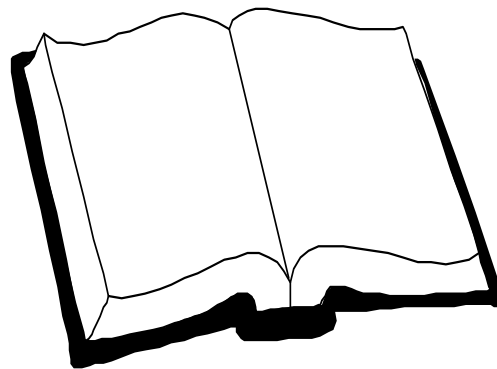


DRAFT

State of Wisconsin

Instructions for the Preparation of an
Agency Internal Control Plan



Prepared by the State Controller's Office
William J. Raftery, CPA
State Controller

April 1997
(Revised November 2005)

**Department of Administration
State Controller's Office
Internal Control Plan**

Table of Contents

General

- I Introduction
- II Internal Control Definitions
- III Internal Control Case Studies
- IV How to Prepare an Agency Internal Control Plan
- V Instructions for Annual Reporting

Appendices

- A Outline of How to Develop an Internal Control Plan
- B Receipting Function
- C Purchasing and Disbursement Function
- D Journal Voucher/Adjustment Function
- E Payroll Function

**Department of Administration
State Controller's Office
Internal Control Plan**

Introduction

The development of agency internal control plans will provide assurance that the State's assets are being safeguarded, that applicable statutes, rules and regulations are being followed, and that the objectives of agency management are being met. An internal control plan identifies management's idea of how activities should be operating.

An internal control plan is more than just a list of procedures or flowcharts of how activities operate. Rather, an internal control plan is a comprehensive document that encompasses all components of an agency's internal controls. As later sections of this document explain internal controls can be separated into 5 basic components (control environment, risk assessment, control activities, information and communication, and monitoring). An agency's internal control plan should contain documentation on its control structure as it relates to these components. The plan for one agency will differ from that of another agency due to size, complexity, resources and other factors.

Development and annual assessment of a plan allows management the opportunity to determine if the actual activities are operating as expected and helps identify any control weaknesses that should be corrected.

This document is intended to provide agencies with guidance in their preparation of an internal control plan. It is not all inclusive and agencies may find other information useful in the development of their plan. While this document contains a number of sections many are intended for reference purposes. Sections I through V should be reviewed to obtain an understanding of what is necessary to develop an internal control plan. Appendix A is also useful because it is an outline version of Section IV. The remaining appendices provide information on specific functions and can be reviewed when developing segments of the plan related to these sections. A brief description of the sections included in this document follows.

Internal Controls - Definition

This section provides a basic definition of internal controls and explains why internal controls are necessary. It also identifies the 5 basic components of internal controls (as explained in the *Internal Control - Integrated Framework*, published by the Committee on Sponsoring Organizations of the Treadway Commission (COSO)) and provides information on each component.

Internal Control Case Studies

This section gives examples of actual cases where poor controls have allowed certain individuals to perform activities that were contrary to management's objectives. In some instances the actions seriously affected the organizations ability to continue to function and in other instances the individual was able to embezzle money from the organization.

How To Prepare an Agency Internal Control Plan

This section provides information on how an agency should proceed with the development of its internal control plan. It is structured around the 5 basic components of internal controls. It provides a crosswalk between these theoretical components and the development of an actual written plan.

Instructions for Annual Reporting

Each agency is responsible for reviewing and evaluating its internal controls on an annual basis. It is also required to report on this annual review to SCO. This section details an agency's responsibilities when performing its annual internal control review. It also discusses what reporting is necessary and the form of the reporting.

Appendix A - Outline of How to Develop an Internal Control Plan

This appendix outlines the process an agency could follow to develop an internal control plan.

Appendix B - Receipting Function

This appendix provides information on the control objectives for this function. It also contains a series of questions that should be answered as part of the evaluation of this process. In addition, a sample flowchart of this process is included.

Appendix C - Purchasing and Disbursement Function

This appendix provides information on the control objectives for this function. It also contains a series of questions that should be answered as part of the evaluation of this process. In addition, a sample flowchart of this process is included.

Appendix D - Journal Voucher/Adjustment Function

This appendix provides information on the control objectives for this function. It also contains a series of questions that should be answered as part of the evaluation of this process. In addition, a sample flowchart of this process is included.

Appendix E - Payroll Function

This appendix provides information on the control objectives for this function. It also contains a series of questions that should be answered as part of the evaluation of this process. In addition, a sample flowchart of this process is included.

**Department of Administration
State Controller's Office
Internal Control Plan**

Internal Control Definitions

Introduction

An agency should recognize that a vital goal of its mission is to safeguard State assets and ensure the proper use of resources. The use of a properly structured internal control process can assist an agency in meeting this goal. However, when establishing control objectives and control techniques, as well as when performing internal control reviews, agencies should be aware of the inherent limitations (budget constraints, statutory and regulatory restrictions, staffing limitations, etc.) that constrain agency action.

Internal Control - Definition

Internal control is broadly defined as follows:

Internal control is a process, effected by an agency's management, other people, and systems designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations.
- Reliability of financial information and reporting
- Compliance with applicable laws and regulations.

This definition reflects certain fundamental concepts:

- Internal control is a process. It's a means to an end, not an end in itself.
- Internal control is effected by people. It's not merely policy manuals and forms, but people at every level of an organization.
- Internal controls should be expected to provide only reasonable assurance, not absolute assurance, to an entity's management.
- Internal control is geared to the achievement of objectives in one or more separate but overlapping categories.

The size of an agency has a significant effect on the nature of the internal control structure and the specific controls. Obviously, it is more difficult to establish adequate separation of duties in a small agency. It would also be unreasonable to expect a small agency to have internal auditors. However, if the various sub-elements of the internal control structure are examined, it becomes apparent that most are applicable to both large and small agencies. Even though a small agency may not have formal policies in manuals, it is certainly possible to have competent, trustworthy personnel with clear lines of authority, proper procedures for

authorization, execution, and recording of transactions, adequate documents, records, and reports, physical control over assets and records, and to a limited degree, checks on performance.

Often the most vital control available in a small agency is the knowledge, concern and supervision of top management personnel. The close working relationship with agency personnel makes possible careful evaluation of the competence of employees and the effectiveness of the overall system. For example, the internal control structure can be significantly strengthened if agency management is responsible for authorizing all payments after carefully reviewing supporting documents, reviewing bank reconciliation's and examining all agency correspondence.

Internal controls should not be looked upon as separate, specialized systems within an agency. They should be recognized as an integral part of each system that is to be used as a management tool to regulate and guide operations. Internal controls are a necessity to achieve proper conduct of government business and to account for available resources. They also facilitate the achievement of management objectives by serving as checks and balances against undesired actions. In this sense, internal controls are management controls. They embrace the whole network of policies, procedures, practices and systems used by management to carry out its functions. By preventing negative consequences from occurring, internal controls help achieve the positive aims of management.

Internal Control Objectives

The objectives of internal control include determining that:

Recorded transactions are valid - The internal control structure cannot permit the inclusion of fictitious or nonexistent transactions in agency accounting records.

Transactions are properly authorized - If a transaction that is not authorized takes place, it could result in a fraudulent transaction, and it could have the effect of wasting or misusing agency assets.

Transactions are properly recorded - Agency procedures must prevent the omission of transactions from the records.

Transactions are properly valued - An adequate internal control structure includes procedures to avoid errors in calculating and recording transactions at various stages in the recording process.

Transactions are properly classified - The proper account classification according to the agency's chart of accounts must be made if the agency's financial position is to be properly stated.

Transactions are recorded at the proper time - The recording of transactions either before or after the time they took place increases the likelihood of failing to record transactions or of recording them at the improper amount.

Transactions are properly posted and summarized - In many instances, individual transactions are batched prior to entry into the accounting system. Adequate controls are needed to make sure summarization is correct.

Programs are managed in accordance with sound business practices (i.e., activities are adequately planned, organized, directed, and controlled).

Elements of an Internal Control Structure

The Committee Of Sponsoring Organizations (COSO) was formed in response to a recommendation made by the National Commission on Fraudulent Financial Reporting. This commission is commonly referred to as the Treadway Commission. The sponsoring organizations are the Financial Executives Institute, the American Institute of Certified Public Accountants, the Institute of Internal Auditors, the American Accounting Association and the Institute of Management Accountants.

The Treadway Commission was formed, in part, because of the savings and loan crisis in the United States. This commission recommended that senior management of public companies attest to the effectiveness of their internal controls. Additionally, they recommended the study sponsors, COSO, develop formal guidance on internal control. This guidance was to be developed for the organizations that make representations on their internal control structures.

The COSO report defined an entity's internal control structure to consist of the following components:

- Control Environment
- Risk Assessment
- Control Activities
- Information and Communication
- Monitoring

Control Environment

The control environment sets the tone of the organization, influencing the control consciousness of its people. It is the foundation of all other components of internal control, providing discipline and structure. Control environment factors include: integrity and ethical values, commitment to competence, management's philosophy and operating style, organizational structure, assignment of authority and responsibility, and human resource policies and practices.

Risk Assessment

Every agency faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is the establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of these objectives, forming a basis for determining how the risks should be managed. An agency's risk assessment process should consider the events and circumstances that may occur and adversely affect its ability to record, process, summarize, and report financial information. Once risks are identified, management considers their significance, the likelihood of their occurrence, and how they should be

managed. Management may initiate plans, programs, or actions to address specific risks or it may decide to accept a risk because of cost or other considerations.

Control Activities

Control activities are the policies and procedures that help ensure that necessary actions are taken to address risks to achieve the entity's objectives. Control activities have various objectives and are applied at different organizational and functional levels. Generally, control activities that may be relevant to an agency's financial management may be categorized as internal controls that pertain to:

Performance Reviews - These control activities include reviews of actual performance versus budget, forecasts, and prior periods. Reviews relate different sets of data (operating or financial) to one another, together with analyses of the relationships and investigative and corrective actions.

Information processing - These control activities ensure the completeness and accuracy of transaction processing, authorization, and validity.

Physical Controls - These activities encompass the physical security of assets including adequate safeguards over access to assets and records such as secured facilities, authorization for access to computer programs and data files, and periodic counting and comparison with amounts shown on control records.

Segregation of duties - Assigning different people the responsibilities of authorizing transactions, recording transactions, and maintaining custody of assets is intended to reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or irregularities in the normal course of his or her duties.

Information and Communication

The information system relevant to financial reporting objectives, which includes the accounting system, consists of the methods and records established to identify, assemble, analyze, classify, record, and report entity transactions (as well as events and conditions) and to maintain accountability for the related assets and liabilities. An effective information system gives appropriate consideration to establishing methods and records that will:

- Identify and record all valid transactions.
- Describe on a timely basis the transactions in sufficient detail to permit proper classification of transactions for financial reporting.
- Measure the value of transactions in a manner that permits recording their proper monetary value in the financial statements.
- Determine the time period in which transactions occurred to permit recording of transactions in the proper accounting period.
- Present properly the transactions and related disclosures in the financial statements.

Communication involves providing a clear understanding of the individual roles and responsibilities pertaining to the internal control structure over financial activities. It includes the extent to which personnel understand how their activities in the financial

information system relate to the work of others and the means of reporting exceptions to an appropriate higher level within the entity. It takes such forms as policy manuals, accounting and financial reporting manuals, and memoranda. Communication also can be made orally and through the actions of management.

Monitoring

Monitoring is a process that assesses the quality of the internal control structure's performance over time. It involves assessment by appropriate personnel of the design and operation of controls on a suitably timely basis and taking necessary actions. Monitoring can be done through ongoing activities or separate evaluations.

**Department of Administration
State Controller's Office
Internal Control Plan**

Internal Control Case Studies

In order to demonstrate the importance of internal controls, we have included two case studies. The first shows how poor internal controls allowed one employee to bring Britain's oldest merchant bank to complete financial ruin. The second reveals how several employees embezzled money from an organization in Wisconsin over a period of several years.

Case Study #1

Barings Bank Debacle

On February 26, 1995, Barings Bank, Britain's oldest merchant bank, announced its collapse. A single employee's trading activity carried this bank into financial ruin.

It appears that this employee, Mr. Leeson, was trading in derivatives and had been incurring losses since he became the general manager and head trader for Baring's Singapore office in 1992. However, Mr. Leeson used an unauthorized and unreported account to adjust transaction prices so that profits would appear on the authorized accounts. Mr. Leeson hid the losses in the unauthorized account.

By the end of 1994, Mr. Leeson had reported false profits of \$150 million dollars for Barings Singapore office. Since this was a major source of revenue for Barings during this period, senior management did not question the validity of Mr. Leeson's trading activities. Also, Barings pay structure was such that these profits actually led to increased bonuses for many of its employees.

Control Environment Weaknesses

The underlying cause for the Barings bank debacle was the lack of segregation of duties. The perpetrator, Mr. Leeson, was responsible for both trading and settlement activity in the Singapore office. This allowed Mr. Leeson to use an unauthorized and unreported account to adjust transaction prices so that profits would appear on the authorized accounts.

This emphasizes the need for a proper segregation of duties in any business activity. If one person has the ability to perpetrate a fraud and conceal it, then there is a violation of the internal control of segregation of duties.

There were other weaknesses in the control environment which may have contributed to the bank's collapse. Mr. Leeson's direct superiors had little knowledge concerning derivatives. Also, the bank had not established an independent risk management unit.

Lack of Risk Assessments

There was a lack of risk assessment activity for Barings bank securities division. One major risk was that Barings had lent over 300 million British pounds to clients for trading, but they only had collateral for 31 million pounds. Another significant risk senior management overlooked was the lack of controls over a foreign office which handled an extremely large amount of money. Finally, senior management did not question why the Singapore office had such large profits in its first two years of operation.

Insufficient Control Activities

Barings could have had better policies and procedures to help detect the fraudulent trading activity. For example, the bank's limits for margin payments were set too high to be effective. In fact, the bank's limits for margin payments were not exceeded until three days before the bank's collapse. Additionally, although the information concerning the fictitious account used to hide the losses was readily available it was not analyzed by anyone.

Inadequate Information and Communication Systems

Barings had failed to create adequately controlled information systems in order to provide timely and accurate information to senior management. This, coupled with poor lines of communication between staff and senior management, created an information deficiency for senior management.

Monitoring

Barings senior management did not update its internal control systems based on direct recommendations relevant to their business activities. Baring's own internal auditors recommended that Mr. Leeson should not have been responsible for trading and settlement of trades. However, Barings senior management did not implement this recommendation. Furthermore, senior management ignored many of the recommendations for establishing controls to manage derivatives risk, made by authoritative organizations.

Case Study #2

Failure to Follow Established Internal Controls

Over a period of several years, embezzlements occurred in an organization in Wisconsin. These embezzlements were not detected during this period because control procedures designed to detect irregularities were not being followed. Field representatives responsible for selling documents to the public were keeping some of the money instead of remitting it to the central office.

Documents for sale are prenumbered and issued to the field offices by the central office. A record is maintained of the documents issued to each location. Documents are sold for a set amount, that is clearly marked on the documents. Monthly each field office remits, to the central office, collections and indicates the number of documents sold. The central office records this information and generates a report that lists, for each field office, the amount of documents issued, sales to date and a remaining balance of outstanding documents. At the

end of the year each field office is responsible for returning collections and any unsold documents to the central office. A final reconciliation report is generated to compare issued amounts to amounts remitted and documents returned. The central office procedures require a reconciliation of the documents returned to the outstanding balances in the reports.

For a period of several years the reconciliation of the documents returned, to the report balances was not performed. In the absence of this control procedure field staff were able to embezzle amounts received for documents sold. The organization was relying on the honesty of the field office employees to ensure that all collections were remitted to the central office.

Due to the fact that adequate control activities were not being carried out, the central office created a poor internal control environment. The lack of follow up indicated to the field representatives that the central office was either not monitoring these remittances or not placing much importance on this requirement. This promoted a lax attitude among those field representatives responsible for making those remittances. It provided an opportunity for employees at the field offices to steal collections with little fear of detection. It also points out the need to follow established control procedures.

**Department of Administration
State Controller's Office
Internal Control Plan**

**How To Prepare an Agency
Internal Control Plan**

Introduction

The systems of internal controls which have evolved in the State and its agencies have served a variety of useful purposes over the years. Generally, controls are more evident in the areas of finance and accounting due to management's perception of the high inherent risks in these areas, and due to the scrutiny that these functions have historically garnered by audit activities. However, regardless of the status of an agency's internal control system, most would agree that there is always room for improvement. This need for improvement is not an indictment against the existing controls, but rather reflects a desire to gain the added assurances that an organized structure will provide. By preparing an internal control plan an agency is providing itself and SCO with this added assurance.

Agency's should be aware that internal control structures, no matter how well designed and operated, can provide only reasonable assurance to management regarding achievement of its objectives. By definition internal controls are designed to provide reasonable assurance that the objectives of a system will be accomplished. Reasonable assurance equates to a satisfactory level of confidence under given considerations of costs, benefits, and risks. Cost refers to the financial measure of resources consumed in accomplishing a specified purpose. Cost can also represent a lost opportunity, such as a delay in operations, a decline in service levels, or low employee morale. A benefit is measured by the degree to which the risk of failing to achieve a stated objective is reduced. Examples include increasing the probability of detecting fraud, waste, abuse or error, preventing an improper activity, or enhancing regulatory compliance. The likelihood of achievement is affected by limitations inherent in all internal control systems. These include the realities that human judgment in decision-making can be faulty, persons responsible for establishing controls need to consider their relative costs and benefits, and breakdowns can occur because of human failures such as simple error or mistake.

How should an internal control plan be prepared?

SCO recommends that agencies use the five components of an internal control structure: Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring as a blueprint for the preparation of their internal control plans. The use of these components, and not a "canned" or strict step-by-step method, will produce internal control plans that have a common basis for comparison, while also providing agencies with a certain level of flexibility.

How voluminous or detailed must the plan be? What documentation should the plan contain?

This depends on a number of factors, including an agency's size, the complexity of its organizational structure, and the functions it performs. The actual hard copy of a plan may contain: policy and procedures manuals, flowcharts of financial processes, agency

mission statements, an affirmation signed by the agency head supporting the agency's efforts to improve its internal control structure, and a description of how the agency intends to monitor its internal control system. The plan's contents will vary by agency. However, the information required to document a specific agency's plan should become apparent as the agency works through the following sections.

Section 1 - Control Environment

See the definition of control environment in the "Definitions" section.

How does an agency incorporate its control environment into its internal control plan?

This can be accomplished by gathering and documenting evidence that supports the assumption that the agency maintains a sound control environment. The following discussion should facilitate the evidence gathering process.

Does your agency have written mission, philosophy or code of conduct statements?

If these documents have been prepared, they should be included in the plan. Such statements serve to clarify the agencies functional goals and objectives. They also provide insight into management's beliefs, attitudes and operating style.

At a minimum, the head of your agency should prepare a statement for inclusion in the plan that affirms their support of the concept of internal controls and provides staff with an understanding and awareness of the benefits of effective internal controls. This statement must also mention that safeguarding the State's assets and ensuring the proper use of State resources is an integral part of the agency's mission and its responsibility.

Maintaining a sound internal control environment requires: (1) The hiring of qualified, competent individuals. (2) Ensuring that employees are adequately trained. (3) Employees of an entity explicitly and implicitly understand their responsibilities. (4) Management has provided its employees with the authority to perform the tasks that they are assigned.

Does your agency maintain written personnel policies or procedures?

If so, include a copy of the procedures in the plan (or reference the document).

Your agency's personnel policies, written or not, must be reviewed and a determination on their sufficiency made. This determination should be documented and should address, at a minimum; (1) Whether they facilitate the hiring of competent, qualified personnel. (2) Whether adequate provisions are made for employee training. For example, does the agency encourage training or have a formal training or continuing education policy? (3) Whether the performance evaluation process employed by your agency is used as a positive tool to reaffirm the agency's mission as it relates to an employee? Does this process assist an employee in succeeding within the agency's framework?

Does your agency maintain up-to-date organization charts?

If yes, include them in the plan. If not, prepare and include them.

Are the position descriptions of your agency's personnel up-to-date and accurate?

When reviewing your agency's employee position descriptions be cognizant of those tasks performed by employees that fall outside of their official position descriptions. Determine if the position descriptions are sufficiently flexible to encompass all tasks performed by agency personnel. If employees perform tasks not covered in their position descriptions, which is often the case in smaller agencies where necessity dictates that employees perform numerous assignments, does an agreed upon mechanism exist, outside of the written position descriptions, by which management assigns these duties? If so, document how the mechanism functions.

If you determine that your agency's position descriptions are up-to-date, a statement to that effect should be included in the plan.

If the position descriptions are not up-to-date, they should be revised and a statement regarding their status should be included in the plan.

Has your agency prepared written reference materials or operating procedures not mentioned above that provide employees with additional functional guidance?

If yes, include them in the plan, or, if they are voluminous, consider including a detailed list of the materials.

While every entity should embrace these control factors, small and mid-sized agencies may implement the control environment factors differently than larger agencies. For example, smaller agencies might not have a written code of conduct but, instead, develop a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example.

Due to the abstract nature of the control environment concept, agencies may find that a number of other pieces of evidential matter maintained by their agency, which are not included in the above discussion, better portray or define their control environments. Agencies should be compelled to include these items in their plans.

Section 2 - Risk Assessment

See the definition of Risk Assessment in the "Definitions" section.

Risk Assessment involves:

The identification of the agency's primary responsibilities and functions and the objectives of those functions.

The identification of the transactions, cycles and systems used to manage financial information that is vital to the accomplishment of agency objectives.

The identification and management of obstacles and risks to agency financial processing and information systems.

How does an agency incorporate risk assessment into its internal control plan?

1. Develop an understanding of how your agency functions.

Risk analysis requires a basic understanding of how an agency functions. In order to obtain the required level of understanding an agency should: (1) Review its mission and operations, its organizational structure, and its funding. (2) Obtain an understanding of the general control environment, the overall financial management process, including the role of the accounting system and other financial management activities. (3) Identify the component systems comprising the complete accounting system.

2. Identify the transaction cycles comprising your agency's overall accounting system.

An agency can identify its transaction cycles by reconciling the financial transactions it uses to the function of the transactions within the agencies accounting system.

Relating transactions to accounting cycles and systems involves:

Listing all the transactions - economic events - an agency must initiate to perform its function

Determining relationships between transaction types

Grouping related transactions into cycles

Your agency should document the transaction cycles identified during this analysis.

Common transaction cycles include:

<u>Transaction Cycle</u>	<u>Examples of Transactions</u>	<u>Possible WiSMART Transactions</u>
Purchasing	Requesting Goods or Services	PD, PO
Disbursement	Payment for Goods and Services	P1, PV, MW, TL
Receipting/Billings	Revenue Processing	CR, RE, CJ
Payroll	Payment of Employees	PR, PV, MW
General Accounting	Journal Voucher	JV, JR, MW
Program Management	Grant Reimbursement Request	P1, PV, MW

3. Identify risks inherent in these transaction cycles and develop strategies to manage them.

Risk ranking factors should be applied to each transaction cycle to identify those with the greatest risk. Risk is defined as the level of vulnerability to fraud, abuse, and mismanagement. Factors considered should include magnitude of funds involved, potential impact of ineffective operation, sources of input, degree of automation, known problems, and recency of prior audits. An agency should document the results of this analysis in its internal control plan. An explanation of how the internal control process is organized to address these risks should also be documented. The management of these risks via the internal control structure should, at a minimum, provide reasonable assurance that financial processing functions work as intended.

The basic concepts of the risk assessment process should be present in every entity, regardless of size. However, the process is likely to be less formal and less structured in

small and midsized agencies. All agencies should have established financial operations objectives. In the past these may have been recognized implicitly rather than explicitly. The process of risk assessment as it relates to an agency's internal control plan provides the agency with the opportunity to review, revise, and explicitly recognize these objectives.

Section 3 - Control Activities

Control activities are the policies and procedures that help ensure that actions are taken to address obstacles and risks to the achievement of an agency's objectives. Generally, control activities that are relevant to an agency's financial management can be categorized as internal controls that pertain to:

- Performance Reviews
- Information Processing
- Physical Controls
- Segregation of duties

The concepts underlying control activities are likely to be similar across all agencies, but the form and formality with which they operate will vary. Smaller agencies may find that certain types of control activities are not relevant because of highly effective management controls. For example, management's retention of authority for approving significant purchases can provide strong control over this activity, lessening the need for more detailed control activities. Adequate segregation of duties can appear to present difficulties in a smaller agency. However, even agencies that have only a few employees can assign responsibilities to achieve appropriate segregation, or, use management oversight of the incompatible activities to achieve the control objectives.

How should this information be incorporated into an agency's internal control plan?

For each function identified pursuant to its risk assessment, an agency will be required to gather, document and analyze certain information.

This will involve documenting the objectives of the internal control system as it relates to the function. Control objective is defined as; a desired goal, or condition, for a specific cycle that reflects the application of the overall objectives of internal control to that cycle. For example, the control objectives of an internal control system as it relates to the receipting function are: (1) To ensure that all monies due the agency are received. (2) To ensure that all receipts are properly and promptly recorded in the State's financial records. (3) To ensure that all receipts are properly and promptly deposited with the State Treasurer. The appendices of this manual contain information on common control objectives for the major transaction cycles.

This process will also involve documenting: (1) The flow of information and documents through the process or function. (2) The internal control activities in place over the function. Most of the information required to complete this step may be found in existing agency documents (written policies, organization charts, procedural write-ups, manuals, memoranda, flowcharts, decision tables, and questionnaires). The appendices of this manual provide additional guidance and documentation guidelines for the major transaction cycles. In fact, if the function under review is contained in these appendices,

an agency must ensure that it gathers sufficient evidence to complete the questionnaires they contain.

This will involve reaching conclusions regarding the internal controls in place over the function. Once sufficient information has been gathered and documented an agency should determine: (1) If internal control weaknesses exist, and if necessary, how it will respond to those weaknesses, (2) The overall soundness of the internal control system over the function, and (3) The agency's plan of action for improving the internal controls over the function. This analysis should be documented in a summary memo.

Section 4 - Information and Communication

The information system relevant to an agency's financial reporting objectives consists of the methods and records established to identify, assemble, analyze, classify, record, and report entity transactions and to maintain accountability for the related assets and liabilities. The quality of system generated financial information affects management's ability to make appropriate decisions in managing and controlling an agency's activities.

What financial information system documentation should an agency include in its internal control plan?

For each information system used by an agency to process and analyze financial data the agency should:

Provide a brief description of the system. Answer questions such as: What is its purpose? How does it function? Where does it fall within the agency's information system structure?

Discuss the systems strengths and weaknesses. Consider providing the following information: Does the agency have a wish list of changes or improvements that it would like to see made to the system? Has the agency developed a concrete plan to make improvements to the system or up-date the system? What are they? Should the system be replaced? Why?

Communication involves providing a clear understanding of the individual roles and responsibilities pertaining to the internal control structure over financial reporting. It includes the extent to which personnel understand how their activities in the financial reporting information system relate to the work of others and the means of reporting exceptions to an appropriate higher level within the entity.

How should an agency evidence its internal control structure communication environment in its internal control plan?

Communication takes such forms as policy manuals, mission statements, accounting and financial reporting manuals, and memoranda. It also can be made orally and through the actions of management. The information an agency has collected and documented pursuant to completing Section 1 - Control Environment should contain a majority of the information required to address the documentation requirements of this section. An agency should review this information and determine if it needs to document additional guidance on its internal control structure communication environment.

Section 5 - Monitoring

Monitoring is a process that assesses the quality of the internal control structure's performance over time. It involves periodic assessment by appropriate personnel of the design and operation of controls and taking necessary actions. Monitoring can be done through ongoing activities or separate evaluations.

How should an agency address the monitoring element in its internal control plan?

To comply with this element of internal control an agency must develop a strategy or plan to ensure that its internal control structure continues to provide reasonable assurance that control objectives are being met. This plan should be documented in writing and included in the agency's internal control plan.

An agency may find it conducive to structure its monitoring programs around the internal control reporting requirements. These requirements are explained in detail in the, "Instructions for Annual Reporting", section of this manual.

Agency's must also develop formal procedures for responding to findings and recommendations reported by auditors. The procedures should be documented in writing and included in the internal control plan. At a minimum, they must: (1) Require prompt evaluation of findings and recommendations. (2) Outline proper actions for response to audit findings and recommendations. (3) Require completion, within established time frames, of all actions that correct or otherwise resolve the matters.

**Department of Administration
State Controller's Office
Internal Control Plan**

Instructions for Annual Reporting

Introduction

Sound internal control requires that an entity reassess its internal control structure, periodically. Internal controls change over time due to staff turn over, duties being shifted and for a variety of other reasons. Agencies will be required to analyze their internal control structures on an annual basis. This provides management with some assurances that controls are operating as expected. Therefore, agencies should, in conjunction with the preparation of their internal control plans, develop procedures for performing reviews of their internal control structures. These procedures should require: (1) A comprehensive review of the internal control structure to determine if it is functioning properly and in accordance with the agency's internal control plan. (2) A determination of whether the internal control structure has been updated accordingly to address operational or procedural changes to processes, program areas or functions, made during the period under review. (3) The identification of internal control weaknesses. (4) That actions be taken to ensure that control weaknesses discovered during the period under review, and in prior periods, have been adequately addressed. (5) That immediate attention be given to all internal control related findings and recommendations reported by auditors during the year.

Agencies must report the results of this review to the State Controller's Office (SCO). Reporting instructions are outlined in the following sections:

General Instructions

1. A review and evaluation of the agency internal controls must be made at or near the end of each calendar year. The timing of the review should be such to allow the agency to submit a report by the fourth Friday of January following the period being reported. The first report is due to SCO by January 23, 1998.
2. Reports should be sent to the Secretary of DOA and the State Controller's Office at the following addresses:

DOA Secretary's Office

US Mail
DOA - Secretary's Office
101 East Wilson Street
PO Box 7864
Madison, WI 53707-7864

Inter-D Mail
DOA-Secretary's Office
10th Floor
Administration Bldg.

State Controller's Office

US Mail
DOA - State Controller's Office
101 East Wilson Street

Inter-D Mail
DOA-State Controller's Office
5th Floor

PO Box 7932
Madison, WI 53707-7932

Administration Bldg.

Report Instructions

The report must include:

1. An acknowledgment from the agency head and chief financial officer that the agency's internal controls have been reviewed and that any material weaknesses in the controls have been reported to SCO.
2. A summary of revisions made to the agency's internal control plan during the period.
3. A description of the processes employed by the agency to review its internal control structure.
4. A listing of internal control weaknesses identified during the agency's review of its internal controls. An indication of how the agency plans to correct these weaknesses, including a time frame for implementation of these corrective actions.
5. A status report on corrective actions initiated in prior years.
6. A discussion of additional actions the agency might be undertaking to improve internal control.
7. The form of the report can be a memo from the agency to SCO or any other format that provides the required information.

**Department of Administration
State Controller's Office
Internal Control Plan**

**Outline of How to Develop an
Internal Control Plan**

This outline provides additional guidance on the preparation of an internal control plan. The steps it contains are organized using the 5 basic components of internal controls: control environment, risk assessment, control activities, information and communication, and monitoring. The outline does not provide an agency with all of the information necessary to actually develop an internal control plan. However, it should provide an agency with a basic understanding of the steps that must be taken when developing its plan. Section III, "How to Prepare an Agency Internal Control Plan", contains a more comprehensive discussion on the preparation of a plan.

Environment

Review, update or establish your agency's mission statements:

1. Formal Mission Statement
2. Philosophy Statement
3. Code of Conduct
4. Written statement by agency head supporting internal controls
5. Strategic plans in place for each of the operating units within the agency.

Review, update or establish your personnel structure

1. Organization chart
2. Personnel policies and procedures
 - a) Hiring
 - b) Training
 - c) Performance evaluations
 - d) Position descriptions
 - e) Other items related to personnel

The documents created by the steps indicated above will form the basis of the internal control plan related to the control environment.

Risk Assessment

1. Identify and list the transaction cycles that comprise the financial activities of your agency. Some examples of cycles are; purchasing, disbursing, receipting, billing, payroll, program management, financial reporting and monitoring.

Review the cycles to determine if an individual cycle should be separated into segments because of differences in procedures for certain transactions. For example, the disbursing cycle might be separated into aids payments, normal operating payments, travel reimbursements, capital purchases, etc.

Appendix A

2. Identify the objectives for each cycle or segment of a cycle. See the appendices for examples of cycles and objectives.
3. Identify obstacles and risks
 - a) Identify the control risks associated with each cycle. Risk assessment involves identifying the factors influencing the likelihood of achieving a cycle's control objectives.
 - b) Rank each cycle in terms of its risk. Risk is the level of vulnerability to mismanagement, errors, fraud and abuse. A number of factors such as, volume, dollars involved, changes in personnel, etc. will have an impact on the risk that would be assigned to a particular cycle.

Control Activities

For those systems with the highest risk:

1. Identify and document control objectives for each cycle or segment of a cycle. The appendices provide examples of different cycles and some of the related control objectives.
2. Explain how the internal control process is organized.
 - a). Document the flow of information through the cycle. Use flowcharts, memos and questionnaires as needed.
 - b). Document the internal control activities in place.
3. Identify internal control strengths.
4. Identify internal control weaknesses.
5. Assess the overall soundness of the internal control system.
6. Plan and document a course of action for improving internal controls.

Information and Communication

Information

1. Prepare a document which briefly describes each of the financial information systems used by your organization.
2. Evaluate each of the financial information systems.
 - a) List potential improvements.
 - b) Update or create plans for improvement as necessary.

Communication

Communication takes such forms as policy manuals, mission statements, accounting and financial reporting manuals, and memoranda.

1. Review the information compiled while addressing the Environment Component.

2. Ensure that sufficient evidence describing the internal control structure communication environment is documented and included.

The information developed through this process should be available to agency staff. Without communicating this information staff will not be aware of the control environment.

Monitoring

1. Implement a system to ensure that your organization's internal control structure continues to provide reasonable assurance that control objectives are being met. This requires a periodic review of the procedures to ensure they are operating as intended.
2. Develop formal procedures for responding to findings and recommendations reported by auditors.

All the documents developed during the review of the processes will make up the agency internal control plan.

Department of Administration
State Controller's Office

Receipting Function

This appendix is provided for two purposes; as a reference material, and to illustrate the information that should be gathered, prepared, and reviewed when an agency performs its analysis of the internal controls over the cash receipting function. The information in this appendix can be used both in the preparation of an internal control plan and in the annual review and evaluation of an agency's internal controls. It is organized as follows:

<u>Section Title</u>	<u>Description</u>
General Control Objectives	Illustrates the general objectives of an internal control system as it relates to the receipting function.
Control Activities that Address Control Objectives	Illustrates common control activities used to accomplish the objectives of the receipting function internal control system.
Control Activities vs. Control Objectives in the Receipting Function	This chart illustrates the relationship between receipting function control activities and control objectives.
Internal Control Questionnaire -Receipting Function	This questionnaire encompasses the information an agency is required to document in conjunction with the development of its internal control plan. By completing the questionnaire an agency should have gathered enough information to make a determination on the sufficiency of the internal controls over its receipting function. Agencies may choose to document the information requested by the questionnaire using a number of methods. These include: completion of the questionnaire, preparation of flowcharts, memos, or checklists.
Flowchart of a Receipting Function with Appropriate Internal Controls	An example receipting function flowchart. Included for illustrative purposes only.

Control Objectives - Cash Receipting Function

The general objectives of an internal control system as it relates to the receipting function are as follows:

To ensure that all monies due the agency are received.

To ensure that all receipts are properly and promptly recorded in the State's financial records.

To ensure that all receipts are properly and promptly deposited with the State Treasurer.

Control Activities that Address Receipting Function Control Objectives

Control activities are the policies and procedures that help ensure that necessary actions are taken to address risks to the achievement of an agency's objectives. Internal controls over the receipting function are the actions designed to ensure that the basic control objectives, as identified above, are met. The control activities that an agency should establish are based on the judgment of agency management. That judgment is affected by circumstances, such as agency size, the number of personnel available, and by conclusions about the relationship of cost and benefits. Users of these reference materials must understand and recognize that important agency specific matters may not be addressed by the following common control activities. In these instances, an agency should design appropriate internal control activities.

The following list contains control activities that are commonly used to accomplish the objectives of an internal control system over the receipting function.

1. Segregation of duties is **necessary** over functions related to cash. **Never allow one employee to handle a cash transaction from beginning to end.** This control activity limits the risk that an employee would perpetrate and/or conceal errors in the normal course of their work. It also reduces the risk that an unintentional error could be processed without detection. Therefore, if an agency has assigned all of the duties related to the cash function to a single employee a severe internal control weakness exists, even if that employee is a longtime employee, thorough, honest and trustworthy. Examples of responsibilities that should be segregated include:

Responsibilities for collection and deposit of cash should be separate from those for recording receipts and entries to the financial records.

Responsibilities for cash receipting should be separate from cash disbursing.

2. Open all mail and count cash in a central location which can be observed by other employees.
3. Prepare a list of incoming cash items, upon receipt, for review by another employee.
4. Restrictively endorse all checks immediately upon receipt.
5. All receipts should be deposited on a timely basis.
6. Account for receipts and balance to collections on a timely basis.
7. Physical safeguards should exist over all cash funds.
8. Establish procedures in compliance with SCO guidelines for the recording, processing, and collecting of account receivables.

Control Activities vs. Control Objectives in the Receipting Function

<u>Control</u>	<u>Description</u>	<u>Control Objective</u>
Separation of Duties	Responsibilities for collection and deposit of cash should be separate from those for recording receipts and entries to the financial records.	To ensure that all receipts are properly and promptly recorded in the State's financial records.
		To ensure that all receipts are properly and promptly deposited with the State Treasurer.
Independent Checks on Performance	Account for receipts and balance to collections on a timely basis.	To ensure that all monies due the agency are received.
Independent Checks on Performance	Open all mail and count cash in a central location which can be observed by other employees.	To ensure that all monies due the agency are received and not diverted by the employee.
Physical Controls Over Assets	Restrictively endorse all checks immediately upon receipt.	To ensure that all receipts are properly and promptly recorded in the State's financial records.
Physical Controls Over Assets	Physical safeguards should exist over all cash funds.	To ensure that all receipts are properly and promptly deposited with the State Treasurer.
Adequate Documents and Records	Establish procedures in compliance with SCO guidelines for the recording, processing, and collecting of account receivables.	To ensure that all monies due the agency are received.

Department of Administration
State Controller's Office

Receipting Function

Internal Control Questionnaire

1. Does your agency maintain written receipt processing or accounts receivable procedures?

If yes, attach a copy of the procedures. In addition, the procedures should be reviewed to determine; if they are accurate, in compliance with statutes and the State Accounting Manual, and if they exhibit sound internal control. Document the results of this review.

If not, prepare the procedures and attach a copy. This action is necessary, because written procedures; provide a mechanism to guide employees in the performance of their duties, they explain to new employees the steps to be performed, and provide for more consistent operation of the process.

2. Does your agency sell goods from locations maintaining a cash drawer? If yes:

What type of control list is used to record cash transactions? For example, cash register tapes or handwritten sales logs.

How often are cash drawers balanced? Who performs this task? Cash drawers should generally be balanced at least daily. If your agency does not balance its cash drawers this frequently, document why not.

How often do supervisory personnel perform cash drawer audits? Who is responsible for performing this function?

Where are cash drawers maintained when they are not in use? Is this a secure location?

How often are reconciliations of the locations inventory and sales records performed? Who is responsible for performing these reconciliations?

Document additional control mechanisms used by your agency over the use of cash drawers.

Appendix B

3. Document how your agency has segregated:

The responsibilities for collection and deposit of cash from those for recording receipts and entries to the financial records.

The responsibilities for cash receipting from cash disbursing.

If applicable, provide evidence that this segregation of duties is consistent with your employee's WiSMART security profiles.

If your agency has not separated these functions, explain why? If compensating controls are in place, what are they? A material internal control weakness may exist if sufficient compensating controls are not in place. If such a weakness is found, it should be reported to SCO in your agency's annual report on internal controls.

4. Does your agency's central mail room, or in smaller agencies, the individual responsible for opening the mail, prepare a list of incoming cash items? Ideally, the checks are given to the party responsible for depositing them and the list is given to an independent third party. This third party would then be responsible for comparing the list totals to deposits made. This reconciliation would ensure that all checks are properly deposited.

If yes, document who prepares the list and how it is used in subsequent reconciliations.

If no, document your agency's justification for not preparing the list? This deficiency by itself does not constitute a material internal control weakness. However, upon consideration of the controls over the entire receipting function, you may determine that the absence of a remittance list and subsequent reconciliation is a material weakness.

5. How is your agency's operation of mail opening and, if applicable, listing of collections checked or supervised? Please explain.
6. Do secure facilities (safes, locked cabinets) exist for the storage of liquid assets (cash, bonds, etc.)?

If yes, what are they and how are they used?

If not, explain why their use is not necessary.

Appendix B

7. How often does your agency deposit funds with the State Treasurer?

Does the volume, or dollar amount, of receipts impact the deposit volume?

Determine if this frequency is in compliance with statutes (s. 20.906), which require that deposits be made at least weekly, or the State Accounting manual, which requires that receipts greater than \$100 be deposited daily.

8. Does your agency maintain any bank accounts?

Does your agency utilize a depository account?

Do any of the agency's branch office locations maintain a bank account (if applicable)?

For each bank account maintained by your agency document the following:

Purpose of the account

Bank Name

Account Title

Account Number

Approximate Balance

Evidence that your agency has received authority to maintain the account

Evidence that the account has been approved by the Depository Selection Board

9. Does your agency have a contingent fund, change fund, or petty cash fund?

If yes, who is responsible (custodian) for administering/safeguarding the funds? In addition, determine if the accounts have been properly authorized.

If your agency has multiple offices determine how this structure impacts the administration of the funds. If a bank account is used in the administration of the fund ensure that it is included in the response to question 8.

10. Does your agency ever receive gifts of cash (liquid assets)?

If yes, what types of gifts?

Where are they held? Are they deposited directly with the State treasurer? If not, document the statute that authorizes your agency to keep such gifts.

Appendix B

11. Does your agency hold any other investments? For example: Stocks, bonds, CD's.

If yes, how were they obtained?

Where are they held? Are they deposited directly with the State Treasurer? If not, document the statute that authorizes your agency to hold such investments.

12. Does your agency record all receipts of funds on the State's central accounting system (WiSMART)?

If not, document the types of receipts that are not recorded on WiSMART. The documented information should include your agency's justification for not recording these receipts. When completed this information should be immediately submitted, for review, to SCO.

13. Does your agency record detailed or summary receivable information in the State's central accounting system (WiSMART)?

If not, provide justification for not entering the information on WiSMART. (The State Accounting Manual issued by the State Controller's Office requires each agency to compile such information and record it on WiSMART monthly.)

14. Does your agency perform periodic reconciliations of its WiSMART cash balances?

If yes, how often? Who is responsible?

If not, your agency should strongly consider performing this reconciliation.

15. Has your agency outsourced functions which require a vendor to collect revenues that the agency would otherwise be responsible for collecting?

If yes, does the vendor deposit **all** receipts directly with the State Treasurer?

Are all expenditures for the vendors services made under authority of an appropriation?

If the vendor does not deposit revenues due the agency in the State Treasury, when collected, or, if expenditures for these goods or services are not made under authority of an appropriation, the matter should be referred to the State Controller and DOA Budget.

Appendix B

16. Does your agency ever account for the receipt of funds as refunds of expenditures?

If yes, in what situations?

Document why the receipts are treated as refunds of expenditures?

17. How are any employee coffee funds, vending machine proceeds or other similar transactions handled?

18. Do supervisory personnel review receipt reports on a regular basis?

If yes, who is responsible for performing these reviews? How often are they performed? How is completion of a review evidenced (i.e., are reports initialed and dated)? What reports are reviewed?

19. Does your agency or someone outside your agency perform audits of the receipt process?

If yes, who performs the exams? How often? How are audit findings resolved?

20. Prepare a summary memo for inclusion in your agencies internal control plan. The memo should include a conclusion regarding the overall soundness of the internal controls over the receipting function. It should also discuss any internal control weaknesses and your agencies plan of action for improving the internal controls over this function.

**Department of Administration
State Controller's Office**

Purchasing and Disbursement Function

This appendix is provided for two purposes; as a reference material, and to illustrate the information that should be gathered, prepared, and reviewed, when an agency performs its analysis of the internal controls over the purchasing and disbursement function. This information can be used both in the preparation of an internal control plan and in the annual review and evaluation on an agency's internal controls. It is organized as follows:

<u>Section Title</u>	<u>Description</u>
General Control Objectives	Illustrates the general objectives of an internal control system as it relates to the purchasing and disbursement function.
Control Activities that Address Control Objectives	Illustrates common control activities used to accomplish the objectives of the purchasing and disbursement internal control system.
Control Activities vs. Control Objectives in the Purchasing and Disbursement Function	This chart illustrates the relationship between the control activities and control objectives in the purchasing and disbursement function.
Internal Control Questionnaire - Purchasing and Disbursement Function	This questionnaire encompasses the information an agency is required to document in conjunction with the development of its internal control plan. By completing the questionnaire an agency should have gathered enough information to make a determination on the sufficiency of the internal controls over its purchasing and disbursement functions. Agencies may choose to document the information requested by the questionnaire using a number of methods. These include: completion of the questionnaire and preparation of flowcharts, memos, or checklists.
Flowchart of a Purchasing and Disbursement Function with Appropriate Internal Controls	An example of a purchasing and disbursement function flowchart. Included for illustrative purposes only.

Control Objectives - Purchasing and Disbursement Function

The general objectives of an internal control system as it relates to the purchasing and disbursement function are as follows:

To ensure the agency receives the goods and services it requires to carry out its mission.

To ensure that purchases are made in accordance with the State's laws, regulations, and procurement rules.

To ensure that only requested goods and services are accepted.

To ensure that purchases and payments are properly authorized, executed and recorded.

To ensure that payments are for goods and services ordered and received.

To ensure that the State pays only agreed upon prices for goods and services.

To ensure that goods and services are paid for out of the correct appropriation and budget.

Control Activities that Address Purchasing and Disbursement Function Control Objectives

Control activities are the policies and procedures that help ensure that necessary actions are taken to address risks accepted in the achievement of an agency's objectives. Internal controls over the purchasing and disbursement function are the actions designed to ensure that the basic control objectives, as identified in the previous section, are met. The control activities that an agency should establish are based on the judgment of agency management. That judgment is affected by various circumstances, such as agency size, the number of personnel available, and by conclusions about the relationship of cost and benefits. Users of these reference materials must understand and recognize that important agency specific matters may not be addressed by the following common control activities. In this instance, an agency should design other appropriate internal control activities.

The following list contains control activities that are commonly used to accomplish the objectives of a purchasing and disbursement function's internal control system.

1. Segregation of duties is **necessary** over this function to provide adequate control. **Never allow one employee to handle an acquisition transaction from beginning to end.** This holds true for every agency, including agencies having very few employees. It is a **severe** internal control weakness to allow an employee to have the ability to perform all of the functions related to the purchasing and disbursing function. Segregation of duties limits the risk that an employee would perpetrate and/or conceal errors in the normal course of their work. It also reduces the risk that an unintentional error could be processed without detection. Examples of responsibilities that should be segregated include:

Responsibilities for voucher preparations should be separate from approval for these transactions and separate from the recording of these transactions.

Duties for approval of disbursements should be separate from the budgeting function, the purchasing function, voucher preparation and the disbursement of funds.

Appendix C

Duties for purchasing should be separate from requisitioning and receiving.

2. Purchases of goods and services should be properly authorized by those designated this responsibility.
3. The person requesting a purchase should indicate the appropriation and coding to be used.
4. Order splitting to avoid higher level approvals should be prohibited.
5. Changes to contracts or purchase orders should require the same approvals as the original order.
6. Adequate procedures should exist to ensure that goods and service are received prior to payment.
7. Someone other than the person approving payment should be responsible for verification of receipt, quantity and quality.
8. Invoices should be received in a central location.
9. A record of approved vendors should be maintained.
10. Review and approval of invoices and vouchers for completeness of supporting documents and proper authorizations should be conducted (preaudit).
11. Purchasing and expenditure reports should be reviewed by an appropriate level of management.

Control Activities vs. Control Objectives in the Purchasing and Disbursement Function

<u>Control Type</u>	<u>Description</u>	<u>Control Objective</u>
Separation of Duties	Responsibilities for voucher preparations should be separate from approval and separate from the recording of these transactions.	To ensure that purchases and payments are properly authorized, executed and accounted for
Separation of Duties	Duties for purchasing should be separate from requisitioning and receiving.	To ensure that purchases and payments are properly authorized, executed and accounted for
Proper Procedures for Authorization	Purchases of goods and services should be properly authorized by those designated this responsibility	To ensure that purchases are properly authorized
Adequate Documents and Records	Adequate written procedures should exist to ensure that goods and service are received prior to payment.	To ensure that payments are for goods and services ordered and received
Proper Procedures for Authorization	Changes to contracts or purchase orders should require the same approvals as the original order.	To ensure that purchases are properly authorized
Adequate Documents and Records	A record of approved vendors should be maintained.	To ensure that purchases are made in accordance with the State's laws, regulations, and procurement rules
Independent Checks on Performance	Review and approval of invoices and vouchers for completeness of supporting documents and proper authorizations should be conducted (preaudit).	To ensure that payments are properly authorized
		To ensure that the State pays only agreed upon prices for goods and services
		To ensure that goods & services are paid from the correct appropriation & budget
Adequate Documents and Records	Purchasing and expenditure reports should be reviewed by an appropriate level of management.	To ensure that purchases and payments are properly authorized, executed and accounted for
		To ensure that goods & services are paid from the correct appropriation & budget

Department of Administration
State Controller's Office

Purchasing and Disbursement Function

Internal Control Questionnaire

1. Does your agency maintain written purchasing and disbursement procedures?

If yes, attach a copy of the procedures. In addition, the procedures should be reviewed to determine; if they are accurate, in compliance with statutes and the State Accounting Manual, and if they exhibit sound internal control. Questions to consider while determining whether the procedures exhibit sound internal control include:

Do procedures exist to ensure that goods and services are received prior to payment?

Is someone other than the person approving payment responsible for verification of receipt, quantity and quality?

Are invoices received in a central location?

Do they include procedures for the physical verification of receipt of goods and services?

Is the person who requested the purchase responsible for indicating the appropriation and coding to be used?

Is order splitting prohibited?

Do changes to contracts or purchase orders require the same approvals as the original order?

Document the results of your review.

If your agency does not maintain written purchasing and disbursement procedures, prepare them and attach a copy. This action is necessary, because written procedures; provide a mechanism to guide employees in the performance of their duties, they explain to new employees the steps to be performed, and provide for more consistent operation of the process.

2. Document how your agency has segregated:

The responsibilities for voucher preparation, voucher approval and voucher record keeping.

The responsibilities for approval of disbursements from the budgeting function, the purchasing function, voucher preparation and the disbursement of funds.

The duties for purchasing from those for requisitioning and receiving.

Appendix C

If applicable, provide evidence that this segregation of duties is consistent with your employee's WiSMART security profiles.

If your agency has not segregated these functions, explain why? If compensating controls are in place, what are they? A material internal control weakness may exist if sufficient compensating controls are not in place. If such a weakness is found, your purchasing and disbursement function must be restructured to address the problem. In addition, the weakness should be reported to SCO in your agency's annual report on internal controls.

3. Document how your agency's preaudit function operates.

Review this process to ensure that it is in compliance with the preaudit procedures set forth in DOA's policy directive issued, June 1, 1993, and your signed agreement with DOA. Document the results of this review. If your preaudit procedures are not in compliance with this directive, develop a plan to remedy the situation, or provide your agency's justification for the deviation. In either case, this incidence of non compliance should be reported to SCO in your agency's annual report on internal controls.

4. Detail what supporting documentation comprises a payment voucher.

Provide evidence that your agency payment voucher includes sufficient documentation to support the payment. Source documentation should include original invoices, account coding charged, payee, address of payee, amount, reference to any purchase orders, etc. Additionally, the voucher should contain a statement that the payment was audited in accordance with Chapter 16 and the delegation agreement. A statement to this affect is required under the statutes. If voucher documentation is not sufficient then develop a plan to remedy the situation.

5. Document your agency's procedure for determining how long to delay payment on an invoice. In addition, review a sample of paid invoices to determine if this policy is consistently applied in practice. Document the results of this review.

Review this information to determine if your agency is properly managing cash by delaying payment to a date required by statute or agreement. The following questions should be addressed when performing this analysis:

Does the policy require that payments be delayed to maximize interest earnings for the state?

Does this policy require payment within the time frame required by section 16.528 of the Wisconsin statutes (the prompt payment law)?

Does this policy outline parameters for taking available discounts if doing so would benefit the state?

Appendix C

6. Does your agency record all disbursements of funds on the State's central accounting system (WiSMART)?

If not, document the types of disbursements that are not recorded on WiSMART. The documented information should include your agency's justification for not recording these transactions. Once documented, this information should be immediately submitted for review, to SCO.

7. Does your agency ever account for disbursements as refunds of revenues?

If yes, in what situations?

Document why these disbursements are treated as refunds of revenues?

8. Document the extent to which your agency uses periodic financial reports to monitor the purchasing and disbursement function. Consider the following points when performing this review:

Does your agency receive or prepare periodic purchasing or disbursement reports? Which of these reports do agency personnel use to monitor these activities? Who is responsible for performing this review? Does this person(s) evidence their review? How frequently are the reviews performed?

9. Does your agency or someone outside your agency perform audits of the purchasing and disbursement function?

If yes, who performs the exams? How often? How are audit findings resolved?

10. Prepare a summary memo for inclusion in your agencies internal control plan. The memo should include a conclusion regarding the overall soundness of the internal controls over the purchasing and disbursement function. It should also discuss any internal control weaknesses and your agencies plan of action for improving the internal controls over this function.

Department of Administration
State Controller's Office

Journal Voucher/Adjustment Function

This appendix is provided for two purposes; as a reference material, and to illustrate the information that should be gathered, prepared, and reviewed, when an agency performs its analysis of the internal controls over its journal voucher/adjustment function. It is organized as follows:

<u>Section Title</u>	<u>Description</u>
General Control Objectives	Illustrates the general objectives of an internal control system as it relates to the journal voucher/adjustment function.
Control Activities that Address Control Objectives	Illustrates common control activities used to accomplish the objectives of the journal voucher/adjustment function.
Control Activities vs. Control Objectives in the JV/Adjustment Function	This chart illustrates the relationship between the control activities and control objectives in the journal voucher/adjustment function.
Internal Control Questionnaire - JV/Adjustment Function	This questionnaire encompasses the information an agency is required to document in conjunction with the development of its internal control plan. By completing the questionnaire an agency should have gathered enough information to make a determination on the sufficiency of the internal controls over its journal voucher/adjustment function. Agencies may choose to document the information requested by the questionnaire using a number of methods. These include: completion of the questionnaire and preparation of flowcharts, memos, or checklists.
Flowchart of a JV/Adjustment Function with Appropriate Internal Controls	An example journal voucher/adjustment function. Included for illustrative purposes only.

Control Objectives - Journal Voucher/Adjustment Function

The general objectives of the internal control system as it relates to the journal voucher/adjustment function are as follows:

- To ensure that adjustments to the State's financial records are for proper purposes.
- To ensure that adjustments to the State's financial records are properly authorized.
- To ensure that adjustments are recorded promptly and accurately.

Control Activities that Address Journal Voucher/Adjustment Function Control Objectives

Control activities are the policies and procedures that help ensure that necessary actions are taken to address risks accepted in the achievement of an agency's objectives. Internal controls over the journal voucher/adjustment function are the actions designed to ensure that the basic control objectives, as identified in the previous section, are met. The control activities that an agency should establish should be based on the judgment of agency management. That judgment is affected by various circumstances, such as agency size, the number of personnel available, and by conclusions about the relationship of cost and benefits. Users of these reference materials must understand and recognize that important agency specific matters may not be addressed by the following common control activities. In this instance, an agency should design other appropriate internal control activities.

The following list contains control activities that are commonly used to accomplish the objectives of a journal voucher/adjustment function's internal control system.

1. Segregation of duties. This control activity limits the risk that an employee could perpetrate and/or conceal errors in the normal course of their work. It also reduces the risk that an unintentional error could be processed without detection. Examples of responsibilities that should be segregated in the journal voucher/adjustment function include:
 - The responsibilities for maintaining the general ledger and custody of assets.
 - The responsibilities for preparing and approving journal entries.
2. Review and approval of all journal vouchers.
3. Procedures to ensure that journal vouchers are supported by adequate descriptions or documentation.
3. Controls that ensure that only authorized individuals can initiate journal vouchers.
4. Supervision by a principal accounting officer over accounting records and accounting employees at all locations.
5. Up-to-date written accounting, policy, and procedural manuals that are distributed to appropriate personnel.
6. Perform periodic review and comparison of general ledger balances to amounts appropriated and budgeted.

Control Activities vs. Control Objectives in the Journal Voucher/adjustment Function

<u>Control Type</u>	<u>Description</u>	<u>Control Objective</u>
Separation of Duties	The responsibilities for preparing and approving journal entries	To ensure that adjustments to the State's financial records are for proper purposes To ensure that adjustments are recorded promptly and accurately
Proper Procedures for Authorization	Review and approval of all journal vouchers	To ensure that adjustments to the State's financial records are properly authorized
Adequate Documents and Records	Procedures to ensure that journal vouchers are supported by adequate descriptions or documentation	To ensure that adjustments to the State's financial records are properly authorized To ensure that adjustments to the State's financial records are for proper purposes To ensure that adjustments are recorded promptly and accurately
Independent Checks on Performance	Supervision by a principal accounting officer over accounting records and accounting employees at all locations	To ensure that adjustments to the State's financial records are for proper purposes
Adequate Documents and Records	Up-to-date written accounting, policy, and procedural manuals that are distributed to appropriate personnel	To ensure that adjustments are recorded promptly and accurately
Independent Checks on Performance	Perform periodic review and comparison of general ledger balances to amounts appropriated and budgeted	To ensure that adjustments to the State's financial records are for proper purposes

Department of Administration
State Controller's Office

Journal Voucher/Adjustment Function

Internal Control Questionnaire

1. Does your agency maintain written journal voucher processing procedures?

If yes, attach a copy of the procedures. In addition, the procedures should be reviewed to determine; if they are accurate, in compliance with statutes and the State Accounting Manual, and if they exhibit sound internal control. Questions to consider while determining whether the procedures exhibit sound internal control include:

Do they discuss the process of reviewing and approving journal vouchers?

Do they require that journal vouchers are supported by adequate descriptions or documentation?

Do they ensure that only authorized individuals can initiate journal vouchers?

Do they require the performance of periodic reviews and comparisons of general ledger balances to amounts appropriated and budgeted?

Do they ensure that all adjustments to the State's financial records are for proper purposes?

Document the results of your review.

If your agency does not maintain written journal voucher processing procedures, prepare them and attach a copy. This action is necessary, because written procedures; provide a mechanism to guide employees in the performance of their duties, they explain to new employees the steps to be performed, and provide for more consistent operation of the process.

2. Document how your agency has segregated:

The responsibilities for maintaining the general ledger and custody of assets.

The responsibilities for preparing and approving journal entries.

If applicable, provide evidence that this segregation of duties is consistent with your employee's WiSMART security profiles.

If your agency has not segregated these functions, explain why? If compensating controls are in place, what are they? A material internal control weakness may exist if sufficient compensating controls are not in place. If such a weakness is found, it should be reported to SCO in your agency's annual report on internal controls.

Appendix D

3. Document the criteria for adjustments including types allowed, and authorization required.

4. Does your agency or someone outside your agency perform audits of this function?
If yes, who performs the exams? How often? How are audit findings resolved?

5. Prepare a summary memo for inclusion in your agencies internal control plan. The memo should include a conclusion regarding the overall soundness of the internal controls over this function. It should also discuss any internal control weaknesses and your agencies plan of action for improving the internal controls over this function.

Department of Administration
State Controller's Office

Payroll Function

This appendix is provided for two purposes; as a reference material, and to illustrate the information that should be gathered, prepared, and reviewed, when an agency performs its analysis of the internal controls over the payroll function. It is organized as follows:

<u>Section Title</u>	<u>Description</u>
General Control Objectives	Illustrates the general objectives of an internal control system as it relates to the payroll function.
Control Activities that Address Control Objectives	Illustrates common control activities used to accomplish the objectives of the payroll internal control system.
Control Activities vs. Control Objectives in the Payroll Function	This chart illustrates the relationship between the control activities and control objectives in the payroll function.
Internal Control Questionnaire - Payroll Function	This questionnaire encompasses the information an agency is required to document in conjunction with the development of its internal control plan. By completing the questionnaire an agency should have gathered enough information to make a determination on the sufficiency of the internal controls over its payroll functions. Agencies may choose to document the information requested by the questionnaire using a number of methods. These include: completion of the questionnaire and preparation of flowcharts, memos, or checklists.
Flowchart of a Payroll Function with Appropriate Internal Controls	An example of a Payroll function flowchart. Included for illustrative purposes only.

Control Objectives - Payroll Function

The general objectives of the internal control system as it relates to the payroll function are as follows:

- To ensure that payroll payments are properly authorized.
- To ensure that payroll payments are for actual hours worked or authorized leave time.
- To ensure that payroll related payments are accurately calculated, recorded and paid.
- To ensure that the payroll is paid for out of the correct appropriation and budget.

Control Activities that Address Payroll Function Control Objectives

Control activities are the policies and procedures that help ensure that necessary actions are taken to address risks accepted in the achievement of an agency's objectives. Internal controls over the payroll function are the actions designed to ensure that the basic control objectives, as identified in the previous section, are met. The control activities that an agency should establish should be based on the judgment of agency management. That judgment is affected by various circumstances, such as agency size, the number of personnel available, and by conclusions about the relationship of cost and benefits. Users of these reference materials must understand and recognize that important agency specific matters may not be addressed by the following common control activities. In this instance, an agency should design other appropriate internal control activities.

The following list contains control activities that are commonly used to accomplish the objectives of a payroll function's internal control system.

1. Segregation of duties. This control activity limits the risk that an employee could perpetrate and/or conceal errors in the normal course of their work. It also reduces the risk that unintentional errors could be processed without detection. Examples of responsibilities that should be segregated in the payroll function include:

The responsibilities of authorizing personnel actions, maintaining time records, supervising employees, recording payroll transactions and distributing checks.

2. Properly authorizing, approving, and documenting all changes in employment (additions and terminations), salary and wage rates, and payroll deductions.
3. Maintaining written personnel policies.
4. Procedures for authorizing, approving, and recording vacations, holidays, and sick leave and approving and controlling compensatory time.
5. Account coding procedures for classification of employee compensation and benefit costs so that such costs are recorded in the proper general ledger account.
6. Review and approval of hours worked, overtime hours, and other special benefits by an employee's supervisor.
7. Review and approval of completed payroll registers before disbursements are made.
8. Having employees who distributed checks or pay envelopes make a report of unclaimed wages directly to a custodian independent of the payroll department.
9. Periodic review and comparison of amounts paid to the amounts appropriated and budgeted.
10. Each unclaimed paycheck should be traced back to the time records and personnel master file.
11. Perform periodic review of payroll summary information by an appropriate level of management.

Control Activities vs. Control Objectives in the Payroll Function

<u>Control Type</u>	<u>Description</u>	<u>Control Objective</u>
Separation of Duties	The responsibilities of authorizing personnel actions, maintaining time records, supervising employees, recording payroll transactions and distributing checks	To ensure that payroll payments are properly authorized
		To ensure that payroll payments are for actual hours worked or authorized leave time
		To ensure that payroll related payments are accurately calculated, recorded and paid
		To ensure that the payroll is paid for out of the correct appropriation and budget
Proper Procedures for Authorization	Properly authorizing, approving, and documenting all changes in employment (additions and terminations), salary and wage rates, and payroll deductions	To ensure that payroll related payments are accurately calculated, recorded and paid
Adequate Documents and Records	Maintaining written personnel policies	To ensure that payroll related payments are accurately calculated, recorded and paid
Independent Checks on Performance	Review and approval of completed payroll registers before disbursements are made	To ensure that payroll related payments are accurately calculated, recorded and paid
		To ensure that the payroll is paid for out of the correct appropriation and budget
Proper Procedures for Authorization	Having employees who distributed checks or pay envelopes make a report of unclaimed wages directly to a custodian independent of the payroll department.	To ensure that payroll payments are for actual hours worked or authorized leave time
Independent Checks on Performance	Perform periodic review of payroll summary information by an appropriate level of management.	To ensure that the payroll is paid for out of the correct appropriation and budget

Department of Administration
State Controller's Office

Payroll Function

Internal Control Questionnaire

1. Does your agency maintain written payroll procedures?

If yes, attach a copy of the procedures. In addition, the procedures should be reviewed to determine; if they are accurate, in compliance with statutes and the State Accounting Manual, and if they exhibit sound internal control. Questions to consider while determining whether the procedures exhibit sound internal control include:

Do they discuss the process of authorizing, approving, and recording vacations, holidays, and sick leave and approving and controlling compensatory time?

Do they ensure that employee compensation and benefit costs are recorded in the proper general ledger account?

Do they require the review and approval of hours worked, overtime hours, and other special benefits by an employee's supervisor?

Do they require that each unclaimed paycheck be traced back to the time records and personnel master file?

Do they require the performance of periodic reviews of payroll summary information by an appropriate level of management?

Do they include time keeping procedures?

Document the results of your review.

If your agency does not maintain written payroll procedures, prepare them and attach a copy. This action is necessary, because written procedures; provide a mechanism to guide employees in the performance of their duties, they explain to new employees the steps to be performed, and provide for more consistent operation of the process.

2. Document how your agency has segregated:

The responsibilities of authorizing personnel actions, maintaining time records, supervising employees, recording payroll transactions and distributing checks.

If applicable, provide evidence that this segregation of duties is consistent with your employee's WiSMART security profiles.

Appendix E

If your agency has not segregated these functions, explain why? If compensating controls are in place, what are they? A material internal control weakness may exist if sufficient compensating controls are not in place. If such a weakness is found, your payroll function must be restructured to address the problem. In addition, the weakness should be reported to SCO in your agency's annual report on internal controls.

3. Does your agency record all payroll information on the State's central accounting system (WiSMART)?

If not, document the types of payroll transactions that are not recorded on WiSMART. The documented information should include your agency's justification for not recording these transactions. Once documented, this information should be immediately submitted to SCO for review.

4. Document the extent to which your agency uses periodic financial reports to monitor the payroll function. Determine if the current level of management oversight is adequate. Consider the following points when performing this analysis:

Which payroll, or financial reports, are used by your agency to monitor payroll activities?
Who is responsible for performing this review? Does this person(s) evidence their review?
How frequently are the reviews performed?

5. Does your agency or someone outside your agency perform audits of the payroll function?

If yes, who performs the exams? How often? How are audit findings resolved?

6. Prepare a summary memo for inclusion in your agencies internal control plan. The memo should include a conclusion regarding the overall soundness of the internal controls over the payroll function. It should also discuss any internal control weaknesses and your agencies plan of action for improving the internal controls over this function.