



Fall 2023 - Internal Control News

09.18.2023

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The purpose of this **DFM Internal Control Quarterly Newsletter** is to provide agencies and departments with articles on good business practices, fraud prevention, and internal control responsibilities. Through articles intended to promote educational and professional development opportunities for state employees, this newsletter seeks to raise awareness across state government on the importance of internal control. We hope that by providing you with this array of information, we can keep you informed of internal control related activities, and help your staff and division implement and maintain effective internal controls.

<https://finance.vermont.gov> Volume 5, Issue 15

DFM Standard Internal Control - Helpful Web Hyperlinks:

Website Resources: <https://finance.vermont.gov/policies-and-procedures/internal-controls>

Standard Internal Control Manager's Guide: [Purpose of Guide \(vermont.gov\)](https://finance.vermont.gov/policies-and-procedures/internal-controls)

Quick Hyperlink Reference Guide: [Finance/files/documents/Pol_Proc/IC/Guidelines.pdf](https://finance.vermont.gov/files/documents/Pol_Proc/IC/Guidelines.pdf)

State Auditor's Fraud, Waste, and Abuse Hotline: 1-877-290-1400 or [Reporting Fraud, Waste or Abuse](https://finance.vermont.gov/policies-and-procedures/internal-controls)

DFM, IC Questions? Contact: fin.internalcontrol@vermont.gov



Government Finance Officers Association

Certificate of
Achievement
for Excellence
in Financial
Reporting

Presented to

State of Vermont

For its Annual Comprehensive
Financial Report
For the Fiscal Year Ended

June 30, 2022

Christopher P. Morrill
Executive Director/CEO

State of Vermont, Wins GFOA's **Certificate**

Vermont's **Annual Comprehensive Financial Report** (ACFR) for the fiscal year ended June 30, 2022, qualifies for the **Certificate of Achievement for Excellence in Financial Reporting**. This achievement is the highest form of recognition in governmental accounting and financial reporting.

- **Christopher P. Morrill, Executive Director / CEO.**

Everyone in Finance & Management contributed to helping us earn this award. Thank you all for your efforts!

- **John Becker, Director of Statewide Reporting**

Terrific! Thanks to all for this confirmation of the quality of product we put out to our Stakeholders. Thank you.

- **Adam Greshin, Commissioner of Finance & Management**

W-9 Signature Date Requirement – Effective 9/18/2023.

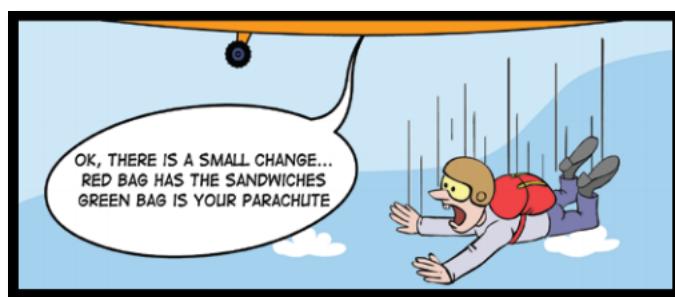
Finance & Management will accept W-9's with a signature dated within the past year. This is a change from the previous requirement of having them dated within the last six months. The Finance & Management website and supporting manuals will be updated to match this change by 9/30/2023.

Form W-9 (Rev. October 2018) Department of the Treasury Internal Revenue Service	Request for Taxpayer Identification Number and Certification ▶ Go to www.irs.gov/FormW9 for instructions and the latest information.
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Internal Controls – Never an Afterthought

State of Vermont March 2023 Presented by: Brent Warner, CPA, CIA, CRMA - Director, Specialized Advisory Services. **WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING.** Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC, an SEC-registered investment advisor ©.

CliftonLarsonAllen (CLA) LLP, our external Auditors, recently presented a web presentation on **Internal Controls** to the State of Vermont. The DFM IC Unit would like to highlight some of the segments of their presentation on **Internal Control Practices** that could potentially impact or assist your Agency.



Learning Objectives

At the end of this session, you will be able to:

- Recognize what internal controls could have been in place to prevent fraud from occurring or detect malfeasance earlier
- Describe the importance of the tone at the top
- Associate fraud risks to internal controls
- Identify examples of why internal controls fail
- Identify how to apply internal control best practices within your organization

Overview of Internal Controls



We think of internal controls as a means to manage risk, but what type of risk?



Inherent Risk: The risk that the risk event will occur absent any controls in place



Residual Risk: The risk that remains after the control has been applied

—CLA

Internal controls should be designed and operating effectively as to allow for the achievement of the organization's objectives.

Internal controls is a process that prevents an adverse risk event from happening or detects the event if it does occur.

What are some challenges in achieving cost-effective internal controls?

Challenges of maintaining a cost-effective internal control environment:

- Obtaining sufficient resources to achieve adequate segregation of duties.
- Management's ability to dominate activities and override controls.
- Recruiting competent individuals to serve on audit committees and on the board of directors.
- Recruiting and retaining personnel with sufficient experience and skill in accounting and financial reporting.
- Focusing management's attention on internal controls.
- Maintaining appropriate controls over information systems with limited technical resources.
- Determining whether internal controls address significant risks.

How do each of the following act/serve as an internal control?

- Policies and procedures
- Segregation of duties
- Budgeting
- Dual control
- Joint custody
- Rotation of duties
- Reconciliation

How might you test each control above to determine if they are effective?

There are five components of the COSO Integrated Framework (2013):

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



Control Environment

- Integrity and ethical values
- Commitment to competence
- Board of Directors or Audit Committee participation
- Management's philosophy and operating style
- Organizational structure
- Assignment of authority and responsibility
- Human resource policies and practices

Risk Assessment

- Dynamic, iterative process for identifying and assessing risks to the achievement of objectives
- Identify and assess changes that could significantly impact the system of internal control:
 - Changes in the institution's operating environment
 - New personnel
 - New or revised information systems
 - Rapid growth within the institution
 - New technology
 - New lines, products or activities
 - Restructuring within the institution
 - Foreign activities
 - New accounting pronouncements
 - Fraud risks

Control Activities

- Actions established through policies and procedures that help ensure management's directives to mitigate risks to the achievement of objectives are carried out
- Remembering our overview of what internal controls are from earlier:
- An inherent process performed designed to accomplish management's objectives
- Accuracy of financial and nonfinancial reporting, compliance with laws and regulations
- Effectiveness and efficiency of operations

Information and Communication

- Information necessary to support the achievement of objectives.
- Information must be relevant and accurate from both internal and external sources.
- Communication is continuous, disseminated throughout the organization.
- Enables a clear message from senior management that control responsibilities must be taken seriously.

Monitoring Activities

- Ongoing, separate evaluations, or some combination of the two are used to ascertain whether each of the five components is present and functioning.
- The results of the evaluation are evaluated against established criteria and communicated to management and the board, as appropriate.
- The criteria can come from regulators, recognized standard-setting bodies or management and the board of directors.



Internal Controls and Fraud

Also, within the 2013 COSO Framework, the inclusion of fraud was added. The Institute of Internal Auditors requires fraud to be included as a consideration within the risk assessment process, so does the 2013 COSO framework.

It is included within the risk assessment component of the framework and is mentioned within the green book.



2022 Global Fraud Study

- 2,110 fraud cases studied causing losses of more than \$3.6 billion
- Estimated 5% of revenue lost to fraud each year
- Average length of time from start to detection was 12 months

Understanding the methods fraudsters use to conceal their crimes can assist organizations in more effectively detecting and preventing similar schemes in the future.

TOP 4
CONCEALMENT
METHODS USED
BY FRAUDSTERS

39% created fraudulent physical documents

32% altered physical documents

25% altered electronic documents or files

28% created fraudulent electronic documents or files



Who reports occupational fraud?

Tip: 42%

Internal audit: 16%

Management review: 12%

Document examination: 6%

By accident: 5%

Account reconciliation: 5%

Automated transaction: 4%

External audit: 4%

Surveillance/monitoring: 3%

Notified by law enforcement: 2%

Confession: 1%

How is occupational fraud initially detected?

Employees: 55%

Customer: 18%

Anonymous: 16%

Vendor: 10%

Other: 5%

Competitor: 3%

Shareholder/Owner: 3%

Most Common Anti-Fraud Controls



How Governance Shapes Internal Controls

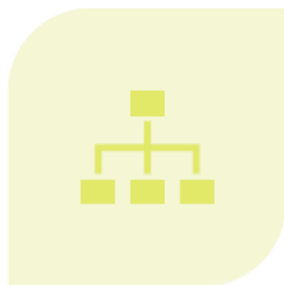
- Governance directly impacts the control environment.
- Principle 1 in the Green Book: Demonstrate Commitment to Integrity and Ethical Values.
 - One of the attributes listed is tone at the top.
 - Management demonstrates the importance of integrity and ethics through their directives, attitudes and behavior.



Governance defined

Per the Institute of Internal Auditors, corporate governance is the blend of processes and structures designed to help an organization achieve its objectives. The processes are not only influenced by risks but also by the organization's efforts to mitigate known risks and discover unknown risks

The Organization for Economic Co-Operations and Development states: "Corporate governance involves a set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance provides structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined."



PER THE GREEN BOOK, THE TONE AT THE TOP IS SET BY THE BEHAVIOR OF MANAGEMENT AND THE BOARD. THE BOARD AND MANAGEMENT'S BEHAVIOR SETS THE EXAMPLE, AND THIS EXAMPLE (THEIR VALUES, PHILOSOPHY AND OPERATING STYLE) IS FUNDAMENTAL TO AN EFFECTIVE INTERNAL CONTROL SYSTEM.



ACCOUNTABILITY IS ALSO DRIVEN BY THE TONE AT THE TOP AND SUPPORTED BY THE COMMITMENT TO INTEGRITY AND ETHICAL VALUES, ORGANIZATIONAL STRUCTURE AND EXPECTATIONS OF COMPETENCE. ALL OF THIS INFLUENCES THE CONTROL CULTURE OF THE ENTITY.

Additional Information on Internal Controls can be found here:
[Internal Controls \(vermont.gov\)](https://www.vermont.gov/controls)



Agency of Administration (AOA), Department of Finance & Management (DFM)

**External DFM
Organizational Chart
Effective 5.22.2023**

IC Best Practice
Series # 14

