Department of Finance and Management
Financial Operations Division
http://finance.state.vt.us/

JUNE 2007 Volume VI

INTERNAL CONTROL NEWS

The purpose of this quarterly newsletter is to provide departments with articles on good business practices, internal controls, and responsibilities. Through articles intended to promote educational and professional development opportunities for employees, this newsletter seeks to raise awareness across state government on the importance of internal controls. We hope that by providing this array of information, we can keep you informed of internal control related activities, and help you implement and maintain effective controls in your areas of operation.

New Finance & Management Policies Issued

On April 1, 2007 the Commissioner of Finance & Management **issued Finance & Management Policy #1: Suspension and Debarment Policies & Procedures**. This policy was created to address federal requirements prohibiting purchases from vendors who have been suspended or debarred by the federal government. Policy #1 has extended the federal requirements to all purchases (within certain thresholds) made by the State of Vermont, regardless of funding source.

The policy requires departments to verify that a vendor has not been suspended or debarred before making a covered purchase. This verification can be accomplished by including a clause in the grant or contractual agreement (all boilerplate grants and contracts now contain this clause), requiring the vendor to sign a certification statement, or manually searching for the vendor on a federal website.

In addition to being a sound business practice, it is anticipated that this policy will resolve several single audit findings received by various programs in SFY 2005 and 2006.

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In mid-June the Commissioner released **Finance & Management Policy #2: Federal Funds Cash Management Policy**, to be effective July 1, 2007. This policy was created to provide statewide standards for the frequency of draws of federal funds.

When the State makes expenditures for a federal program but does not draw in the associated federal funds, it advances its own cash for federal purposes and loses interest revenue. A review of federal deposits during SFY2006 revealed wide fluctuations in federal draw frequency across the State. Without formal statewide policies and procedures, decisions about federal draw frequency were left to each agency/department. Unfortunately, this meant that federal draws did not necessarily occur in a manner that was in the State's best financial interest.

The Department of Finance & Management concluded that statewide minimum standards were needed to reduce lost interest revenue and to create consistency. They began discussions with agencies and departments about creating a policy in the fall of 2006. In May 2007 a draft policy was released for comment which led to the final version effective July 1.

These policies can be found on the Policies page of the Finance & Management website at http://finance.state.vt.us/Policies.htm. For questions, please contact Karen Jaquish at 828-3201.

Prior Year Payables

With the upcoming start of a new state fiscal year, departments are reminded that all FY 2008 vouchers and journals that pertain to prior year payables must be adequately documented in VISION. To comply, departments are required to include a **PY** prefix in the *Invoice Field* for vouchers and to use **PY** in the *Journal Class* field on the header tab for journals.

Prior year payables are defined as payment for goods or services that were received or performed prior to July 1, 2007. All known prior year payables must be posted in VISION by August 24, 2007.

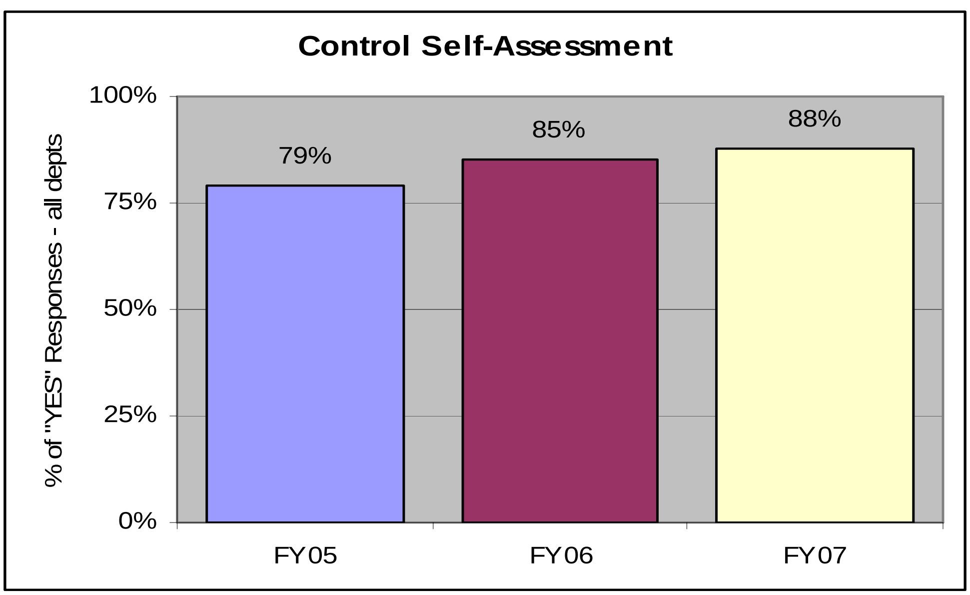
Generally accepted accounting principles (GAAP) require the State to present its financial statements on an accrual basis which includes, but is not limited to, recognizing spending that occurs in a subsequent fiscal period but pertains to the prior year. Therefore, the proper coding in VISION of prior year payables (i.e. "**PY"**) allows Financial Operations to extract the relevant data and make the necessary entries to comply with GAAP requirements.

Please refer to the FY 2007 Year-End Closing Instructions for additional information on processing transactions that pertain to prior years.

Internal Control Self-Assessment - Update

The 3rd annual "Self-Assessment of Internal Control" questionnaire has been completed by all organizations. The statewide results reveal, for the second year in a row, an overall improvement in the state's internal control system. The following chart illustrates the aggregate percentage of "YES" responses for each of the three years (*excludes "N/A" responses*); "YES" responses are a positive indicator of the existence of specific control activities or best practices.

As with last year, we will be providing each department with comparative data designed to show changes in their control system from previous years, and, how their control levels compare to the statewide average. Additionally, as part of this year's review, we intend to address those areas where departments have indicated non-compliance with the requirements of an Administrative Bulletin, Finance & Management Policy, or VISION Procedure, etc.



When a Major Breakdown Occurs

By definition, **internal controls** only provide **reasonable assurance** regarding the achievement of an organization's objectives. Organizations never want (*or often never expect*) their controls to breakdown, but even well-designed control systems can breakdown. Staff may misunderstand instructions, they may make errors in judgment, or they may commit errors due to carelessness, distraction, or fatigue. When a major breakdown does occur, organizations should use the event as a learning opportunity in an effort to prevent future recurrences. Following are some recommended steps that an organization can take:

- **Rectify Situation**

Take immediate steps to resolve the situation and minimize or contain the exposure or loss. Inform key stakeholders, including senior management, of the event and the intervening actions that have been taken to correct for this specific breakdown.

- **Interview Key Participants**

Discuss the circumstances and events that led to the breakdown with the staff that were directly involved. Seek feedback and recommendations on how the process may be improved. The purpose of this interview is to examine "how" and "why" the breakdown occurred: Is there a knowledge gap? Do employees have a misunderstanding of their duties/responsibilities? Is additional training needed? Are key controls inadequate or missing? Are there employee performance issues?

- **Risk Assessment**

Organizations should evaluate the "likelihood" and "impact" of the undesirable event occurring in the future. Likelihood represents the probability the undesirable event would occur again if there were no additional controls put in place to further prevent or reduce the risk. In evaluating likelihood, organizations can use past history as an indicator but must also consider changes (e.g. staffing, systems, processes) in their current operating environment. Impact is a measure of the magnitude the undesirable event has on the organization, key stakeholders, customers, vendors, etc. In gauging the magnitude of the undesirable event, some criteria to consider are: threats to health & safety, violations of laws and regulations, loss of assets or revenue, disruption to the State's operations, and impairment of public trust or confidence.

- **Take Corrective Action**

Following the above steps should help an organization decide on the extent of corrective action that is necessary to reduce the risk of future breakdowns. Events that have minimal impact and a low likelihood of recurring may require only minimal or no corrective action. Conversely, when there is a significant impact and a high likelihood of recurring, organizations likely need to perform more extensive modifications to their procedures and controls.

- **Post-Event Review**

Discuss with staff (*directly and indirectly involved*) the impact and consequences of the event. The intent is not to disparage individuals but to attach context and importance to the work they perform. By discussing the issue broadly it raises the awareness for other employees of "what could go wrong", thus reducing the risk that the breakdown could occur again. Convey any improvements or process changes that have been implemented as a result of this breakdown.

- **Address Employee Performance**

Providing employees with candid, constructive, and timely feedback on their performance clarifies management's expectations and reflects a commitment to competence; if applicable, take disciplinary action as appropriate for the situation.

Operational Guidance - FAQ

Question: My department needs to reimburse an employee for an expense which includes a sales tax. Since the State is tax-exempt, is it okay to include the "tax" in the amount we reimburse the employee?

Answer: Yes, reimbursing an employee for an expense that includes tax is allowable provided, *as with all expenses,* the expense is for an authorized purpose and adequately documented (e.g. proof of payment). It is the State of Vermont that is a tax-exempt entity, not individual employees. In such transactions, the State bears an indirect burden of the tax… i.e. the State is not paying a tax but is merely reimbursing an employee for his/her expenses.

However, from a best practices perspective the department may wish to restrict, to the extent practical, these types of transactions by its employees as… (1) the direct cost to the department is greater than if the transaction had been direct billed (*since the department does qualify for the tax exemption*) and (2) the transaction may circumvent any purchasing/procurement controls that the department has in place.

Staff Happenings

- Melissa Jenkins has recently joined the Financial Operations staff as a VISION Financial Analyst in the Accounting section. Previously, Melissa worked in accounting and grants management for the Department of Public Safety.

Important Dates

July 1, 2007 Effective date of **F&M Policy #2: Federal Funds Cash Management**

- Please refer to the timeline on pages 7-9 of the FY 2007 Year-End Closing Instructions for a comprehensive list of requirements and deadlines related to year-end closing and production of the State's Comprehensive Annual Financial Report (CAFR).