeeper *before* monthly reconciliations are started. We suggest that monthly bank statements be sent directly to the Supervisor. The Supervisor should open the statements, review them and the canceled checks, and then sign off for approval on each statement. If the Supervisor is unavailable, this step could be done by a Town Councilperson.

Trust is not an Internal Control

“We trusted our finance director; how could she steal from our organization?” This is an all too common lament after an organization uncovers embezzlement. Fraud studies show that, with a change in personal circumstances, such as need or opportunity, or a change in beliefs and perceptions, a high percentage of people will steal. Given the statistics and the fraud stories, it is important to understand why internal controls, which decrease vulnerability to fraud, are so important. Trust, unfortunately, is not among them.

Strong internal controls require training and careful planning, but the payoff is worthwhile. Segregation of duties is fundamental, and includes ensuring that financial responsibilities are spread over a number of people. For example, individuals who approve invoices should not sign checks. It also includes employee policies, such as mandating regular vacations so that a normal flow of transactions occurs in an employee’s absence. An accounting manual that details the financial division’s responsibilities is an excellent tool that helps minimize the potential chaos caused by staff turnover.

Timely reporting is another effective control. Monthly financial statements should be presented and discussed with management and the board or finance committee. Even if

the finance committee and board do not meet monthly, they can review financial statements and monthly cash flow projections and be prepared to act on them at the next meeting. These statements are more effective when compared to the prior year and to the budget, with variances explained.

Officer Roles

The chief executive is charged with fiduciary oversight of the organization (including the finance department), and should have a basic understanding of financial statements, internal controls, and the budgeting process, as well as awareness of marketplace issues that may affect the organization.

A knowledgeable and competent finance director is another essential part of every organization. This individual should have a degree and professional experience in accounting; specialized experience is preferable. The finance director must also have communication skills for working with staff, board and committee members, vendors, and service providers. The finance director's responsibilities generally include establishing and maintaining internal controls, financial policies and procedures, budgets, financial statements, projections, and forecasts. Compensation must be competitive; typically this position commands the second- or third-highest salary in an organization.

The finance director's performance should be evaluated annually by a compensation committee (which in small organizations might be only the chief executive), and the salary level reviewed and adjusted when appropriate. Important evaluation criteria include timely and accurate financial reporting to both management and the board; timely preparation for the audit process; accurate filing of tax and informational returns and the resolution of comments received in the auditor's management letter. The external auditor can assess the finance director in terms of both skills and the ability to work with the audit process.

To monitor priorities and staffing needs, the chief executive should understand and monitor the workload of the finance director and finance department. Within budget constraints it is important for the finance area to have enough staff to ensure the appropriate segregation of duties. In small organizations, the bookkeeper is often the only finance staff member. Then, board members may have to assist in establishing segregation of duties by reviewing disbursements in greater detail.

The board members have a fiduciary duty to the organization and are a part of the internal control process. Typically, much of this oversight is carried out by the finance committee and its members. In smaller boards however, the entire board is the finance committee.

Our Audit Team is Changing

We welcome Daniel Nitschke to our audit team. Dan graduated from Alfred University and will be taking the CPA exam this year. We are excited to have him join our team and know you will enjoy working with him.

Our Firm

Gray Certified Public Accounting, P.C. has the professional qualifications and experience to provide the prompt, capable service you expect from a CPA firm at the reasonable cost upon which you insist. We do this by employing experienced people who are able to work quickly and efficiently. We are flexible and structure every engagement to meet our client's needs, while intruding minimally on your normal functions.

We annually audit Towns, Villages, and other government entities, including libraries, economic development agencies, and water conservation districts. We have performed many local government audits including government-wide single audits, Department of Housing and Urban Development grant program audits, Rural Development grant program audits, Federal Emergency Management Assistance program audits, New York State grant program audits, and audits and internal control reviews of the Justice Court, Town Clerk, Tax Collector, and Bookkeeper functions. We can be of service to you in performing your annual audit and in making recommendations to improve your financial management and internal controls. We happily provide references!

We have been Peer-Reviewed many times and continuously receive complimentary reports from the American Institute of Certified Public Accountants.

Our audit team members are participants in the Town Finance Association of Monroe County, the American Institute of Certified Public Accountants, and the New York State Society of Certified Public Accountants.

If we can be of any assistance or answer any questions, please call Dawn M. Minemier, CPA at (585) 262-5090, ext. 220.