

INTERNAL CONTROL NEWS

SEPTEMBER 2009

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.

News from the World of PeopleSoft



Last December we provided an update on the PeopleSoft Expansion Project which includes upgrading Human Capital Management (HCM) and implementing new functionality. As we reported, funding was a hurdle and this is still the case. Throughout the next legislative session, developing a funding strategy and deciding on an appropriate funding model will be critical.

However, during this pause in project implementation work continues. Below are a few highlights:

- **Employee Self-Service (ESS):** The ability to view employee data and apply for jobs online has existed for many years and it's been almost a year since the requirement to view pay advices through ESS. With some experience under our belt, we are evaluating how we are doing. A team is starting to gather data regarding experience with ESS and what we can do better.
- **Human Resource's business logic:** A critical first step to the overall project is to capture all of the rules surrounding pay, benefits, leave, and expenses. An effort is underway to consolidate this mass of information in a format that maps into HCM. A team from the Departments of Finance & Management and Human Resources has been diligently working to achieve this goal and has made considerable progress.
- **Governance structure:** In an effort to align both HCM and VISION with the needs of the Agency of Administration and the State of Vermont, a team has come together to oversee these systems. The team consists of two bodies – a Governance Board and a Change Control Board. The Change Control Board consists of two representatives each from the Departments of Finance & Management, Human Resources, and Information & Innovation and is meeting weekly. The Governance Board consists of the Commissioners of the departments listed above and one representative from each department who is also on the Change Control Board.

Control Environment

This is the 2nd in a series of articles on the five [internal control standards](#) – **control environment, risk assessment, control activities, communication & information, monitoring** (re: [March 2009 issue](#)) – that comprise the general framework of an internal control system.

Frequently referred to as the “tone at the top”, the **control environment** is the foundation for the other four internal control standards. When management sets a positive tone, leads by example, and cultivates a supportive attitude among its employees then the internal control system is more likely to be strong and effective. Management establishes and influences the control environment by:



- **Ethical Values & Integrity**
 - Provide guidance for proper behavior through policy statements, codes of conduct and by behavioral example
 - Remove or reduce temptations for unethical behavior
 - Establish methods for reporting ethical violations and consistently enforcing disciplinary practices when appropriate.
- **Philosophy & Operating Style**
 - Acceptance of regulatory control imposed by others
 - Attitude towards accounting and information technology functions
 - Attitude towards internal and external reporting requirements
 - Use of aggressive or conservative accounting principles
 - Support for and responsiveness to internal and external audits and evaluations
- **Commitment to Competence**
 - Hire staff with necessary skills and knowledge
 - Ensure staff receives adequate on-going training and supervision
 - Provide staff with timely, candid and constructive performance evaluations
- **Structure**
 - Levels of authority, responsibility and decision-making are clearly defined for key positions and functions
 - Functional sub-units and relationships among them are clearly depicted in the organizational structure and understood by employees
 - Appropriate lines for reporting up-and-down the organizational ladder are established and adhered to
 - Policies, procedures and direct communications ensure employees are aware of their duties, responsibilities, and management’s expectations

Strategies to Control Expenditures

As government employees we are responsible for ensuring the funds entrusted to us are used prudently and that all expenditures be both reasonable and necessary. This mandate never changes, but in tough economic times it takes on even greater significance. As departments continue to scrutinize their budgets for efficiencies and savings, here are some recommended management strategies to control expenditures and cut costs*:

Lead by Example

Leaders need to set an example by demonstrating to employees that they care about saving money, even on the smallest items.

Create a Cost Conscious Workplace Culture

Develop a culture within your department where everybody is responsible for challenging costs; acknowledge and celebrate cost reductions as you do other organizational successes.

Keep Sounding the Warning Bell

Instill and maintain a sense of urgency where employees act immediately to reduce costs; if it doesn't remain in the forefront, employees will view it as the "flavor of the month" and quickly dismiss it as unimportant.

Strategic Costs

Know those costs and expense accounts most directly tied to achieving your department's mission and goals - and try to aggressively cut everything else.

Be Wary of the Routine

Never let expenses become routine. Dive into non-strategic expense accounts looking for savings; go in assuming you are spending too much in these accounts.

All Up for Grabs

Opportunities to control costs are easier to find if you assume all costs are not necessary until proven otherwise. Prior to incurring/approving expenses ask, "What's the good business reason for doing this?" and "How will this help achieve our mission and goals?"

Use Your Gut

Avoid "analysis paralysis" when setting cost cutting goals; frequently, relying on your experience and intuition will save time and money. If you cut too far, you'll know fairly quickly and can adjust.

Prior Authorization

Beef up prior authorization levels based on expense type and/or dollar threshold to help control costs; frequently elevating authorization levels to higher levels of management will act as a cost deterrent by itself.

* Portions excerpted from *Finance Week* and *Maximize Your Profits* (Stephen Diorio).

VISION Training Announcement

The VISION Finance Support Team is in the process of scheduling open-enrollment training classes during October for all VISION modules. These hands-on training classes are planned for ½ day sessions and will be held at our Montpelier training room on the 3rd floor of 109 State Street. Stay tuned to the [VISION Training](#) page on the Finance & Management website for specific dates, times and sign-up information. VISION End-Users will be notified by email once this information is posted to the website.



Departments may also contact the VISION Finance Support Team to arrange individualized training sessions to address their organization's specific VISION training needs and business requirements.

Fraud Red Flags

Just during the past eight months the media has reported numerous fraud and embezzlement investigations of employees at Vermont-based businesses, including an auto dealership, supermarket, school, medical office, department store, specialty foods, municipality, newspaper, bank, residential care facility, and a ski resort. As indicated by this list, *and the fact that a significant amount of fraud goes unreported*, fraud can and does happen to all types of organizations...including VT State Government. When employees, managers, and auditors are aware of and act upon the **red flags** that could occur within their workplace it increases the likelihood that wrong-doing will be detected or even prevented.



A red flag is a set of circumstances that are unusual in nature or vary from the normal activity. A red flag is a signal that something could be wrong and may indicate the presence of fraud. Red flags, by themselves, do not confirm or prove fraud (*sometimes an "error is just an error"*) but rather they are warnings signs that may warrant further investigation by management. Red flags may also indicate other serious issues deserving of management's attention such as employee performance problems, misunderstanding of duties, or inadequate training.

Studies of fraud cases have consistently shown red flags were present but were either not recognized or were recognized but not acted upon. Once a red flag is identified it should be evaluated by a responsible person through financial analysis, observation, or other technique to determine whether the situation merits corrective action, further investigation, or referral to legal authorities. Generally, the risk of fraud is increased when there is a presence of multiple or recurring red flags; red flags can be behavioral or transaction-based, below are some examples:

Behavioral

- "New found" wealth...expensive cars, jewelry, homes, trips
- Financial pressures at home...spouse losing job, divorce, family responsibilities – medical, college, etc.
- Refusal to take vacation or sick leave or accept promotions (for fear of detection)
- Significant personal debt and credit problems
- Behavioral changes - may be indication of addiction to alcohol, drugs, gambling
- Defensive to reasonable questioning from management, auditors
- Providing irrational or implausible responses to questions
- Reluctance to share/distribute workload or provide specific details on job duties

Cash/Accounts Receivable

- Frequent discrepancies in cash count
- Excessive number of voids, discounts and refunds
- Mutilated/destroyed cash register receipts
- Employee working from open cash drawer
- Unexplained increase in use of petty cash
- Personal (employee) checks included in cash funds
- Unusual journal entries affecting cash accounts
- Differences between daily receipts and bank deposit
- Use of "*Less Cash*" line on deposit tickets
- Discrepancies between deposits and amounts posted to customer accounts

- Customer complaints about amounts owed
- Date differences between customer payments and deposits
- Increase in delinquent accounts or write-offs
- Customer with unusual/unknown name, address or phone number
- Bank accounts not reconciled in a timely manner



Purchasing/Accounts Payable

- Purchases from an atypical vendor for department
- Invoice amounts just below internal dollar thresholds that would otherwise trigger additional approvals/controls
- High occurrence of vendor checks routed to department employee
- Small initial purchases from vendor, followed by much larger purchases
- Unusual or suspicious request to change vendor's banking information
- Vendor complaints or billing for past due amounts (that have been paid)
- Vendor name anomalies, e.g., vendor name very similar to widely recognized/used vendor, vendor name consists only of initials
- Vendors without a physical address (i.e., PO Box only)
- Vendor address matches employee address
- Vendors with no phone numbers or using an answering service
- Altered vendor invoices
- Copies of vendor invoices instead of originals
- Consecutively numbered invoices from the same vendor
- Unusual or unexplained increase in expenses over budgeted amounts
- Invoices for unspecified or vaguely defined services
- Unusual or abnormal number of expense reimbursements to an employee
- Duplicate travel expense reimbursements submitted by employee (and approved by supervisor)
- Inconsistent overtime hours (e.g., employee doesn't normally work overtime, overtime charged during non-peak periods)

State employees who suspect fraud in their workplace have an obligation to report it to management (or in accordance with their department's policies) or by contacting the State Auditors Office [Confidential Line](#) for reporting waste, fraud, or abuse at 1-877-290-1400.

Staff Happenings



- Lindsay Kurrle, CPA, has been hired as the Assistant Director of Statewide Reporting. Lindsay's previous experience includes work on government audits as a KPMG Senior Accountant and as Controller for Central Vermont Medical Center.
- Peggy Brooks has been hired as a Statewide Reporting Analyst II. Peggy's previous experience includes accounting and financial reporting in the captive insurance industry and as Controller for Vermont Public Power Supply Authority and Chittenden County Transportation Authority.

Internal Control News is published quarterly by the Dept of Finance & Management. Please contact [Kevin Gilman](#) with comments or suggestions.