Office of the State Controller
Risk Mitigation Services

INTERNAL CONTROL QUESTIONNAIRE

June 30, 2009

David T. McCoy
State Controller

State of North Carolina
Office of the State Controller

DAVID T. MCCOY
STATE CONTROLLER

May 15, 2009

MEMORANDUM

TO: Boards and Commissions

FROM: David T. McCoy
State Controller

SUBJECT: Self-Assessment of Internal Controls Questionnaire

Please carefully review the ***Self-Assessment of Internal Controls Questionnaire*** (ICQ) to be completed for the fiscal year ending June 30, 2009. A new ICQ **must** be completed each fiscal year and maintained by your office for review by the Office of the State Controller (OSC) and the Office of the State Auditor. Any cycles deemed not applicable should be indicated on Attachment I. Any inadequate internal controls should be indicated on Attachment II.

OSC **requires** that the form, ***Confirmation of Self-Assessment of Internal Controls***, be completed and returned to this office by July 31, 2009.

A complete copy of the ICQ and related Attachments as well as the form, ***Confirmation of Self-Assessment of Internal Controls*** is located on the OSC web site:

http://www.osc.nc.gov/sigdocs/sig_docs/documentation/policies_procedures/ICQ_BandC.html

Questions concerning the ICQ should be directed to OSC Risk Mitigation Services, email us at OSC.Risk.Mitigation@osc.nc.gov

Office of the State Controller

Confirmation of Self-Assessment of Internal Controls

Agency ______________________________

To be completed by the Chief Fiscal Officer:

A self-assessment of internal controls has been conducted for the year ending June 30, 2009. As a part of this self-assessment, the Internal Control Questionnaire as promulgated by the Office of the State Controller, has been completed and is available for review by the Office of the State Auditor and the Office of the State Controller. Any instances of cycles deemed not applicable have been explained in Attachment I. Any instances of inadequate internal controls have been explained in Attachment II.

Signature:____

Printed name:____

Title:____

Date:____

Please return this form by <u>July 31, 2009</u> via fax or mail to:

Risk Mitigation Services
Office of the State Controller
1410 Mail Service Center
Raleigh, NC 27699-1410

Fax: (919) 981-5567

Office of the State Controller

Self-Assessment of Internal Controls for
Boards and Commissions

Table of Contents

Office of the State Controller

Self-Assessment of Internal Controls

Introduction

The Self-Assessment of Internal Control, commonly referred to as the Internal Control Questionnaire (ICQ) is a tool to be utilized by North Carolina State government agencies to assist in confirming the presence of a sound system of internal controls. For purposes of this document, the term agency is used to refer to all state departments or divisions, universities, community colleges, occupational licensing boards, or any other state entities that are reported within the State of North Carolina Comprehensive Annual Financial Report (CAFR).

A proper system of internal control provides *reasonable assurance* that the financial statements are fairly presented and that management's goals are being properly pursued. Such a system includes fully documented policies and procedures which accomplish among other items the following:

A. Transactions that are executed according to management's general or specific authorization.

B. Transactions that are recorded as necessary to:

   1. prepare the financial statements to conform with generally accepted accounting principles, and

   2. account for assets.

C. Access to assets is permitted only according to management's authorization.

D. The asset records are compared with the existing assets at reasonable intervals and action is taken to reconcile any differences.

The ultimate responsibility for strong system of internal control rests with management. On an annual basis, when submitting financial statement information management must attest to the accuracy of that information along with the soundness of internal controls. The ICQ should be used as a key tool in making these assertions.

The ICQ consists of the following sections and accounting cycles:

- Control Environment
- Financial Reporting Cycle
- Budget Reporting Cycle
- Cash Receipts Cycle
- Accounts Receivable Cycle
- Purchasing/Accounts Payable Cycle
- Human Resource Cycle
- Inventory Cycle
- Capital Assets Cycle
- Computer Security Cycle
- Investment Cycle
- Debt Cycle
- Tax/Payroll Compliance Cycle

Within each cycle, except the control environment, five internal control elements are to be reviewed. Many aspects of internal control are currently documented in the Office of the State Controller (OSC) North Carolina Accounting System Information Guide (SIG). The SIG contains information on statewide policies and procedures and is updated on a regular basis.

The Risk Mitigation Services Section of OSC should be contacted if there are any questions concerning this questionnaire. The internal control questionnaire should be maintained for review and audit.

The Statewide Internal Control Framework

Note: This Framework contains information adapted from the Committee of Sponsoring Organizations of the Treadway Commission's Internal Control – Integrated Framework, published in 1992.

Introduction

North Carolina State Government is a highly significant organization both fiscally and in number of employees and locations. The State's budget often surpasses the Gross Domestic Product of many small countries. Every citizen of North Carolina is touched by state government, with millions of individuals and families using State services daily. In order to successfully govern the State in such complex environments operations must be effectively managed. Internal control enables management to effectively deliver services to the citizens of North Carolina, and to help ensure the reliability of financial statements and compliance with laws and regulations.

Because of the crucial importance of internal controls and the complexity of state government, the Office of the State Controller has composed this Framework to establish a single definition of internal control applicable Statewide and also to detail the elements which a sound system of internal control should possess.

Internal Control…A Definition

Internal Control has often meant radically different things to different people. Common understandings of internal control have centered on the routine actions surrounding certain transactions meant to ensure correctness and reduce risk of loss. While those actions are indeed examples of specific internal controls, a more comprehensive definition is required. Following is the State of North Carolina's definition of internal control:

Internal control is broadly defined as an integral process, effected by an entity's governing body, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

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

This definition establishes that internal control:

- Affects every aspect of government - all people, processes and infrastructure.
- Is a basic organizational element and not an add-on feature.
- Is dependent upon people and will succeed or fail depending on people.
- Provides a level of comfort (reasonable assurance) regarding the likelihood of achieving organizational objectives.
- Assists an organization to achieve its mission.

Elements of Internal Control

Internal control consists of following five interrelated elements:

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

These elements connect all the business processes of an organization and must be in place and properly functioning for an effective system of internal control to flourish. The following paragraphs offer detail on how these elements function within a system of internal control.

Control Environment

The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other elements of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values and competence of the entity's people; management's philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its people and the attention and direction provided by governing body. As the foundation, if the control environment of an organization is compromised, all internal control elements will face severe problems.

Risk Assessment

Every entity faces a variety of risks from external and internal sources that must be assessed. For risk assessment to function properly, objectives must be set and risk tolerance known. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be mitigated. Because conditions change, risk assessment must be a perpetual activity.

Control Activities

Control activities are those specific policies, procedures and tasks that help provide reasonable assurance that objectives will be met. They help ensure that necessary actions are taken to mitigate risks. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operations, security of assets and segregation of duties.

Information and Communication

Information pertinent to the operation of an organization must be identified, captured and communicated in an effective form. Effective communication must occur in a broader sense as well, flowing down, across and up the organization. Employees must have a clear understanding of management expectations and management must hear and understanding employees' concerns. The State's citizens must have access to necessary information. With modern communication means available, a state government entity has little reason not to communicate information properly.

Monitoring

Monitoring is a process that assesses and seeks to mitigate the risk that internal controls within the State will not provide reasonable assurance that operational, reporting and legal/regulatory objectives are met. Although external audits conducted by the Office of the State Auditor do provide a monitoring function related to controls, primary monitoring must be a function internal to state government. Such internal monitoring can occur within the following formal activities:

- Internal Audit Activities
- Self - Assessment of Internal Control Questionnaires

Also important to the monitoring element are the procedures that are performed by a State entity that allow its management to attest to the accuracy of financial reporting information regularly submitted to OSC. Monitoring must also occur on a less formal basis as a part of management's operation of government.

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

These components should be considered inextricably linked both with one another and with the definition of internal control. The objectives of a system of internal control cannot be achieved without the working of each element within the system. State government strives to achieve the internal control objectives of efficient and effective operations, sound financial reporting and compliance with laws and regulations. These five elements are the means of achieving reasonable assurance that those objectives will be met.

Reasonable Assurance

As stated in the definition and repeated above, internal control aims for reasonable assurance. Even a highly effective system of internal controls cannot guarantee that an organization will meet all objectives. Any system designed to strive for such a goal would consume many resources and inhibit delivery of government services. A sound system of internal control finds the balance between assurance and operations and offers a reasonable assurance that objectives will be met.

<u>Responsibilities</u>

Everyone in an organization has responsibility for internal control. Management must implement the system and set the “tone at the top” but all levels within an organization must take ownership of internal control. Responsibilities must be effectively communicated to all levels and support of the system of internal control must be considered a part of proper workplace performance. When necessary, understanding must be communicated through formal training methods.

Note: In authoring the Framework many sources outside State Government have been consulted and as with all work related to internal control this office owes much to the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Their groundbreaking work is reflected in much of this document, as it is in nearly all discussions related to internal control.

INTERNAL CONTROL STANDARDS

INTRODUCTION

These standards define the minimum level of quality acceptable for internal control systems and set the criteria for evaluation of both individual controls and entire systems. They apply to all operations and administrative functions (both manual and automated) and are not intended to interfere with the development of legislation or policy in an agency.

Standards are provided for the following areas:

- General standards
- Specific standards
- Audit resolution standards.

General standards ensure an atmosphere of strong internal control throughout all agencies. They reflect the overall attitude of the state government leadership that strong internal controls are necessary in all agencies. Specific standards provide more direct process level guidance, while the audit resolution standard requires agencies to resolve audit findings and recommendations quickly and efficiently.

Following are further details regarding these standards:

GENERAL STANDARDS

1. REASONABLE ASSURANCE

Internal control systems are to provide reasonable assurance that management objectives are accomplished. A sound system recognizes that the cost of internal control should not exceed the benefits achieved, and reasonable assurance equates to a satisfactory level of confidence given the considerations of costs, benefits and risks. The required determinations call for judgment to be exercised by agency staff.

In exercising that judgment, agencies should:

a) Identify:

   - Risks inherent in agency operations,
   - Criteria for determining low, medium, and high risks,
   - An acceptable level of risk under varying circumstances.

b) Assess the quantity and quality of risks.

Costs refer to the financial measure of resources consumed in accomplishing a specified purpose; costs can also represent a lost opportunity, a decline in service or low employee morale. A benefit is measured by the degree that the risk of failing to achieve a stated objective is reduced. Examples include increasing the chance of detecting fraud, waste, abuse or error, preventing an improper activity, or increasing regulatory compliance.

2. SUPPORTIVE ATTITUDE

This standard requires that management and employees maintain and show a supportive attitude toward internal control at all times. Managers and employees are to be attentive to internal control matters. They need to take steps to promote the effectiveness of the control. Attitude affects the quality of performance and the quality of internal control.

A positive and supportive attitude is started and fostered by management. It is ensured when internal control is consistently a management priority. Positive attitudes are fostered by managers' commitment to achieving strong control. This commitment is met through good organizational structure, personnel practices, communication, protection and use of resources. Systematic accountability, monitoring and systems of reporting and general leadership are required. One important way to prove management's support for good internal control is emphasizing the value of internal auditing. The manager also proves commitment by showing responsiveness to information developed through internal audits.

The organization of an agency provides its management with the overall framework for planning, directing, and controlling its operations. Good internal control requires clear separation of duties.

General leadership is critical to maintaining a positive and supportive attitude toward internal control. Adequate supervision, training, and motivation of employees in the area of internal control are important.

3. COMPETENT PERSONNEL

Managers and employees are to have personal and professional integrity. They are to be qualified to perform their assigned duties, as well as to understand the importance of ensuring sound internal controls. Personal and professional integrity must be shown.

Many elements influence the integrity of managers and their staff. For example, personnel should periodically be reminded of their obligations under an operative code of conduct.

Hiring and staffing decisions should include proof of education and experience. Once on the job, the individual should be given formal and on-the-job training. Managers who have a good understanding of internal control are vital to effective control systems.

Counseling and performance appraisals are also important. Part of the appraisal should be based on determining that they support implementation and maintenance of internal control.

4. CONTROL OBJECTIVES

Internal control objectives are to be identified or developed for each agency activity. They are to be logical, applicable, and reasonably complete. This standard requires that objectives be tailored to an agency's operations.

All operations of an agency can be grouped into one or more groups called cycles. Cycles make up all specific activities (such as identifying, classifying, recording, and reporting information) required to process a transaction or event. Cycles should be compatible with an agency's organization and division of responsibilities.

Financial cycles cover the traditional control areas concerned with revenues and expenditures, assets, and financial information. The questionnaire addresses the following financial cycles:

The Financial Reporting Cycle encompasses the year-end accounting procedures and financial statement preparation. The cycle includes the recording of accruals and compilation of financial statement information.

The Budget Reporting Cycle includes the establishment, revision, reporting and administration of the budgets as directed by the entity and Office of State Budget and Management.

The Cash Receipts Cycle involves the preparation of receipts, deposits, and special reports for the funds received by an entity. The cycle could also include petty cash transactions. An entity may have more than one receipting area. If the processes are different indicate the variations on the internal control questionnaire.

The Accounts Receivable Cycle includes the recording, collection, billing and aging of accounts receivable. An entity may have several accounts receivable systems. A separate internal control questionnaire should be completed for each accounts receivable cycle.

The Purchasing/Accounts Payable Cycle records the purchase and payments for goods and services for all non-salary expense transactions. The cycle includes the recording of obligations, issuance of checks and the liquidation of encumbrances. There could be several different accounts payable systems within an entity. A separate internal control questionnaire should be completed for each separate accounts payable and purchasing system. For example, a university may have university purchasing/accounts payable and stores purchasing and payable.

The Human Resource Cycle pertains to the preparation and maintenance of payroll and personnel records required by state and federal governmental agencies for employees within the entity.

The Inventory Cycle involves the receiving and maintenance of various inventory items within an entity. The items may include supplies, uniforms, food or household items. The cycle would include the physical inventory of the items. A separate internal control questionnaire would be needed for each different inventory method.

The Capital Assets Cycle should adequately document, control and account for the expenditure of state and federal funds for capital items. The capital assets cycle provides history of capital items from purchase or installation to disposal. The fixed asset system refers to automated and manual systems within the entity.

The Computer Security Cycle involves the existence of data logs, procedures for disaster control and recovery and authorization codes.

The Investment Cycle comprises the acquisition, disposal, record keeping and monitoring of market values of securities held by the entity.

The Debt Cycle involves the processing and recording of debt. The cycle includes the issuance, retirement and redemption of bonds.

The Tax/Payroll Compliance Cycle involves the preparation of information returns required by the Internal Revenue Service for employees and nonemployees of the governmental entity. The cycle includes the determination of employee status and proper reporting of employment related moving expense reimbursements.

The Major Financial Assistance Cycle for federal and state programs relates to the administration and financial management of contracts and grants awarded by federal and state programs. The internal control questionnaire for the major financial assistance cycle is divided into nine sections including eligibility, types of service, and matching or level of effort. A separate questionnaire is to be completed for each major grant or award. A major grant or award is defined to be programs receiving $19 million or more from the federal government.

5. CONTROL TECHNIQUES

Internal control techniques are the means by which control objectives are achieved. Techniques include such things as policies, procedures, separation of duties, and physical arrangements. This standard requires that internal control techniques continually provide a high degree of assurance that the internal control objectives are being achieved.

To make sure the control objectives are being achieved; the techniques must be effective and efficient. To be effective, techniques should fulfill their intended purpose in actual application. They should provide the coverage and operation as intended. As for efficiency, techniques should be designed to derive maximum benefit with minimum effort. Techniques tested for effectiveness and efficiency should be those in actual operation and should be evaluated over time.

6. CONTINUOUS MONITORING

Agency heads are to set up and maintain a program of internal review that is designed to identify internal control weaknesses. Needed changes are to be implemented to correct any weaknesses.

SPECIFIC STANDARDS

1. DOCUMENTATION

Internal control systems, as well as all transactions and other significant events are to be clearly documented. Such documentation is to be readily available for examination. This standard requires written evidence of an agency's internal control objectives, techniques and accounting systems.

Documentation of internal control systems should include identification of the cycles and related objectives and techniques. It should appear in management directives, administrative policy, and accounting manuals. Documentation of transactions or other significant events should be complete and accurate. The transaction should be traced from its inception through its completion.

This standard requires that the documentation of internal control and transactions be purposeful and useful to managers. It should also fulfill the needs of the auditors or others involved in analyzing operations.

2. RECORDING OF TRANSACTIONS AND EVENTS

This standard requires that transactions and other significant events be promptly recorded and properly classified. Transactions must be promptly recorded if information is to maintain its value to management in decision-making and in controlling operations. This standard applies to:

- The entire process or life cycle of a transaction or event, including the initiation and authorization.
- Its final classification in summary records.

3. EXECUTION OF TRANSACTIONS AND EVENTS

Transactions and other significant events are to be authorized and executed only by persons acting within the scope of their authority. Such authorization deals with decisions to exchange, transfer, use, or commit resources for specified purposes and conditions. It is the principal means of assuring that only valid transactions and other events are entered.

Authorization should be clearly communicated to managers and employees. Documentation should include the specific conditions and terms under which authorizations are made. Conforming to the terms of this standard means employees are carrying out their assigned duties as set up by management.

4. SEPARATION OF DUTIES

It is necessary to reduce the risk of error, waste, or wrongful acts as well as the risk of such acts going undetected. This is achieved by making sure no one individual controls all key aspects of a transaction or event. Duties and responsibilities should be assigned to different individuals to be sure those effective checks and balances exist.

Key duties include the following: authorizing, approving, and recording transactions, issuing and receiving assets, making payments, and reviewing or auditing transactions. Collusion can reduce or destroy the effectiveness of this internal control standard.

5. SUPERVISION

Qualified and continuous supervision is to be provided to ensure that internal control objectives are achieved. This requires supervisors to review and approve the assigned work of their staffs. It also requires that staffs are provided with the necessary guidance and training to reduce errors, waste, and wrongful acts. Specific management directives must be achieved.

Assignment, review, and approval of a staff's work require that duties be clearly communicated to each staff member. Each staff member's work must be reviewed to the extent necessary. The work must be approved at critical points to be sure that work flows as intended.

Assignment, review, and approval of a staff member's work should result in the proper processing of transactions and events. This includes following approved procedures and requirements. Errors, misunderstandings, and improper practices must be detected and eliminated. Wrongful acts must be prevented from occurring or recurring.

6. ACCESS TO AND ACCOUNTABILITY FOR ASSETS

An individual is to be assigned custody, accountability, and maintenance for assets. Periodic comparison should be made of the assets with the records to determine whether the two agree.

The basic concept behind restricting access to assets is to reduce the risk of unauthorized use or loss, and to help achieve management goals. Restricting access to assets depends upon the vulnerability of the assets and the perceived risk of loss. These two factors should be assessed periodically. For example, access to and accountability for documents, such as checks, can be achieved by:

- Locking them in a safe,
- Assigning a sequential number,
- Assigning custodial responsibility.

Assigning and maintaining accountability for assets involves directing and communicating responsibility to specific individuals within an agency.

AUDIT RESOLUTION STANDARD

Managers are to promptly resolve any weaknesses in the internal control structure as determined by their self-assessment as well as immediately resolving any findings from the Office of the State Auditor. To do this, the following points must be considered:

- Findings and recommendations must be promptly evaluated.
- Determine the proper actions in response to audit findings and recommendations.
- Resolve all weaknesses in internal control brought to management's attention.

This standard requires managers to take prompt, responsive action on all findings and recommendations to correct identified deficiencies. Where audit findings identify opportunities for improvement rather than cite deficiencies, responsive actions are those that produce improvements.

The resolution process begins when the results of an audit are reported to management. It is completed only after action has been taken to complete one of the following steps:

- Identified deficiencies are corrected.
- Improvements are produced.
- Determined that after achieving a compliant status the cost of implementing the recommendations would outweigh the intended benefits.

Office of the State Controller

Self-Assessment of Internal Controls

Control Environment

Objectives and Risks

Agency ____________________________ Year-End _________

Objectives		Risks
Management attitude recognizes the importance of and commitment to the establishment and maintenance of a strong system of internal control as communicated to all employees through actions and words. Management adheres to a code of conduct and other policies regarding acceptable business practices, conflicts of interest, or expected standards of ethical and moral behavior, and communicates these policies to all employees.		• Employees lack of knowledge of internal controls. • Code of conduct and/or ethics policy which has been adequately communicated (i.e. intranet, posters, memorandum, etc.) does not exist.
Organizational structure units are clearly defined and up to date to perform the necessary functions and determine that appropriate reporting relationships have been established.		• Organizational chart is not current. • Employees unaware of reporting relationship in the organizational structure. • Duplication of functions by units.
Personnel are qualified and properly trained for the functions in order for control procedures to operate in the manner intended. Current job descriptions are established detailing the responsibilities and qualifications for each position.		• Personnel not qualified to perform tasks assigned. • Personnel not adequately trained. • Lack of continuing education for personnel. • Job descriptions not coordinated with actual job performances.
Delegation of authority or limitation of authority exists to provide assurances that responsibilities are effectively discharged.		• One employee controls all phases of a transaction. • Management goals are not communicated to staff employees.

Policies and procedures that are documented provide a basis for reviews, follow-up evaluations and audits.		• Functions are not performed uniformly among units. • Statutory requirements not being met. • Lack of support for functions and transactions performed.
Budgetary and reporting practices provide benchmarks by which management can measure accomplishments.		• Management does not have guidelines to measure performance. • Management cannot communicate expectations to the organizational units. • Unusual transactions or events will not be detected. • Management cannot determine if goals are being achieved.
Organizational checks and balances provide authority for certain functions that minimize the potential for waste, fraud, abuse or mismanagement.		• The organizational units do not perform responsibilities therefore the potential for waste, fraud and abuse could occur.

Office of the State Controller

Self-Assessment of Internal Controls

Control Environment

Control Policies and Procedures

Agency ____________________________ Year-End ______

Bolded questions identify critical controls. A critical control is a control that will prevent or detect an error in the event that all other controls fail.

A. Integrity and Ethical Values

Yes No N/A

___ ___ ___ 1. Does a written Code of Conduct (Code) exist and does it apply to all employees or at least to individuals (internally and externally) who are in a position to influence the financial statements (including the Chief Executive Officer, Chief Financial Officer, Controller or persons performing similar duties?

___ ___ ___ 2. Is the Code communicated prominently throughout the agency (i.e. agency website, posters, intranet, e-mail, etc)?

___ ___ ___ 3. **Is the Code periodically updated and reviewed (i.e. the code of conduct reviewed on an annual basis)?**

___ ___ ___ 4. **Does the agency have an anonymous and confidential Whistleblower policy for communicating and receiving information regarding fraud, errors in financial reporting and misrepresentation or false statements made by management?**

___ ___ ___ 5. Have transactions been executed in accordance with the Code and the approved written policies and procedures?

B. Commitment to Competence

___ ___ ___ 6. **Does management analyze and document the knowledge and skills required to accomplish tasks?**

___ ___ ___ 7. Are job responsibilities formally documented and reviewed annually by management (CFO) and other individuals in position of significant influence over financial reporting?

C. Management's Philosophy and Operating Style

___ ___ ___ 8. Has management established overall objectives in the form of a mission statement, goals or other written operating statement(s)?

___ ___ ___ 9. Have objectives been clearly communicated to all employees?

___ ___ ___ 10. Are objectives established for key areas (i.e. operations, financial reporting, compliance, etc.)?

___ ___ ___ 11. Are policies and procedures consistent with statutory authority?

___ ___ ___ 12. Are operations performed in accordance with statutes governing the public agency?

___ ___ ___ 13. **Does senior management review financial results and performance measures at least once a quarter?**

___ ___ ___ 14. Are unusual variances between budget and actual examined?

___ ___ ___ 15. Does the agency compare its actual performance with its goals and objectives?

___ ___ ___ 16. Are principal accounting records and accounting employees at all locations under the supervision of the principal accounting office?

___ ___ ___ 17. Does the agency have a functioning internal audit staff to review the operations of the agency?

___ ___ ___ 18. **Does the internal audit staff report to an official independent of the operations under review?**

___ ___ ___ 19. Does management follow-up on audit findings?

D. Organizational Structure

___ ___ ___ 20. **Are written policies and procedures for all major areas periodically reviewed and approved by senior management and readily available for use by all employees?**

___ ___ ___ 21. **Is there an organizational chart that clearly defines the lines of management authority and responsibility?**

___ ___ ___ 22. On at least an annual basis, does senior management review and update the organizational structure of the agency?

23. Are all the agency's operations centralized or decentralized? (circle one)

___ ___ ___ 24. If decentralized, is monitoring of the areas adequate?

E. Assignment of Authority and Responsibility

___ ___ ___ 25. Are specific limits established for certain types of transactions and delegations clearly communicated and understood by employees within the agency?

___ ___ ___ 26. Have specific lines of authority and responsibility been established to ensure compliance with Federal and State laws and regulations?

___ ___ ___ 27. Does management understand the concept and importance of internal controls, including division of responsibility?

___ ___ ___ 28. **Is the internal control structure supervised and reviewed by management to determine if it is operating as intended?**

___ ___ ___ 29. **Are responsibilities segregated so that no single employee controls all phases of a transaction?**

___ ___ ___ 30. Are there adequate policies and procedures for authorization and approval of transactions at the appropriate level?

___ ___ ___ 31. Are sufficient training opportunities to improve competency and update employees on new policies and procedures available?

___ ___ ___ 32. If known areas of knowledge are limited, has help been enlisted from peers, auditors or outside consultants to identify alternatives and suggest solutions?

___ ___ ___ 33. Have managers been provided with clear goals and direction from the governing body or top management?

___ ___ ___ 34. Are external audits performed on a periodic basis?

___ ___ ___ 35. Is information (i.e. findings, recommendations, etc.) provided by external auditors considered and acted upon in a timely manner?

F. Human Resource Policies and Practices

___ ___ ___ 36. **Does management ensure compliance with the State's and/or agency's personnel policies and procedures concerning hiring, evaluating, promoting, compensating, and terminating employees?**

___ ___ ___ 37. Are job descriptions (and other documents that define key position duties/requirements) current, accurate and understood?

___ ___ ___ 38. Are employees cross-trained to ensure the uninterrupted performance of personnel functions?

G. Risk Assessment

___ ___ ___ 39. **Does the agency have mechanisms in place to anticipate, identify, and react to risks presented by changes in government, economic, industry, regulatory, operating, or other conditions that can affect the achievement of the agency's goals and objectives?**

40. Please identify the three most significant risks to the agency:

____

____

____

___ ___ ___ 41. Is risk identification incorporated into management's short-term and long-term forecasting and strategic planning?

Office of the State Controller

Self-Assessment of Internal Controls

Financial Reporting Cycle

Objectives and Risks

Agency ____________________________ Year-End _________

Objectives		Risks
All transactions are properly accumulated, classified and summarized in the accounts.		• General ledger not in balance. • Subsidiary ledgers not in balance with general ledger. • Inconsistent application of accounting policies and procedures.
All closing entries are initiated by authorized personnel and reviewed and approved in accordance with established policies and procedures.		• Inadequate closing procedures may result in confusion of responsibility, delay in completing the closing. • Transactions improperly included or excluded as a result of inadequate cutoff procedures. • Unauthorized or inappropriate journal entries. • Inadequate support for journal entries.
All necessary data is obtained and processed in accordance with established policies and procedures.		• Absence of adequate procedures may result in misclassification of balances, omission of an accounting unit, unacceptable delays and excessive work. • Omission of information which should be provided in financial reports, lack of control over data submitted and review process.
All internal and public financial reports are prepared on the basis of appropriate supporting data, provide required information, and are reviewed and approved before issuance.		• Financial reports not supported by underlying accounting records. • Inconsistent presentation of financial data. • Incomplete review of data, permitting possible errors or omissions.

Office of the State Controller

Self-Assessment of Internal Controls

Financial Reporting Cycle

Control Policies and Procedures:

Agency__________________________ Year-End _________

Bolded questions identify critical controls. A critical control is a control that will prevent or detect an error in the event that all other controls fail.

A. Control Activities / Information and Communication:

Yes No N/A

___ ___ ___ 1. Is there a formal plan under which responsibilities for the year end closing of the financial statements are clearly defined including target dates for completing tasks?

___ ___ ___ 2. Do written accounting policies and procedures exist and are they properly available and communicated to all applicable personnel?

___ ___ ___ 3. Is the general ledger chart of accounts properly maintained by authorized personnel?

___ ___ ___ 4. Is a competent individual assigned the responsibility to supervise the conversion from cash basis to modified accrual basis accounting for the year-end financial reporting?

___ ___ ___ 5. Does the agency maintain the trial balances, adjustments and supporting workpapers to support the process of closing the general ledger and preparing financial statements and financial statement note disclosures?

___ ___ ___ 6. Are balances in the general ledger periodically substantiated, evaluated, reviewed, or supported by account reconciliations?

___ ___ ___ 7. **Are the reconciliations of subsidiary ledgers to control accounts prepared and reviewed by someone other than the preparer on a monthly basis?**

___ ___ ___ 8. Are revenue accounts reviewed to identify any deferred revenue?

___ ___ ___ 9. Are fund types reviewed to verify fund classifications?

___ ___ ___ 10. **Are journal entries prepared and reviewed by someone other than the preparer?**

___ ___ ___ 11. Is the supporting documentation attached to the journal entries and are they secure in a safe location?

___ ___ ___ 12. Does the agency maintain and follow procedures for record filing, retention, and disposition?

___ ___ ___ 13. Are the operating units required to certify that information submitted for the preparation of the financial statements is accurate?

___ ___ ___ 14. **Are the financial statements and note disclosures agreed to the underlying supporting documentation (i.e. general ledger, reconciliations, journal entries, CAFR worksheets)?**

___ ___ ___ 15. **Are the note disclosures agreed to the financial statements?**

___ ___ ___ 16. **Are the financial statements and note disclosures reviewed and approved by knowledgeable staff before being transmitted to the State Controller?**

B. Monitoring:

___ ___ ___ 17. **Has management identified accounts, such as those requiring complex calculations or accounting estimates which are especially at risk of misstatement and developed policies and procedures to address those risks timely?**

___ ___ ___ 18. Does management review accounting estimates? (depreciation, allowance for doubtful accounts, etc.)?

___ ___ ___ 19. Has management instituted a process to identify and address changes in accounting and reporting pronouncements?

___ ___ ___ 20. Are the financial statements and note disclosures updated to reflect any new GASB pronouncements or any other significant standards?

Office of the State Controller

Self-Assessment of Internal Controls

Budget Reporting Cycle

Objectives and Risks

Agency ____________________________ Year-End _________

Objectives		Risks
Preparation of a budget, whether or not legally required, which internally and externally communicates goals and objectives and serves as a "benchmark" against which actual performance is measured.		• No practical means by which to measure performance. • Internal departments and staff unsure of goals of the executive. • Absence of effective control over expenditures.
Obtain assurance that expenditures are incurred in conformity with the budget and plan of operations.		• Violation of law. • Expenditures incurred in excess of budget authorization. • Arbitrary or unauthorized transfers between budget categories.
Budget versus actual reporting is provided on a timely basis and explanations are provided for significant deviations.		• Lack of timely information on budget versus actual status prohibits corrective action. • Department managers unaware of status of their budget and potentially prohibited from executing plans. • Unbudgeted actual transactions may not be detected.

Office of the State Controller

Self-Assessment of Internal Controls

Budget Reporting Cycle

Control Policies and Procedures:

Agency ____________________________ Year-End __________

Bolded questions identify critical controls. A critical control is a control that will prevent or detect an error in the event that all other controls fail.

A. Control Activities / Information and Communication:

Yes No N/A

1. Are the following budget responsibilities performed by different people:

___ ___ ___ a. Preparation and approval of the budget submitted to the legislature?

___ ___ ___ b. Implementation and approval of the budget submitted to the legislature, including budget revisions?

___ ___ ___ c. Recording budget revisions in the general ledger and the approval or implementation functions?

___ ___ ___ 2. Have procedures been adopted and communicated establishing authority and responsibility for transfers (budget revisions) between budget categories?

___ ___ ___ 3. Are budgetary increases or decreases (as they relate to programs), that are mandated by the legislature communicated to operating departments? Is this done in a timely manner?

___ ___ ___ 4. Is an encumbrance system used to ensure that actual expenditures do not exceed budgeted amounts?

___ ___ ___ 5. **Are actual expenditures and revenues compared to budgeted amounts monthly and on a timely basis?**

___ ___ ___ 6. **Are budget revisions approved by an authorized person before being entered into the accounting system?**

___ ___ ___ 7. Are restricted revenues segregated to ensure that the revenues are used only for restricted purposes?

B. Monitoring:

___ ___ ___ 8. Does the accounting department or budget officer submit approval as to availability of funds before the issuance of a purchase order or expenditure commitment?

___ ___ ___ 9. **Are over expenditures or under realized revenues discussed with departmental personnel and are there explanations for significant variation from budgeted amounts?**

Office of the State Controller

Self-Assessment of Internal Controls

Cash Receipts Cycle

Objectives and Risks

Agency ____________________________ Year-End _________

Objectives		Risks
All collections are properly identified, control totals developed, and collections promptly deposited intact.		• Failure to record cash receipts; withholding or delaying the recording of cash receipts.
All bank accounts and cash on hand are subject to effective custodial accountability procedures and physical safeguards.		• Misappropriated cash or petty cash funds; diverted cash receipts; unauthorized cash disbursements; loss of funds.
All transactions are promptly and accurately recorded in adequate detail records and appropriate reports are issued.		• Covering unauthorized transactions by substituting unsupported credits or fictitious expenditures to cover misappropriated collections; under or overestimating cash or receivables.
All transactions are properly accumulated, correctly classified and summarized in the general ledger; balances are properly and timely reconciled with bank statement balances.		• Misstating cash balances; covering unauthorized transactions by falsifying bank reconciliation.

Office of the State Controller

Self-Assessment of Internal Controls

Cash Receipts Cycle

Control Policies and Procedures:

Agency ______________________________ Year-End __________

Bolded questions identify critical controls. A critical control is a control that will prevent or detect an error in the event that all other controls fail.

A. Control Activities / Information and Communication:

Yes No N/A

___ ___ ___ 1. Is there a formal organizational chart defining responsibilities for processing and recording cash transactions?

___ ___ ___ 2. Do written procedures exist regarding the collection of funds, timely deposit, and recording of funds in the accounting records at each cash receipting location?

___ ___ ___ 3. Is a restrictive endorsement placed on incoming checks at the earliest point of receipting?

___ ___ ___ 4. Do deposit slips have an official depository bank number preprinted on the document?

___ ___ ___ 5. **If payments are made in person (seminars, workshops, etc.), are manual receipts used and accounted for and balanced to the deposits?**

___ ___ ___ 6. Are pre-numbered receipts issued for all cash collections and are numbers of all receipts accounted for?

___ ___ ___ 7. **Are logs of receipt book issuances maintained and reconciled?**

___ ___ ___ 8. Are unused portions of receipt books required to be returned to the issuance location?

9. **Are the following responsibilities performed by different people:**

___ ___ ___ a. **Custodian of the funds, reconciliation of the funds and access to cash receipts?**

___ ___ ___ b. **Filling out the disbursement receipts, disbursement, and reconciliation?**

___ ___ ___ **c. Making a deposit, billing, making General Ledger entries and collecting?**

___ ___ ___ **d. Collecting cash, balancing cash, closing cash registers, making a deposit, maintaining Accounts Receivable records and making General Ledger entries?**

___ ___ ___ **e. Collecting of licenses, fines, and inspections (etc.) and making General Ledger entries?**

___ ___ ___ **f. Collecting cash and reconciling the bank account?**

___ ___ ___ **g. Cash registers reconciled daily by a person not involved in cash receipting?**

___ ___ ___ **h. Preparation of the deposit and verifying the validated bank deposit?**

___ ___ ___ 10. Is a mail receipts log maintained for mail receipts?

11. Is the mail receipts log reconciled to:

___ ___ ___ a. The cash receipts journal?

___ ___ ___ b. Validated deposit slips?

___ ___ ___ 12. Are receipts deposited daily as required by Daily Deposit Act?

___ ___ ___ 13. Are the authorization records of the depository banks up to date?

___ ___ ___ 14. Is there adequate physical security surrounding cashiering areas?

___ ___ ___ 15. Are employees prohibited from cashing personal checks at cashiering areas?

___ ___ ___ 16. Is cash receiving centralized to the maximum extent possible?

___ ___ ___ 17. Are all employees handling cash receipts adequately bonded?

___ ___ ___ 18. **Are responsibilities for preparing and approving bank account reconciliations and investigation of unusual reconciling items segregated from those for other cash receipts or disbursement functions?**

___ ___ ___ 19. "Not sufficient funds" checks delivered to someone independent of those processing and recording cash receipts?

___ ___ ___ 20. For cash disbursements, are there controls over warrant, sight draft, or check-signing machines, as to signature plates and usage?

___ ___ ___ 21. Are there controls to ensure each cash disbursement is properly vouchered and approved by the proper authorities before the disbursement occurs?

___ ___ ___ 22. Are there controls over the supply of unused and voided warrants, sight drafts, or checks?

___ ___ ___ 23. Is the responsibility for processing a credit card payment segregated from the processing of a void?

___ ___ ___ 24. **Are total cash receipts (cash, credit cards, wires) reconciled on a daily basis to the total dollar value sold? (For example, total dollar amount reconciled to number of licenses issued.)**

___ ___ ___ 25. When funds are not deposited by the end of the day are the funds secured (safe) overnight until the next day?

B. Monitoring:

___ ___ ___ 26. Do you have an OSC approved Cash Management Plan on file?

___ ___ ___ 27. Do you have an OSC approved Delegation of Disbursing Authority on file?

___ ___ ___ 28. Is effective control maintained over receipts of gifts, grants, donations, etc. and is a follow-up made by a responsible official to see that they have been classified and recorded properly?

___ ___ ___ 29. Are funds periodically counted by a person other than the custodian at unannounced times?

___ ___ ___ 30. **Does management review and approve bank reconciliations on a monthly basis?**

___ ___ ___ 31. Are policies documented for changes in a new system or method for accounting for cash?

___ ___ ___ 32. **Are timely corrective actions taken in cash discrepancies?**

___ ___ ___ 33. If you accept credit cards for payment, do you have documentation to reflect that your agency is PCI (Payment Card Industry) compliant?

Office of the State Controller

Self-Assessment of Internal Controls

Accounts Receivable Cycle

Objectives and Risks

Agency ____________________________ Year-End _________

Objectives		Risks
Ensure that appropriate records are maintained for all businesses, users of government services, and individuals or entities against whom taxes or fees are assessed.		• Government loss of revenue as a result of billing errors. • Eligible parties who have failed to file tax or other informational returns not identified. • Systems may permit unauthorized removal of taxpayers or others from rolls. • Employees diversion of revenue for personal use.
Billing of taxes and services is performed promptly and in proper amounts; self-assessed taxpayers monitored; exemptions are only provided to those authorized.		• Billings inaccurately or incompletely prepared. • Sales, income and other self-assessed taxpayers may pay amounts less than required by law. • Revenue lost due to inadequate procedures or improper accounts.
All collections are properly identified, control totals developed, and collections promptly deposited intact and applied to the proper accounts.		• Withholding or delaying the recording of cash receipts and application of funds to the proper accounts. • Employee diversion of receipts for personal use. • Failure to receive proper distribution of taxes collected by another level of government. • Amounts improperly written-off and collections diverted to personal use.

Billings, adjustments and collections are properly recorded in individual receivable accounts.		• Account balances reduced by unauthorized transactions. • Cash flow from payments delayed by late billings or deposits.
Revenues, collections and receivables are properly accumulated, classified and summarized in the accounts.		• Errors in transaction postings to detail or control accounts not detected in a timely manner. • Problem accounts do not receive prompt attention, resulting in revenue or cash-flow loss.

Office of the State Controller

Self-Assessment of Internal Controls

Accounts Receivable Cycle

Control Policies and Procedures

Agency ____________________________ Year-End __________

Bolded questions identify critical controls. A critical control is a control that will prevent or detect an error in the event that all other controls fail.

A. Control Activities / Information and Communication:

Yes	No	N/A		
___	___	___	1.	Is there a formal organizational chart defining responsibilities for preparing bills, recording payments, collecting amounts due and following up of on unpaid accounts?
___	___	___	2.	Does the agency have written credit and collection policies that meet the requirements of the Statewide Accounts Receivable program and the policies and procedures established by OSC and the Attorney General?
___	___	___	3.	Do procedures exist to prepare and send billings as soon after the sale of goods or performance of service as possible, but at least within the month?
___	___	___	4.	Have procedures been documented to collect monies due within the established payment terms?
___	___	___	5.	Have procedures been adopted to notify the Attorney General's office and follow through the collection after 90 days?
___	___	___	6.	Does the agency participate in the Setoff Debt Program established by Chapter 105A of the General Statutes?
___	___	___	7.	Has an allowance account been established for doubtful accounts to reflect the amount of the agency's receivables that management estimates will be uncollectible?
___	___	___	8.	Are accounts written off the agency's financial accounting records when all collection procedures have been exhausted without success and reason adequately documented?
___	___	___	**9.**	**Do write-offs or adjustments have proper authorizations?**

___ ___ ___ 10. Do procedures exist to prevent the interception or alteration by unauthorized persons of billings or statements after preparation but before they are mailed?

___ ___ ___ 11. Does the agency have established policies and procedures concerning refunds of overpayments, issuance of billing adjustments?

___ ___ ___ 12. Are all services or goods provided to individuals or other governmental units billed when goods are provided or services rendered?

___ ___ ___ 13. Are payment terms 30 days after billing, unless contractual requirements specify otherwise?

___ ___ ___ 14. Are subsidiary accounts receivable and notes receivable records maintained and reconciled at least monthly with the general ledger control account?

15. Are the following amounts properly recorded:

___ ___ ___ a. Amounts due from local governments?

___ ___ ___ b. Amounts due from federal agencies?

___ ___ ___ c. Amounts due from other departments/divisions/agencies?

___ ___ ___ d. Amounts due from other funds?

___ ___ ___ e. Interest Receivable?

___ ___ ___ f. Trade Receivables?

___ ___ ___ g. Taxes Receivable?

___ ___ ___ 16. Does the agency charge interest at the rate established pursuant to G.S. 105-241.1(I) on a past-due account receivable from the date the account receivable was due until it is paid?

___ ___ ___ 17. Are remittance advices and billings retained to support entries to accounts receivable records?

___ ___ ___ 18. Are individual receivable records posted only from authorized documents?

___ ___ ___ 19. Are databases and, where appropriate, usage records accurately maintained to ensure that amounts due are billed correctly?

___ ___ ___ 20. Are charges for goods or services based on authorized rates and approved by the appropriate State/Federal authorities?

___ ___ ___ 21. Are statements of account balances mailed at least once a month?

___ ___ ___ 22. Is the accounting department notified directly and in a timely manner of billings and collection?

___ ___ ___ 23. Are collections on accounts receivable deposited daily, rather than held for posting to detail records?

24. To aid in collection, does the agency obtain the following minimum prescribed information on prospective debtors:

___ ___ ___ a. Full name and any previous name(s) if applicable?

___ ___ ___ b. Home and office address(es) for the past two years?

___ ___ ___ c. Telephone numbers for home and place of employment?

___ ___ ___ d. Federal Employer Identification Number?

___ ___ ___ e. Social Security Number for individuals or sole proprietorships contracting with the State?

___ ___ ___ f. For other individuals, Social Security Number and/or Driver's License Number?

___ ___ ___ g. Date of Birth?

___ ___ ___ h. Place and type of employment and employer's address, and previous employer if less than two years in present job?

___ ___ ___ i. A credit bureau report may be required depending on the amount of the potential receivable and the guidelines of the agency or institution?

25. Are the following duties performed by different people:

___ ___ ___ **a. Billing and collecting of accounts receivable funds?**

___ ___ ___ **b. Maintaining detail accounts receivable records, collecting, and general ledger posting?**

___ ___ ___ **c. Writing off or adjusting to accounts receivable and the maintenance of accounts receivable records?**

___ ___ ___ **d. Investigating disputes with billing amounts and the maintenance of accounts receivable records?**

___ ___ ___ **e. Reconciling, investigating reconciling items and posting detail accounts receivable records?**

___ ___ ___ 26. Are all collections on accounts receivable posted to individual receivable accounts?

___ ___ ___ **27. Is access to the accounts receivable accounting system limited only to authorized individuals?**

B. Monitoring:

___ ___ ___ **28. Are corrections and adjustments to cash receipts documented and approved by management?**

___ ___ ___ **29. Are all non-cash credits, such as credit memos, allowances, and bad debts properly authorized?**

___ ___ ___ 30. Are there controls to ensure that individuals with delinquent accounts are not receiving additional credit?

___ ___ ___ 31. For institutions of higher education, are there controls to ensure that no student having any outstanding past-due accounts is allowed to enroll for the next term?

___ ___ ___ **32. Is an aging schedule prepared monthly and reviewed by management?**

___ ___ ___ 33. Are delinquent accounts followed up?

___ ___ ___ 34. Are all legal remedies followed to collect write-offs or uncollectible accounts with the Attorney General?

___ ___ ___ 35. Are there procedures to adjust billings for new rates?

___ ___ ___ **36. Are accounts reviewed by someone independent of cash and accounts receivable accounting?**

Office of the State Controller

Self-Assessment of Internal Controls

Purchasing/Accounts Payable Cycle

Objectives and Risks

Agency ____________________________ Year-End _________

Objectives		Risks
All requests for goods and services are initiated and approved by authorized individuals, and are in accordance with budget and appropriation guidelines.		• Purchases from unauthorized vendors. • Purchases are in violation of a conflict of interest policy. • Purchases are not timely. • Purchases not in accordance with budget and/or appropriations provisions.
All purchase orders are based on valid, approved requests and are properly executed as to price, quantity and vendor.		• Payment in excess of optimum price. • Quantities not adequate or in excess of need.
All materials and services received agree with the original orders.		• Payment for materials or services not received. • Damaged or missing goods not reported.
All invoices processed for payment represent goods and services received and are accurate as to terms, quantities, prices and extensions; account distributions are accurate and agree with established account classifications.		• Payment based on improper price or terms. • Accounting distribution of cost is inaccurate.
All checks are prepared on the basis of adequate and approved documentation, compared with supporting data and properly approved, signed and mailed.		• Incorrect or duplicate payments. • Alteration of checks. • Disbursement for materials or services not properly documented or approved.
All disbursement, accounts payable, encumbrance transactions are promptly and accurately recorded as to payee and amount.		• Improper cash, accounts payable, and encumbrance balances.
All entries to accounts payable, reserve for encumbrances, asset and expense accounts and cash disbursements are properly accumulated, classified and summarized in the accounts.		• Misstated financial statements. • Misstated internal financial data.

Office of the State Controller

Self-Assessment of Internal Controls

Purchasing/Accounts Payable Cycle

Control Policies and Procedures:

Agency ___________________________ Year-End __________

Bolded questions identify critical controls. A critical control is a control that will prevent or detect an error in the event that all other controls fail.

A. Control Activities / Information and Communication:

Yes No N/A

___ ___ ___ 1. Is there a formal organizational chart defining the responsibilities of preparing, recording, approving and following up on all purchases and accounts payable functions?

___ ___ ___ 2. Do procedures exist for processing invoices not involving materials or supplies (for example, lease or rental payments, and utility bills)?

___ ___ ___ 3. Do procedures exist ensuring accurate account distribution of all entries resulting from invoice processing?

___ ___ ___ 4. Do procedures exist for disbursement approval and check-signing?

___ ___ ___ 5. Has the agency established procedures to ensure that all voided checks are properly accounted for and effectively canceled?

___ ___ ___ 6. Is a written policy established to ensure that the best possible price is obtained for purchases not made from state contract or subject to competitive bidding requirements?

___ ___ ___ 7. If construction contracts are awarded, are bid and performance bonds as well as retainage required to assure performance?

8. Do invoice processing procedures provide for:

___ ___ ___ a. Obtaining copies of requisitions, purchase orders and receiving reports?

___ ___ ___ b. Comparison of invoice quantities, prices, and terms with those indicated on the purchase order?

___ ___ ___ c. Comparison of invoice quantities with those indicated on the receiving reports?

___ ___ ___ d. As appropriate, checking accuracy of calculations?

___ ___ ___ e. Alteration/mutilation of extra copies of invoices to prevent duplicate payments?

___ ___ ___ f. All file copies of invoices are stamped paid to prevent duplicate payments?

___ ___ ___ 9. Are purchase orders prenumbered and issued in sequence?

___ ___ ___ **10. Are purchase orders or contracts required to be approved by appropriately designated officials before issuance?**

___ ___ ___ **11. Are changes to contracts or purchase orders subject to the same controls and approvals as the original agreement?**

___ ___ ___ 12. Is an adequate record of open purchase orders and agreements maintained?

___ ___ ___ 13. Are payments made as close to the discount date as possible, and if applicable, that exemptions from sales, federal excise, and other taxes are claimed?

___ ___ ___ 14. Is splitting orders to avoid higher levels of approval prohibited?

___ ___ ___ 15. If a receiving department is not used, do adequate procedures exist to ensure that goods for which payment is to be made have been verified and inspected by someone other than the individual approving payment?

___ ___ ___ 16. Are goods received accurately counted and examined to see that they meet quality standards?

___ ___ ___ 17. Are copies of receiving reports sent directly to purchasing or accounting?

___ ___ ___ 18. Are all invoices received from vendors in a central location, such as the accounting department?

___ ___ ___ 19. Are there steps in the processing procedures to prevent or detect duplicate payments?

___ ___ ___ 20. Are payments made only on the basis of original invoices and to suppliers identified on supporting documentation?

___ ___ ___ 21. Are the accounting and purchasing departments promptly notified of returned purchases, and are such purchases correlated with vendor credit advices?

___ ___ ___ 22. Is proper control maintained over vendor credit memos?

___ ___ ___ 23. Are signed checks delivered directly to the mail room, making them inaccessible to persons who requested, prepared, authorized or recorded them?

24. Are the following duties performed by different people:

___ ___ ___ a. Requisitioning, purchasing, and receiving functions and the invoice processing, accounts payable, and general ledger functions?

___ ___ ___ b. Purchasing, requisitioning and receiving?

___ ___ ___ c. Invoice processing and making entries to the general ledger?

___ ___ ___ d. Preparation of cash disbursements, approval, and entries to the general ledger?

___ ___ ___ e. Making detail cash disbursement entries and entries to the general ledger?

___ ___ ___ 25. Are disbursements approved for payment only by properly designated officials?

___ ___ ___ 26. Are travel expenses for out-of-state, out-of-country, and excess allowances approved in advance?

___ ___ ___ 27. Are invoices (vouchers) reviewed for accuracy and completeness of supporting documents and properly approved?

___ ___ ___ 28. Is the individual responsible for approval or check-signing furnished with invoices and supporting data to be reviewed prior to approval or check-signing?

___ ___ ___ 29. Are adjustments of recorded accounts payable or other liabilities properly approved?

___ ___ ___ 30. Is check signing limited to only authorized personnel?

___ ___ ___ 31. Are unused checks adequately controlled and safeguarded?

___ ___ ___ 32. Is it prohibited to sign blank checks in advance?

___ ___ ___ 33. Is it prohibited to make checks out to the order of "cash"?

___ ___ ___ 34. If facsimile signatures are used, are the signature plates adequately controlled and separated physically from blank checks?

___ ___ ___ 35. Are signature plates only under the signer's control used and does that person or an appropriate designee record machine readings to ascertain that all checks signed are properly accounted for?

B. Monitoring:

___ ___ ___ 36. Are transfers between funds approved by management**?**

___ ___ ___ 37. Before commitment, are funds not obligated, but remaining in the budget verified by the accounting or budget department as sufficient to meet the proposed expenditure?

___ ___ ___ 38. Is a government representative or architect required to inspect construction projects before approval of payment?

___ ___ ___ 39. Are requests for progress payments under long-term contracts related to contractors' efforts and are they formally approved by a designated contract administrator/officer with formal approval authority?

___ ___ ___ 40. Are debit balances in accounts payable and other liabilities reviewed and researched?

___ ___ ___ 41. Are reasonable limits set on amounts that can be paid by facsimile signatures?

___ ___ ___ 42. Are all records, checks and supporting documents retained according to the applicable (state or federal) record retention policy?

___ ___ ___ 43. Does the accounting department record and follow up on partial deliveries?

___ ___ ___ 44. Are P-card purchases reconciled monthly by someone other than the card holder?

___ ___ ___ 45. Are all prescribed statewide policies and procedures regarding the use of P-cards followed?

___ ___ ___ 46. Are P-card transactions audited on a periodic basis?

Office of the State Controller

Self-Assessment of Internal Controls

Human Resources Cycle

Objectives and Risks

Agency ____________________________ Year-End _________

Objectives		Risks
Additions, separations, wage rates, salaries and deductions are authorized and documented. Payroll and personnel policies are in compliance with grant agreements and federal and state laws.		• Unauthorized or fictitious names are added to the payroll. • Payments continue to terminated employees. • Wage rates and salaries used are at a higher rate than authorized. • Payroll reimbursement through grant funding denied. • Penalty for noncompliance with federal and state laws.
Employees' time and attendance data are properly reviewed and approved.		• Employees are paid for time which they did not work. • Employees are paid for time which was unnecessary or unauthorized.
Employees' time and attendance data are properly processed and documented and accurately coded for account distribution.		• Employees are paid for time which they were absent from work. • Coding of accounting distribution for payroll costs in error.
Computations for gross pay, deductions and net pay are accurate and based on authorized time and rates; the recording and summarization of payments to be made and cost to be distributed are accurate and agree with established account classifications.		• Employee compensation and payroll deductions are computed erroneously. • Payroll and related costs are not distributed in accordance with established account classification. • Reimbursable payroll costs are not recovered under grant or shared cost programs. • Amounts paid at rates different than those authorized.

Payments for employee compensation and benefits are made to or on behalf of only bona fide employees for services performed as authorized.		• Payments made to unauthorized individuals. • Employees paid for unauthorized benefits.
Employee compensation and benefit costs are properly accumulated, classified and summarized in the accounts.		• The accounting distribution of payroll and related costs are classified improperly. • Accrued liabilities or disclosures for employee benefits are misstated.

Office of the State Controller

Self-Assessment of Internal Controls

Human Resources Cycle

Control Policies and Procedures

Agency ____________________________ Year-End __________

Bolded questions identify critical controls. A critical control is a control that will prevent or detect an error in the event that all other controls fail.

A. Control Activities / Information and Communication:

Yes No N/A

___ ___ ___ 1. Is there a formal organizational chart defining the responsibilities of processing, recording, approval and distribution of payroll and of personnel activities?

___ ___ ___ 2. Are agency personnel policies (those not established by the Office of State Personnel) in writing?

___ ___ ___ 3. Does each supervisor or manager have a copy or access to a copy of the policies and procedures manual?

___ ___ ___ 4. Do all supervisors and managers have at least a working knowledge of the State's personnel policies and procedures?

___ ___ ___ 5. Is nepotism or conflict of interest in employment prohibited?

___ ___ ___ 6. Are personnel files maintained for all employees?

___ ___ ___ 7. Is access to payroll/personnel files limited to authorized individuals?

___ ___ ___ 8. **Are approved notices of additions, separations, and changes in salaries, wages, and deductions reported to the payroll processing section according to the payroll scheduled cut-off date?**

___ ___ ___ 9. **Are terminated employees interviewed as a physical check on departures and as a final review of the termination settlement to ensure that all keys, equipment, credit cards, etc. are returned by the terminating employee?**

___ ___ ___ 10. **Are completed payroll transmittals reviewed and approved by a responsible official before check processing?**

___ ___ ___ 11. **Are payroll registers reconciled to the payroll accounts in the general ledger by a knowledgeable person not otherwise involved in payroll processing?**

12. Are individual employee time and attendance records:

___ ___ ___ **a. Prepared and signed by each employee for each pay period?**

___ ___ ___ **b. Sufficiently detailed to show time charged properly?**

___ ___ ___ **c. Reviewed and signed by each employee's supervisor?**

___ ___ ___ **d. Reconciled with centralized time and attendance records?**

13. Are the following duties performed by different people:

___ ___ ___ a. Processing personnel action forms and processing payrolls?

___ ___ ___ b. Supervising and timekeeping, payroll processing, disbursing, and making general ledger entries?

c. Personnel distribution (if applicable) and:

___ ___ ___ 1) Hiring and firing employees?

___ ___ ___ 2) Approving time reports?

___ ___ ___ 3) Payroll preparation?

___ ___ ___ d. Recording the payroll in the general ledger and the payroll processing function?

___ ___ ___ 14. **Are hours worked, overtime hours, compensatory time, and other special benefits (on-call, shift premium) reviewed and approved by the employee's supervisor?**

___ ___ ___ 15. Is a policy established concerning overdrawn vacation or sick leave?

___ ___ ___ 16. Are vacation and sick leave approved by supervisors?

___ ___ ___ 17. Are appropriate time records maintained for all leave?

___ ___ ___ 18. Is overdrawn vacation or sick leave deducted when calculating final compensation upon termination?

___ ___ ___ 19. **Are individual employee leave records reconciled, at least annually, to appropriate records maintained for accumulated employee benefits (vacation, sick leave, etc.)?**

B. Monitoring:

___ ___ ___ 20. **Are comparisons of gross pay of current to prior period payrolls reviewed for reasonableness by a knowledgeable person not otherwise involved in payroll processing?**

___ ___ ___ 21. Are unclaimed payroll checks returned to a custodian independent of the payroll department?

___ ___ ___ 22. Are background checks performed on individuals hired for sensitive positions?

___ ___ ___ 23. Is information on employment applications verified and are references contacted?

___ ___ ___ 24. Are all employees given a performance evaluation?

___ ___ ___ 25. Does the agency have separate payroll and personnel offices?

Office of the State Controller

Self-Assessment of Internal Controls

Inventory Cycle

Objectives and Risks

Agency ______________________________ Year-End _________

Objectives		Risks
All transactions are approved by authorized individuals.		• Purchase unauthorized materials acquired in excess of need, at appropriate prices, or at unfavorable terms.
All inventory items are subject to effective custodial accountability procedures and physical safeguards.		• Theft by employees or outsiders; inadequate insurance coverage.
All receipts and withdrawals of inventory are properly recorded and the records reflect actual quantities on hand.		• No basis for comparing actual usage with expected usage; inability to determine material reorder points.
All transactions are properly accumulated, classified and summarized in the accounts.		• Misstated financial statements; concealment of shortages.

Office of the State Controller

Self-Assessment of Internal Controls

Inventory Cycle

Control Policies and Procedures

Agency ____________________________ Year-End __________

Bolded questions identify critical controls. A critical control is a control that will prevent or detect an error in the event that all other controls fail.

A. Control Activities / Information and Communication:

Yes No N/A

___ ___ ___ 1. Is there a formal organizational chart defining the responsibilities of ordering, accepting, approving, processing and recording of the inventory?

___ ___ ___ 2. Are policies established to ensure that inventories are not stockpiled or to prevent over-ordering?

___ ___ ___ 3. Are policies established to ensure that obsolete and inactive items in inventory are sent to State Surplus Property?

___ ___ ___ 4. Are steps documented to ensure that goods received are accurately counted?

___ ___ ___ 5. **Does the agency maintain perpetual inventory records and are all inventory items put on the perpetual inventory system?**

___ ___ ___ 6. When issuing inventory, is the proper fund, purpose, and object charged in the general ledger?

___ ___ ___ 7. Does the person receiving the goods sign the requisition as evidence of receipt?

___ ___ ___ 8. Are the approved and completed requisitions kept on file?

___ ___ ___ 9. Upon receipt of goods, does the signed receiving report go to the accounting office?

___ ___ ___ 10. Are entries to perpetual inventory records made timely upon the receipt of goods?

___ ___ ___ 11. **Are receiving reports used to record purchases to the perpetual inventory records?**

12. Are the following duties performed by different people:

___ ___ ___ **a. Receiving and issuing inventory and the operational duties?**

___ ___ ___ **b. Receiving and issuing of inventory and taking the physical inventory?**

___ ___ ___ **c. Receiving and issuing of inventory and the approving of expenditures, recording transactions in the general ledger, and reconciliation of subsidiary records to control accounts?**

___ ___ ___ 13. Is a definite responsibility designated for each inventory type?

___ ___ ___ **14. Are work orders or requisitions required to be approved by appropriately designated officials as a basis of issuing inventories?**

___ ___ ___ **15. Is physical access to inventories restricted to authorized personnel?**

___ ___ ___ 16. Is there appropriate insurance coverage for significant inventories?

___ ___ ___ 17. Are all employees responsible for inventories adequately bonded?

___ ___ ___ 18. Are written instructions given and explained to all personnel involved in the physical count of the inventory?

19. Are physical Inventories:

___ ___ ___ **a. supervised by someone independent of the custodial or record keeping functions?**

___ ___ ___ **b. made by or tested by employees independent of the department being inventoried?**

___ ___ ___ **c. recorded on permanent inventory count sheets?**

___ ___ ___ **d. re-recorded on count sheets signed and dated by the person supervising the count?**

___ ___ ___ **e. planned to provide provisions for cut-off of receipts and issues?**

___ ___ ___ **f. reflected in the perpetual records based on the actual inventory quantities?**

___ ___ ___ 20. Are prenumbered tags used during the physical inventories count?

___ ___ ___ 21. Is there a proper cut-off of receipts and issues from inventory at year end?

___ ___ ___ 22. Is access to the perpetual inventory records limited to authorized individuals?

___ ___ ___ **23. Are adjustments to inventory records approved by a properly designated official?**

B. Monitoring:

___ ___ ___ **24. Is a physical inventory taken at least annually?**

___ ___ ___ **25. Are perpetual inventory balances reconciled against the general ledger control accounts at least annually?**

___ ___ ___ **26. Does management review the above reconciliations at year-end?**

___ ___ ___ 27. Does management assess inventory policies and procedures periodically?

Office of the State Controller

Self-Assessment of Internal Controls

Capital Assets Cycle

Objectives and Risks

Agency ____________________________ Year-End _________

Objectives		Risks
All capital asset transactions are initiated by authorized individuals in accordance with established criteria.		• Fictitious purchases or payments to contractors or suppliers, with or without kickbacks to employees. • Purchases from vendors whose interests are in conflict with the organization. • Purchases of unnecessary assets. • Disposal or scrapping of serviceable assets. • Purchases of assets which do not meet established quality standards.
Advance approval is obtained for all significant capital asset transactions.		• Unauthorized purchases, construction contracts or leases with companies or individuals related to executive or legislative representatives. • Purchases from related parties without the knowledge of senior officials. • Delay or cancellation of a project due. • Expenditures in excess of originally approved amounts without review and approval.
Adequate project cost records are maintained, and in progress and completed project reports are issued.		• Actual costs that exceed projected amounts. • Overpayments to contractors. • Misclassification of costs between capital and operating budgets.

All capital assets are accurately recorded in detail records which are compared with existing assets at reasonable intervals. All capital assets are adequately safeguarded.		• Use of equipment or other assets for other than the unit of government's benefit. • Theft of tools and equipment, maintenance or supply parts. • Payment of insurance on assets no longer owned. • Unauthorized disposals of assets or diverted proceeds from sales of assets. • Physical loss of assets through inadequate security or insurance coverage. • Continue ownership of obsolete or otherwise nonproductive assets. • Preparation of financial statements which do not accurately reflect existing assets.
All capital assets transactions are properly accumulated, classified and summarized in the general ledger accounts.		• A misstatement of reported financial position and results of operations. • Violations of loan covenants and/or rules and regulations of various grantor agencies. • Financial or operational decisions based upon erroneous information.

Office of the State Controller

Self-Assessment of Internal Controls

Capital Assets Cycle

Control Policies and Procedures

Agency ____________________________ Year-End __________

Bolded questions identify critical controls. A critical control is a control that will prevent or detect an error in the event that all other controls fail.

A. Control Activities / Information and Communication:

Yes No N/A

___ ___ ___ 1. Is there a formal organizational chart defining the responsibilities of purchasing, receiving, recording, approving and performing the inventory?

___ ___ ___ 2. Are there formal written procedures for performing a physical inventory?

___ ___ ___ 3. Is a capitalization policy established which is consistent with Purchase and Contract requirements and Federal rules and regulations?

___ ___ ___ 4. Are fixed asset records maintained that adequately classify and identify individual items?

___ ___ ___ 5. **Are the fixed asset system and control accounts reconciled monthly?**

___ ___ ___ 6. Are construction records adequate to accumulate costs associated with constructed capital assets including force (in-house) labor and materials obtained from inventory?

7. Is the individual responsible for capital assets notified when:

___ ___ ___ a. assets are received?

___ ___ ___ b. assets are donated?

___ ___ ___ c. asset location changes are made?

___ ___ ___ d. assets are transferred to State Surplus Property?

___ ___ ___ e. assets are sold?

___ ___ ___ f. assets are stolen, vandalized or missing?

___ ___ ___ g. assets are reassigned to a different organizational agency or to another agency?

___ ___ ___ 8. Are gains or losses properly recognized from disposals of capital assets in proprietary fund types?

___ ___ ___ 9. Are capital assets tagged when procured?

___ ___ ___ 10. **Are the capital asset subsidiary accounts reconciled to the capital asset control accounts monthly?**

___ ___ ___ 11. **Are property records reconciled to property accounts at least annually?**

___ ___ ___ 12. **Are the beginning balances, additions, disposals and ending balances reflected in the note disclosures reconciled to the fixed asset system?**

___ ___ ___ 13. Are capital asset additions properly valued?

___ ___ ___ a. Is the total purchase price, less discount and any expenditure required to place asset in its intended state of operation the amount capitalized?

___ ___ ___ b. Does the recorded asset cost of land purchases include: purchase price, legal and title fees, surveying fees, appraisal and negotiation fees, damage payments, and site preparation costs?

___ ___ ___ c. Does the recorded asset cost of building include: purchase price, contract price or job order costs plus any other expenditures necessary to put a building or structure into its intended state of operation, including professional fees, damage claims, cost of fixtures, insurance premiums, interest, and related costs incurred during the period of construction? Are maintenance costs expensed rather than capitalized?

14. **Are the following duties performed by different people:**

___ ___ ___ **a. Custodian of the capital assets and taking the annual inventory?**

___ ___ ___ **b. Reconciliation of the Fixed Asset System with the control accounts and making entries in the Fixed Asset System?**

___ ___ ___ **c. Custodian of the capital assets and tagging?**

___ ___ ___ **d. Custodian of the capital assets and investigating the missing capital assets?**

___ ___ ___ **e. Custodian of the capital assets, making entries in the Fixed Asset System and making entries in the general ledger?**

___ ___ ___ 15. **Are all asset purchases and receipts approved by a designated person with proper authority?**

___ ___ ___ 16. **Are all disposals of property approved by a designated person with proper authority?**

___ ___ ___ 17. If other than the Statewide $5,000 capitalization threshold, has agency management chosen and documented the threshold level in the Internal Policy/Procedure Manual?

___ ___ ___ 18. Has the agency documented the inventory level below $5,000 that will be utilized**?**

___ ___ ___ 19. Is someone assigned custodial responsibility by location for all assets?

___ ___ ___ 20. Is access to the perpetual capital asset records limited to authorized individuals?

___ ___ ___ 21. Is there adequate physical security surrounding the capital asset items?

___ ___ ___ 22. Are assets believed to be stolen or vandalized reported to the State Bureau of Investigation (SBI) according to state law?

B. Monitoring:

___ ___ ___ 23. **Are the Physical Inventory Worksheets approved by the Chief Fiscal Officer or responsible supervisor before the fixed asset officer makes changes to the Fixed Asset System?**

___ ___ ___ 24. **Are capital asset inventory worksheets (physical count) reconciled to the fixed asset listing at year-end?**

___ ___ ___ 25. Is such insurance coverage independently reviewed periodically?

___ ___ ___ 26. Has the Internal Policy/Procedure Manual been updated with any changes in the agency, or agency philosophy?

___ ___ ___ 27. Is a physical inventory of capitalized assets and inventoried items taken each time there is a change at a management or supervisory level that has responsibility for the assets?

___ ___ ___ 28. Are missing items investigated and reasons for them missing documented?

Office of the State Controller

Self-Assessment of Internal Controls

Computer Security Cycle

Objectives and Risks

Agency ____________________________ Year-End _________

Objectives		Risks
Definition and communication of organizational structure, policies and procedures.		• Control may be superficial, inconsistently followed, or subject to override or circumvention. • Segregation of incompatible duties. • Opportunities to perpetrate and conceal fraud may exist if personnel have direct or indirect access to assets.
Management and user involvement and approval.		• Personnel may not fully understand users' needs or the accounting aspects of the systems; systems may be developed that perform improper calculation, prepare erroneous reports or cause other processing errors. • Systems may be designed with inadequate control in the application programs. • User control may be incomplete or ineffectual as a result of poor knowledge of the system and the processing functions performed by the application programs.
Restricted access to application system documentation.		• Unauthorized persons may obtain detailed knowledge of applications and use that knowledge to perpetrate irregularities.

Authorization and approval of systems changes.		• Personnel may make systems changes that do not conform to users' needs; this may result in processing errors. • Unauthorized program modifications may be implemented to perpetrate and conceal fraud.
Monitoring integrity of master files.		• Master files may contain erroneous data that cause errors in all transactions using those data. • Master file data may be altered to allow the processing of fraudulent transactions. • Master file data may be altered prior to the preparation of statements or confirmation.
Verifying accuracy of output.		• Unauthorized or fraudulent transactions introduced during processing may not be detected.

Office of the State Controller

Self-Assessment of Internal Controls

Computer Security Cycle

Control Policies and Procedures

Agency ____________________________ Year-End __________

Bolded questions identify critical controls. A critical control is a control that will prevent or detect an error in the event that all other controls fail.

A. Control Activities / Information and Communication:

Yes No N/A

1. Is there a formal organizational chart which identifies the individuals responsible for the:

___ ___ ___ a. Computer systems?

___ ___ ___ b. Computer security?

___ ___ ___ 2. Has management considered the appropriate segregation of duties among personnel involved in the IT security function?

___ ___ ___ 3. Have roles and responsibilities been clearly defined and communicated?

___ ___ ___ 4. Is the financial system's business owner management appropriately included in the design of the IT security function from a data ownership?

___ ___ ___ 5. Does management have a controlled process in place to update the security policy and procedure documentation on a periodic basis?

___ ___ ___ 6. **Is a formal documented security administration process in place to ensure that all applications access, including restricted access to financial applications, is approved?**

___ ___ ___ 7. Has management implemented a formal process for changing financial data file permissions?

___ ___ ___ 8. Has management implemented a formal security administration process for granting, changing, and removing direct access to financial data?

___ ___ ___ 9. **Does management periodically review monitoring reports to identify potential unauthorized activity?**

___ ___ ___ 10. When an employee or contractor is terminated, are the following precautions implemented immediately:

___ ___ ___ a. The employee or contractor is denied access to the equipment?

___ ___ ___ b. The employee or contractor is denied access to any data, program listing, etc.?

___ ___ ___ c. All other employees are informed of the employee's termination?

___ ___ ___ d. The employee or contractor's user-id and password are deleted from the computer system?

___ ___ ___ 11. Is there a time out/screen saver and/or log off function, which will protect a terminal if left unattended?

___ ___ ___ 12. Does a login name and a password uniquely identify users when they sign on to the system (e.g. no group users IDs)?

___ ___ ___ 13. If an employee incorrectly enters their password three times in a row, does the computer system deny them access to the computer system until reset by the system administrator?

___ ___ ___ 14. Do all PCs under control of the agency use a recognized anti-virus (A/V) or end-point security program? Does the agency run the A/V program on a regular schedule?

___ ___ ___ 15. Does the agency have a firewall established for their Lan or for individual workstations?

___ ___ ___ 16. Is there a written disaster recovery (DR) plan?

17. **Does the DR plan include identification of the following?**

___ ___ ___ **a. Critical applications?**

___ ___ ___ **b. Staff responsibilities?**

___ ___ ___ **c. Steps for recovery of the system?**

___ ___ ___ **d. Computer equipment needed for temporary processing?**

_ ___ ___ **e. Business location(s) that could be used to process critical applications in the event of an emergency?**

___ ___ ___ 18. **Has the agency taken steps to prevent and minimize potential damage and interruption through the use of data and program backup procedures including off-site storage of backup data as well as environmental controls, staff training, and hardware maintenance and management?**

___ ___ ___ 19. Are there provisions for retaining and/or copying master files, and is there practical means of reconstruction a damaged or destroyed file**?**

B. Monitoring:

___ ___ ___ 20. **Does the agency monitor information systems access, investigates apparent violations, and takes appropriate remedial and disciplinary action?**

___ ___ ___ 21. **Does the department or management balance control totals generated during computer processing with those originally established and reconcile all discrepancies?**

Office of the State Controller

Self-Assessment of Internal Controls

Investment Cycle

Objectives and Risks

Agency ____________________________ Year-End _________

Objectives		Risks
All purchase or sales transaction are initiated by authorized individuals, conform to investment objectives, policies and regulations and are properly documented and approved.		• Unrecorded or unauthorized transactions; transactions at inappropriate prices or at unfavorable terms; payment of fictitious or inflated prices.
All documents evidencing ownership or other rights are subject to effective custodial accountability procedures and physical safeguards.		• Unauthorized use of assets for personal gain; loss or theft of assets.
All transactions are promptly and accurately recorded in adequate detail records and appropriate reports are issued.		• Misappropriation of interest income, proceeds from sales transactions; concealment of unauthorized transactions.
All transaction are properly accumulated, classified and summarized in the accounts.		• Misstating financial statements; concealment of misappropriations.

Office of the State Controller

Self-Assessment of Internal Controls

Investment Cycle

Control Policies and Procedures

Agency ____________________________ Year-End __________

Bolded questions identify critical controls. A critical control is a control that will prevent or detect an error in the event that all other controls fail.

A. Control Activities / Information and Communication:

Yes No N/A

___ ___ ___ 1. Are there approved written policies and procedures that document the investment processing and identify control procedures?

___ ___ ___ 2. Are policies and procedures established to ensure investments are received or appropriately reflected in the custodial accounts?

___ ___ ___ 3. Are investment purchases or sells recorded in the sub-ledger/general ledger on the date traded?

___ ___ ___ 4. Are policies and procedures established to ensure the purchase and sell of investments are properly recorded?

___ ___ ___ 5. Are competitive bids sought for certificate of deposit purchases?

___ ___ ___ 6. Are certificates of deposit and interest coupons sufficiently safeguarded?

___ ___ ___ 7. If applicable, are individuals with access to securities bonded?

___ ___ ___ 8. Are policies and procedures established to ensure investment income received is recorded properly?

___ ___ ___ 9. Does investment income earned get recorded on a timely basis?

___ ___ ___ 10. Are investment earnings credited to the proper fund?

___ ___ ___ 11. Are investment earning calculations and accruals reviewed at year-end?

___ ___ ___ 12. Do specific procedures exist for tracking maturing investments and interest payments?

___ ___ ___ 13. **Are investment guidelines including authorized individuals, investment asset allocation, and safekeeping formally approved and reviewed annually?**

___ ___ ___ 14. Is the acquisition and disposal of investments authorized by a person with approval authority?

___ ___ ___ 15. Have authority and responsibility been established for investment opportunity evaluation (investment performance review)?

16. Are the following responsibilities performed by different people:

___ ___ ___ a. Cash flow management, investment transactions, safekeeping of the investments, and recording to the general ledger?

___ ___ ___ b. Record-keeping functions for securities and income separate from those having access to physical securities, those authorizing security transactions, and those having duties in the cash area?

___ ___ ___ c. Initiating, evaluating, and approving transactions segregated from those for detail accounting, general ledger and other related functions?

___ ___ ___ d. Monitoring investment market values and performance segregated from those performing investment acquisition?

___ ___ ___ e. Maintaining detail accounting records segregated from those for general ledger entries?

___ ___ ___ f. Custodial responsibilities for securities or for other documents evidencing ownership or other rights assigned to an official who has no accounting duties?

___ ___ ___ 17. **Does a governing body or statute restrict investments by asset type and/or limit amounts? Can officials override these restrictions with proper authorization?**

___ ___ ___ 18. **Are all securities held or registered in the name of the agency or the State Treasurer, if applicable?**

19. Are detail records maintained that include the following information, if applicable, on each evidence of ownership:

___ ___ ___ a. Date of the purchase, identification of the investment, purchase amount or cost, and maturity date?

___ ___ ___ b. Physical location of item, i.e., safekeeping agent, etc.?

___ ___ ___ c. Interest dividend or income rates and accrual or receipt dates?

___ ___ ___ d. Ownership by fund?

___ ___ ___ 20. **Do procedures exist for reconciling the detail accounting records (custodian fiscal agent statements) with the sub-ledger/general ledger on a monthly basis? Are differences researched and resolved within a timely manner?**

B. Monitoring:

___ ___ ___ 21. **Is the classification of investments in the sub-ledger/general ledger periodically reviewed? Does this classification agree with the note disclosures?**

___ ___ ___ 22. Does a responsible official determine that the income earned is credited to the proper fund?

___ ___ ___ 23. **In respect to question 17 above, does a responsible official determine that investments are of the character and type permitted by legal requirements? If restrictions are overridden, are the reasons and authority for the action properly documented?**

___ ___ ___ 24. **Is the performance of the investment portfolio periodically evaluated quarterly by persons independent of investment portfolio management activities?**

___ ___ ___ 25. Are appropriate personnel authorized to release securities from safekeeping agent authorized by the governing body?

___ ___ ___ 26. Are securities or legal documents or agreements evidencing ownership or other rights kept in a vault with limited access, or preferable, protected in a safe deposit box, on deposit with a corporate trustee, or investment broker/custodian?

___ ___ ___ 27. For agencies with an investment portfolio, does a written Ethics Policy, Conflicts of Interest, Delegation of Authority Policy exist and does it apply to all investment employees?

___ ___ ___ 28. **Does management require personnel with investment authority to disclose any Conflicts of Interest on an annual basis?**

___ ___ ___ 29. **For agencies with an investment portfolio, does management require a SAS 70, Type II report on the custodian's operations on an annual basis? This is an external audit report. Does management review the SAS 70, Type II report to verify that controls are operating correctly?**

Office of the State Controller

Self-Assessment of Internal Controls

Debt Cycle*

Objectives and Risks

Agency ____________________________ Year-End _________

* **Cycle is only applicable to organizations that can legally issue debt. This will exclude most state agencies and related entities.**

Objectives		Risks
All debt transactions are initiated by authorized individuals and approved by the general assembly or by officials to whom this authority has been delegated.		• Unnecessary borrowings; illegal borrowings; unidentified contractual or restrictive obligations. • Unauthorized issuance of debt securities; misappropriation of proceeds from debt transactions.
All documents relating to notes and other debt instruments are subject to effective custodial controls and physical safeguards.		• Unauthorized use for unissued, canceled or retired debt instruments; loss or theft of negotiable instruments.
Adequate detail accounting records are maintained and appropriate reports issued.		• Unauthorized use of debt proceeds; undetected violations of debt covenants.
All transactions are properly accumulated, classified and summarized in the accounts.		• Misstating financial statement balances; concealment of unauthorized debt payments.

Office of the State Controller

Self-Assessment of Internal Controls

Debt Cycle*

Control Policies and Procedures

Agency ____________________________ Year-End __________

Bolded questions identify critical controls. A critical control is a control that will prevent or detect an error in the event that all other controls fail.

*** Cycle is only applicable to organizations that can legally issue debt. This will exclude most state agencies and related entities.**

A. Control Activities / Information and Communication

Yes	No	N/A		
___	___	___	1.	Is there a formal organizational chart which identifies the responsibilities for processing and recording debt are clearly defined?
___	___	___	2.	Are policies established to ensure that debt issued is authorized? Does specific legislation or regulations allow the organization to issue debt?
___	___	___	3.	Are separate accounting records maintained for each debt issuance?
___	___	___	4.	Are all proceeds from bond issues subject to arbitrage rebate requirements accounted for separately from the agency's other funds to facilitate tracking of the investment earnings?
___	___	___	5.	Are policies established to ensure that debt issued is correctly recorded as to amount and fund?
___	___	___	6.	Are policies established to ensure that proceeds of debt issued are recorded properly?
___	___	___	7.	Are all bond order and secondary market disclosure requirements complied with and appropriate IRS forms (8038-G or 8038-GC) filed?
___	___	___	8.	Is the agency compliant with all debt service and other fiscal requirements of the bond resolutions?
___	___	___	9.	Are policies established to ensure that cash is available for payment of interest and matured debt?

___ ___ ___ 10. Are policies established to ensure that interest payments are recorded properly?

___ ___ ___ 11. Are procedures established to ensure that the redemption of mature debt is correctly recorded as to amount and fund?

___ ___ ___ 12. Are procedures established to ensure that the defeasance of debt is correctly recorded as to amount and fund?

___ ___ ___ 13. Are policies established to ensure that access to unissued debt and related records is limited?

___ ___ ___ 14. Are interest payments reconciled to debt outstanding?

___ ___ ___ 15. **Are detail records on debt reconciled to general ledger controls monthly?**

16. **Are the following responsibilities performed by different people?**

___ ___ ___ a. **Handling and recording of debt?**

___ ___ ___ b. **Reviewing and reconciling control accounts separate from the person who records the information?**

___ ___ ___ c. **Recording of cash separate from the recording of the debt?**

___ ___ ___ d. **Maintaining detail records on debt separate from cash functions?**

___ ___ ___ 17. Is a fiscal agent used for debt issue, interest payments, and redemption?

___ ___ ___ 18. Do evidences of debt and principal repayment checks/transfers require the signature of two responsible officials who are authorized and who are independent of each other?

___ ___ ___ 19. **Is debt issued only in the agency's name or in the State’s name?**

___ ___ ___ 20. **If fiscal agents are used for the payment of bonds and interest, does the agency receive periodic reports of bonds outstanding and unclaimed interest and are these reports reconciled on a quarterly basis?**

___ ___ ___ 21. Is the agency meeting the arbitrage rebate requirements for all tax-exempt financing?

B. Monitoring:

___ ___ ___ 22. Are redeemed bond coupons canceled and accounted for prior to payment of bond interest and reconciled to bond records by an independent employee?

___ ___ ___ 23. In relation to question 2 above, do all debt issues have to be properly authorized in accordance with applicable legal requirements (i.e. voters, governing body, other governmental agencies or top financial officers)?

___ ___ ___ 24. Does a responsible official determine that debt is retired from the appropriate revenue sources?

___ ___ ___ 25. Does a responsible official periodically determine whether the governmental unit is in compliance with agreement restrictions and report results to a higher authority?

___ ___ ___ 26. Does a responsible official review use of proceeds from bonds sales to ensure that proceeds are used in accordance with legal requirements?

Office of the State Controller

Self-Assessment of Internal Controls

Tax/Payroll Compliance Cycle

Compliance With IRS Information Return Reporting Requirements

INFORMATION RETURNS

Information Returns are returns required by the Internal Revenue Service to carry out the Revenue Laws of the United States. Information Returns are procedural in nature and therefore do not normally require payment of any tax. While there may be no tax due with Information Returns, failure to file the required information returns can subject the non-reporting agency/university to substantial penalties. In addition, there are penalties for reporting payments in the incorrect amounts.

Good fiscal management requires that penalty exposure be kept at a minimum by an understanding of the applicable IRS reporting requirements and by being able to identify transactions of a reportable nature within the accounting system of the reporting entity.

CATEGORIES OF INFORMATION RETURNS

There are four main categories of Information Returns:

1. Information Returns of persons subject to special provisions of the tax law. For example, returns showing income, deductions, and distributions of:

    - Partnerships
    - Exempt Organizations
    - S Corporations

2. Information Returns of employers reporting wages and other payments to employees.

3. Information Returns of employee benefit plans.

4. Information Returns for payments made to non-employees and transactions with other persons.

Items 2, 3, and 4 above apply to governmental agencies and universities. Returns for reporting wages and other payments and Information Returns of employee benefit plans are not discussed here. The next page summarizes the rules and regulations that relate to information returns for payments made to non-employees and transactions with other persons (item 4 above) and is followed by specific guidelines for completing certain informational returns that apply to governmental agencies and universities.

The guidelines for Information Returns Policy are as follows:

Form	Title	What to Report	Amounts to Report	Due to Recipients	Due to IRS
1042-S	Foreign Person's U.S. Source Income Subject to Withholding	Interest, dividends, royalties, pensions, and personal compensation.	All Amounts	March 15	March 15
1099-A	Acquisition or Abandonment of Secured Property	Acquisition or abandonment of secured property for which you are the lender.	All Amounts	January 31	February 28
1099-B	Proceeds from Broker and Barter Exchange Transactions	Sales or redemption of securities, commodities, or barter exchange transactions.	All Amounts	January 31	February 28
1099-DIV	Dividends and Distributions	Dividends, capital gains, nontaxable, and liquidation distributions.	$10 or more except $600 or more for liquidations	January 31	February 28
1099-G	Certain Government Payments	Unemployment compensation, state and local tax refunds, agriculture payments, and taxable grant payments.	$10 or more except unemployment and tax refunds, $600 for all others	January 31	February 28
1099-INT	Interest Income – Taxable and Tax Exempt	Interest Income	$10 or more	January 31	February 28
1099-MISC	Miscellaneous Income	Rents, royalties, prizes, awards, payments to crew members of fishing boats, proceeds from the sale of catch, physicians, medical services, healthcare providers, crop insurance proceeds, and non-employee compensation. Also, payments to attorneys in connection with legal services. Gross payments to attorneys are reported if the service amount cannot be determined.	$10 or more for royalties, and $600 for all other	January 31	February 28

1099-R	Distributions From Pensions, Annuities, and Retirement	Distributions from Pensions, Annuities, and Retirements	All Amounts	January 31	February 28
1099-S	Proceeds From Real Estate Transactions	Proceeds from the sale or exchange of real estate. Form 1099-S is not required for sale or exchange of principal residence for $250,000 or less (500,000) if married.	All Amounts	January 31	February 28
W-2G	Certain Gambling Winnings	Horseracing and State conducted lotteries.	$600	January 31	February 28

Do not file information returns for:

1. Payments for merchandise;

2. Rental payments paid to real estate agents;

3. Scholarship or fellowship grants that are taxable to the recipient because they are paid for teaching research or other services as a condition for receiving the grant. Such payments are considered as wages and must be reported on a Form W-2.

4. Payments made by governmental agencies to informants as an award, fee, or reward for information about criminal activity; and

5. Employee's wages, moving and relocation reimbursements, and travel reimbursements must be reported on a Form W-2.

FORM 1099-A, ACQUISITION OR ABANDONMENT OF SECURED PROPERTY

You must complete Form 1099-A if, in connection with your trade or business, you lend money, and, in full or partial satisfaction of the debt, you:

1. Acquire an interest in the property that is secured for the debt; or

2. Have reason to know that the property has been abandoned.

A **governmental unit** that lends money secured by property must also file Form 1099-A at the time an ownership interest is acquired. For governmental units this reporting requirement applies irrespective of the trade or business requirement. Property means real property such as a personal residence, or tangible personal property held for investment or used in a trade or business. For purposes of Form 1099-A reporting, property also includes **intangible** property.

Property is considered **abandoned** when the facts and circumstances show that the borrower intended to and has permanently discarded the property from use. If you expect to begin a foreclosure, execution, or similar sale within 3 months of the date you had reason to know the property was abandoned, the reporting requirement arises on the date you acquire an interest in the property or a third party purchases the property at such sale.

You are considered to have **acquired an interest** in the property at such time as you acquire title to the property or at the date of possession when the burdens and benefits of ownership are acquired. If an **objection period** is involved, use the date the objection period expires.

FORM 1099-A, MINIMUM FILING AMOUNTS

Form 1099-A is required for all amounts. There is no minimum payment amount as there is with Form 1099-MISC. More than 250 in a calendar year must be reported on magnetic media.

AMOUNT TO REPORT ON FORM 1099-A

In the case of full or partial satisfaction of any indebtedness, where you acquire an interest in any property that is security for such indebtedness, you should report:

1. The amount of such indebtedness at the time of such acquisition, and

2. The amount of indebtedness satisfied in such acquisition.

In the case in which you have reason to know the property in which you have a security interest has been abandoned, you will report the amount of indebtedness at the time of such abandonment.

FORM 1099-G, STATEMENT FOR RECIPIENTS OF CERTAIN GOVERNMENT PAYMENTS

This form must be filed with the IRS if, as a unit of a federal, state, or local government, you:

1. Made certain payments such as unemployment compensation or state and local income tax refunds, in the amount of $10 or more; or

2. Withheld federal income tax under the backup withholding rules; or

3. Made any taxable grants under a program administered by a federal, state, or local program to provide subsidized energy financing or grants for projects designed to conserve or produce energy. (This is required only for section 38 property, generally depreciable or amortizible or a dwelling unit located in the United States); or

4. **Also report amounts of any other taxable grant in the amount of $600.00 or more, including amounts your agency or university is handling in a nominee capacity such as Department of Agriculture payments.**

No return is required for the following state tax credits:

1. Property tax credits
2. Farm preservation credits
3. Home heating credits
4. Solar energy credits

A federal grant is ordinarily taxable unless stated otherwise in the legislation authorizing the grant. **NOTE: Fellowship grants are not reportable.**

FORM 1099-INT, STATEMENT FOR RECIPIENTS OF INTEREST INCOME

Form 1099-INT must be filed with the IRS if you are the payer of interest and you:

1. Paid or credited interest of $10 or more on earnings from savings and loan associations, credit unions, bank deposits, corporate bonds, etc. (also, include interest of $600 or more from sources other than the kinds listed if in the course of your trade or business);

2. Withheld foreign tax eligible for the recipient's foreign tax credit on interest;

3. Had original issue discount on short-term obligations of one year or less; or paid interest on bearer certificates of deposit; or

4. Withheld federal income tax on interest under the backup withholding rules.

Only report interest payments made during the conduct of your trade or business, including governmental and nonprofit organizations, or for which you are a **nominee or middleman**, for from which you withheld federal income tax or foreign tax.

The **nominee/middleman** provisions of Code Sec. 6049 are of special importance to governmental entities. Agencies and universities that have "pooled" funds held in a trustee capacity for students, inmates, patients, minors and others, and invested in interest bearing accounts, will need to issue Forms 1099-INT to show the correct owner of the beneficial interest in the account if the interest earned exceeds $10. The nominee/middleman provisions do not apply if the actual owner's name appears on the interest information return prepared by the bank.

Tax exempt interest on installment purchases or capital leases and interest on government issued bonds must be reported as informational item on Form 1099-INT. As a general rule, interest on state and local bonds is tax exempt if the bonds are used exclusively for traditional governmental purposes. In the case of bonds issued after August 15, 1986, bond interest may not be tax-exempt when it is derived from:

a) State or local bonds that have not been issued in registered form;
b) Arbitrage bonds; or
c) Private activity bonds that are not exempt as qualified bonds.

Do not report on Form 1099-INT any interest income paid or credited on a **long-term original issue discount obligation**. This interest, along with the original issue discount, is reported on Form 1099-OID.

FORM 1099-S, STATEMENT FOR RECIPIENTS OF PROCEEDS FROM REAL ESTATE TRANSACTIONS

Generally, reporting is required if the transaction consists in whole or in part of the sale or exchange for money, indebtedness, property, or services, of any present or future ownership interest in any of the following:

1. Improved or unimproved land, including airspace.

2. Inherently permanent structures, including any residential, commercial, or industrial building.

3. A condominium unit and its appurtenant fixtures and common elements, including land.

4. Stock in a cooperative housing corporation.

5. Payments of timber royalties made under a “pay-as-cut” contract, reportable under section 6050N.

SALE OR EXCHANGE

A sale or exchange includes any transaction properly treated as a sale or exchange for Federal income tax purposes, even if the transaction is not currently taxable. However, sales of personal residences are not reportable if the seller certifies that the profit will not exceed $250,000 ($500,000 if married).

OWNERSHIP INTEREST

An ownership interest includes fee simple interest, life estates, reversions, remainders, and perpetual easements. It also includes any previously created rights to possession of use for all or part of any particular year. This includes a leasehold, easement, or timeshare, if such rights have a remaining term of at least 30 years, including any period for which the holder may renew such rights, determined on the date of closing. For example, a preexisting leasehold on a building with an original term of 99 years and a remaining term of 35 years on the closing date is an ownership interest; however, if the remaining term is 10 years, it is not an ownership interest. An ownership interest does not include any option to acquire real estate.

INVOLUNTARY CONVERSIONS AND THREAT OF IMMINENT DOMAIN

A sale of real estate under threat of imminence of seizure, requisition, or condemnation is generally a reportable transaction. This is important to a governmental organization that under the law has the power of imminent domain.

EXCEPTIONS TO THE REPORTING REQUIREMENTS

The following transactions are not reportable. However, you may choose to report them; but if you do, the return filed and the statement furnished to the transferor must comply with the reporting rules.

1. Any transactions in which the transferor (seller) is a corporation, a governmental unit, or an exempt volume transferor. If the transferee (buyer) is a state or political subdivision then the normal reporting rules apply.

2. A transfer in full or partial satisfaction of a debt secured by the property. This includes a foreclosure, a transfer in lieu of foreclosure, or an abandonment. Report on a Form 1099-A.

3. A de minimis transfer for less than $600.

4. An interest in crops or surface or subsurface natural resources, i.e., timber, water, ores, and other natural deposits, whether or not such crops or natural resources are severed from the land.

PERSON REQUIRED TO REPORT

The following explains who is required to file Form 1099-S

1. If you are the person responsible for closing the transaction, you must file Form 1099-S. If a Uniform Settlement Statement, prescribed under the Real Estate Settlement Procedures Act of 1974, is used, the person responsible for closing is the person listed as settlement agent on that statement.

2. If a Uniform Settlement Statement is not used, or if no settlement agent is listed, the person responsible for closing is the person who prepares the closing statement. This includes the settlement statement or other written document that identifies the transferor, transferee, and the real estate transferred, and describes how the proceeds are to be disbursed.

3. If no closing statement is used, or if two closing statements are used, the person responsible for closing is in the following order:

    a) The transferee's (purchaser's) attorney if the attorney is present at the delivery of the transferee's note or a significant part of the cash proceeds to the transferor if the attorney prepares or reviews the preparation of the documents transferring legal or equitable ownership;

    b) The transferor's attorney if the attorney is present at the delivery of the transferee's not or a significant part of the cash proceeds to the transferor or if the attorney prepares or reviews the preparation of the documents transferring legal or equitable ownership; or

    c) The disbursing title or escrow company that is most significant in disbursing proceeds. If there is more than one attorney described in (a) or (b), the one whose involvement is most significant is the person responsible for filing.

4. If no one is responsible for closing the transaction as explained above, the person responsible for filing is, in order:

    a) The mortgage lender;
    b) The transferor's broker;
    c) The transferee's broker; or
    d) The transferee.

Under the Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647), real estate brokers were officially redesignated as "real estate reporting persons" for 1989 and subsequent years.

NOTE: If the person acting as broker in a real estate transaction is an employee of your agency/university and the exceptions to the reporting requirements listed here do not apply; then, your agency/university should prepare the 1099s for the transferor or should enter into a designation agreement to have another of the parties to the transaction prepare the Form 1099-S.

The penalties that may be assessed relative to Form 1099-S reporting are:

1. Failure to file information return;
2. Failure to furnish a statement to the transferor;
3. Failure to include correct information;
4. Failure to supply identifying numbers
5. Willful failure to supply information

Office of the State Controller

Self-Assessment of Internal Controls

Tax/Payroll Compliance Cycle

Compliance With IRS Information Return Reporting and Backup Withholding Requirements

Objectives and Risks

Agency ____________________________ Year-End _________

Objectives		Risks
All transactions reportable for IRS Information Return reporting and Backup Withholding purposes are properly identified, accumulated, and reported to the proper taxing authorities.		• The tax system of the United States is one of voluntary compliance. If procedures designed to insure compliance are not being followed the fairness of the system could be compromised. • Agency may be subject to penalties for noncompliance with IRS information return reporting requirements. • Revenue properly reportable to the Internal Revenue Service could be underreported. • Revenue properly reportable to the North Carolina Department of Revenue could be underreported.
All calendar year-end Form 1099 Information Return reporting and Backup Withholding procedures are in written form. These procedures have been reviewed by authorized personnel and approved in accordance with established policies and procedures.		• Inadequate procedures for determining Form 1099 reportable payments and reportable payees. • Vendor files contain inadequate information for proper reporting. • Change in agency personnel could cause a failure to properly account for and report information returns as required by law.

Office of the State Controller

Self-Assessment of Internal Controls

Tax/Payroll Compliance Cycle

Compliance With IRS Information Return Reporting Requirements

Control Policies and Procedures

Agency ____________________________ Year-End _________

Note: The following documentation questions concern all Information Return Reporting Forms.

A. Documentation

Yes No N/A

___ ___ ___ 1. Is there a formal plan of organization under which responsibilities are assigned for identifying Form 1099 reportable payments and reportable payees?

Name of person responsible: _____________________________________

Title: ____

___ ___ ___ 2. Does the agency have written instructions available for responsible agency personnel to use as a guide for consistent, accurate, preparation of IRS Forms 1099 at calendar year-end?

___ ___ ___ 3. Does the formal plan identify the specific individuals responsible for "flagging" transactions for subsequent Form 1099 reporting to the IRS?

___ ___ ___ 4. Does the formal schedule have target dates for completing tasks associated with calendar year Form 1099 reporting?

___ ___ ___ 5. Have policies and procedures been established concerning calendar year-end cutoff of 1099 accounting transactions?

___ ___ ___ 6. Have policies and procedures been established concerning agency follow up on IRS Error Listings (CP2100 Notices)?

___ ___ ___ 7. Do agency policies and procedures require that Backup Withholding take place as required by IRS regulations?

Note: The remaining questions concern individual Information Return Reporting Forms.

C. Recording and Execution of Transaction and Events - 1099-A

Yes No N/A

___ ___ ___ 1. Does the entity lend money secured by property? (Property meaning real, tangible or intangible.)

___ ___ ___ 2. Has your agency ever acquired an interest in property in full or partial satisfaction of debt on that property?

___ ___ ___ 3. Has your agency ever acquired an interest in loaned property for the reason that you had money on that property and the property was subsequently abandoned?

___ ___ ___ 4. If yes to 2 or 3 above, did you issue IRS Form 1099-A?

___ ___ ___ 5. If Form 1099-A is issued, did the entity report the amount of indebtedness at the time of acquisition and the amount of indebtedness satisfied in the acquisition?

D. Recording and Execution of Transaction and Events - 1099-G

Yes No N/A

___ ___ ___ 1. Has the entity made payments such as unemployment compensation or state and local tax refunds at $10.00 or more?

___ ___ ___ 2. Has the entity withheld federal income tax under the backup withholding rules?

___ ___ ___ 3. Has the entity made any taxable grants under a program administered by a federal, state, or local program to provide subsidized energy financing or grants for projects designed to conserve energy?

___ ___ ___ 4. Has the entity made payments of taxable grants in the amount of $600.00 or more? (Including amounts your agency or university handled a nominee capacity such as Department of Agriculture payments.)

___ ___ ___ 5. Are 1099-G's issued for any yes answers to the above questions?

E. Recording and Execution of Transaction and Events - 1099-INT

Yes No N/A

___ ___ ___ 1. Does the agency have "pooled" funds held in a trustee capacity for students, inmates, patients, minors and others, that are invested in interest bearing accounts?

___ ___ ___ 2. Does agency have capital leases or installment purchases in which it is paying tax exempt interest in excess of $10.00 or more?

___ ___ ___ 3. Does the agency pay interest through the course of its trade or business in excess of $600.00 that is taxable to the recipient?

___ ___ ___ 4. Did the pooled funds earn interest of $10.00 or more for any individual payee?

___ ___ ___ 5. Does the actual owner's name appear on the interest information return prepared by the bank?

___ ___ ___ 6. If yes to questions 1, 2, 3, or 4 did the agency issue a 1099-Int?

___ ___ ___ 7. If yes to question 4, did the agency inquire with the bank whether or not the bank issued the appropriate 1099-INT?

F. Recording and Execution of Transaction and Events - 1099-MISC

Yes No N/A

___ ___ ___ 1. Did the entity make payments of $10.00 or more for royalties?

___ ___ ___ 2. Did the entity make payments of $600.00 or more for rent, including rent of office space, machine rentals, pasture rentals etc.? (Public housing agencies must report rental assistance payments made to owners of housing projects.)

___ ___ ___ 3. Did the entity make payments of $600.00 or more for fees, commissions, or other forms of compensation to persons not treated as your employees for services rendered in your trade or business?

___ ___ ___ 4. In connection with medical assistance programs, or health, accident and sickness insurance programs, make payments of $600.00 or more to physicians or other suppliers or providers of health care services?

___ ___ ___ 5. Did the entity withhold federal income tax on miscellaneous income under the backup withholding rules?

___ ___ ___ 6. If yes to the above questions, did the entity issue a 1099-MISC?

G. Recording and Execution of Transaction and Events - 1099-S

Yes No N/A

___ ___ ___ 1. Did the entity have a transaction that consisted in whole or in part of the sale or exchange for money, indebtedness, property, or services, or any present or future ownership interest in the following:

- Improved or unimproved land, including airspace;
- Inherently permanent structures, including any residential, commercial, or industrial building;
- A condominium unit and its appurtenant fixtures and common elements, including land;
- Stock in a cooperative housing corporation; or
- Payments of timber royalties made under a "pay-as-cut" contract, reportable under section 6050N.

___ ___ ___ 2. Did the entity purchase real estate under threat or imminence of seizure, requisition, or condemnation is generally a reportable transaction?

___ ___ ___ 3. Was the purchase generally a reportable transaction for a governmental entity?

___ ___ ___ 4. Was the entity or employees, responsible for closing any real estate transactions under the real estate reporting hierarchy?

___ ___ ___ 5. If yes to the above questions, did the entity issue a 1099-S?

H. Recording and Execution of Transaction and Events - 1098

Yes No N/A

___ ___ ___ 1. Did the entity receive mortgage interest of $600.00 or more from an individual on any one mortgage during the year? (This includes a governmental unit and a cooperative housing corporation receiving mortgage interest of $600.00 or more from an individual.)

___ ___ ___ 2. If yes to above, did the entity issue a form 1098?

Office of the State Controller

Self-Assessment of Internal Controls

Tax/Payroll Compliance Cycle

Compliance With the IRS Backup Withholding Requirements

BACKUP WITHHOLDING:

The IRC 3406(a) requires payers under certain circumstances to withhold 28% of vendor payments as backup withholding taxes on payments of interest, rents, royalties, commissions, non-employee compensation, and certain other payments. Payments subject to backup withholding are defined in IRC sections 6041, 6041(a), 6042(a), 6044, 6045, 6049(a), 6050A, and 6050N. Backup withholding is required for governments under three circumstances:

1. Backup withholding is required when the agency requests a Taxpayer Identification Number (TIN) from a vendor and one is not provided. The agency must backup withhold on any payments made to this vendor. Once backup withholding begins, the agency must continue to withhold until the vendor provides his/her TIN.

2. The IRS sends the agency a first B Notice (CP2100) and the vendor does not respond within 30 days to the agency's request for certification of the TIN. The agency must begin to backup withhold on any payment made to this vendor. Backup withholding continues until the vendor provides a TIN certified on IRS Form W-9.

3. The IRS sends the agency a second B Notice within a three year period. The agency must begin backup withholding immediately. Backup withholding continues until the IRS notifies the agency to stop withholding. This notification may be an IRS Letter 147C or SSA Form 7028.

IRS CP2100 NOTICES:

Each year the IRS issues CP2100 Notices for prior year information returns that contained missing, incorrect and/or currently not issued taxpayer identification numbers. Upon receipt of the CP2100, IRS procedures require each agency/recipient to compare their records with the information furnished by the IRS. There are two separate procedures that must be followed depending on whether the CP2100 listing agrees or disagrees with the agency's records.

For account information that **does not agree to the agency's records**, check to see if the correct information was given on the return, if the information was changed after filing, or if the IRS changed the information when processing the return. In these instances, it is not necessary to respond to the IRS, but it is necessary to do the following:

1. If the correct information was not entered on the return, correct the records and include that information on any future returns filed. Do not send a “B” Notice to the payee.

2. If the information changed after filing the return, be sure to include that information on any future information returns filed. Do not send a “B” Notice to the payee.

3. If the IRS changed the information, make note on the agency records and take no further action.

For account information that **agrees to the agency’s records**, the agency must determine whether this is the “first” or “second” time within three calendar years the IRS has sent notification that the TIN is incorrect. Procedures **must** be in place that allow the agency/university to determine whether this is the first or second notification since the procedures to follow are different for each notification.

1. First Notice

a) Send the first “B” Notice, a copy of Form W-9, and an optional reply envelope to the vendor within 15 business days from the date of the CP2100 notice or the date you received it (whichever is later). Date the “B” Notice no later than 30 business days from the date of the CP2100 notice or the date received. The outer envelope must be clearly marked “IMPORTANT TAX INFORMATION ENCLOSED” or “IMPORTANT TAX RETURN DOCUMENT ENCLOSED”.

b) Allow the payee 30 calendar days to provide a newly signed Form W-9. **Keep this W-9**. Please note, once the IRS has informed the agency that the TIN of a vendor does not match, a telephone call is not sufficient documentation.

c) Update agency records with the corrected information received from the vendor and include it on any future information returns filed.

2. Second Notice

a) Send the second “B” Notice, a copy of Form W-9, and an optional reply envelope to the vendor within 15 business days from the date of the CP2100 notice or the date you received it (whichever is later). Date the “B” Notice no later than 30 business days from the date of the CP2100 notice or the date received. The outer envelope must be clearly marked “IMPORTANT TAX INFORMATION ENCLOSED” or “IMPORTANT TAX RETURN DOCUMENT ENCLOSED”. **Do not send Form W-9**.

b) The **vendor must** contact the Social Security Administration (SSA) to have a social security number validated or the Internal Revenue Service (IRS) to validate an employer identification number (EIN).

c) Allow 30 business days from the date of request to receive either SSA Form 7028, Notice to Third Party of Social Security Assignment from the SSA or a copy of IRS Letter 147C from the vendor.

d) Begin backup withholding on payments made to payees if SSA Form 7028 or IRS Letter 147C is not received within 30 business days. Backup withholding must continue until either validation is received.

DEPOSITING AND REPORTING BACKUP WITHHOLDING:

It is the responsibility of the agency to deposit and report backup withholding. Once funds are withheld, the withholding agent must deposit the money using the same rules as those used for employment taxes. Most deposit situations will require that a deposit be made by the fifteenth day of the following month in which backup withholding occurred. Withheld taxes are deposited in a federal reserve bank using a Form 8109, Federal Tax Deposit Coupon. (Note: agencies on the North Carolina Accounting must follow special depository procedures. Contact the Office of the State Controller for assistance with making your deposit.) IRS Form 945, Annual Return of Withheld Federal Income Tax must be used to report backup withholding. This return is due by January 31 of the following calendar year.

MISCELLANEOUS BACKUP WITHHOLDING INFORMATION:

The Backup Withholding rules apply to taxable grants or agricultural payments reported on Form 1099-G. It does not apply to any other Form 1099-G type payment. Backup withholding rules apply even if the amount is less than $600 per year.

At the present time the backup withholding rate is 28% of the payment amount.

Once backup withholding has begun, continue to withhold until the payee provides a TIN. Do not refund the amounts withheld before the TIN was provided. Reflect these amounts on Form 1099-MISC. The payee will get credit for the withholding just as employees get credit for the wages withheld from their paychecks.

Failure to withhold will result in a liability for the amount that should have been withheld. Relief of that liability is only by obtaining an affidavit (Form 4669) from the payee stating that the payee included the payment on a tax return. Obtaining a Form W-9 allows withholding to stop (at least until the second B Notice), but does not relieve the liability for missing withholding.

Office of the State Controller

Self-Assessment of Internal Controls

Tax/Payroll Compliance Cycle

Compliance With IRS Information Return Reporting and Backup Withholding Requirements

Objectives and Risks

Agency ____________________________ Year-End _________

Objectives		Risks
All transactions reportable for IRS Information Return reporting and Backup Withholding purposes are properly identified, accumulated, and reported to the proper taxing authorities.		• The tax system of the United States is one of voluntary compliance. If procedures designed to insure compliance are not being followed the fairness of the system could be compromised. • Agency may be subject to penalties for noncompliance with IRS information return reporting requirements. • Revenue properly reportable to the Internal Revenue Service could be underreported. • Revenue properly reportable to the North Carolina Department of Revenue could be underreported.
All calendar year-end Form 1099 Information Return reporting and Backup Withholding procedures are in written form. These procedures have been reviewed by authorized personnel and approved in accordance with established policies and procedures.		• Inadequate procedures for determining Form 1099 reportable payments and reportable payees. • Vendor files contain inadequate information for proper reporting. • Change in agency personnel could cause a failure to properly account for and report information returns as required by law.

Office of the State Controller

Self-Assessment of Internal Controls

Tax/Payroll Compliance Cycle

Compliance With IRS Backup Withholding Requirements

Control Policies and Procedures

Agency _____________________________ Year-End _________

A. Documentation

Yes No N/A

___ ___ ___ 1. Is there a formal plan of organization under which responsibilities are assigned for identifying payees and payments subject to Backup Withholding?

Name of person responsible: ______________________________________

Title: ____

___ ___ ___ 2. Does the agency have written instructions available for responsible agency personnel to use as a guide for consistent, accurate, preparation of all IRS Forms required for Backup Withholding?

___ ___ ___ 3. Does the formal plan identify the specific individuals responsible for determining if the notice received from the IRS is the first or second notification?

___ ___ ___ 4. Does the formal schedule have target dates for completing tasks associated with Backup Withholding within the time periods required by the IRS?

B. Recording and Execution of Transaction and Events

Yes No N/A

___ ___ ___ 5. Has the entity received CP2100 Notices for prior years information returns that contained missing, incorrect and/or currently not issued taxpayer identification numbers?

___ ___ ___ 6. Has the entity compared its records with the information furnished by the IRS?

7. If the account information does not agree to agency records, has the agency checked to see if:

___ ___ ___ a. The correct information was given on the return?

___ ___ ___ b. The information changed after the return was filed?

___ ___ ___ c. The IRS changed the information when processing the return?

___ ___ ___ 8. If the correct information was not given on the return, has the agency corrected its records and included that information on future information returns that may be filed?

___ ___ ___ 9. If the correct information changed after the return was filed, has the agency included that information on future information returns that may be filed?

___ ___ ___ 10. If the IRS changed the information when processing the return, has the agency corrected their records?

___ ___ ___ 11. If the account information does agree to agency records, has the agency determined if it is the first or second notice within three calendar years?

12. If the CP2100 is the first notice received, has the agency in all cases:

___ ___ ___ a. Sent the first “B” notice, a copy of Form W-9, and an optional reply envelope to the vendor within 15 business days from the CP2100 Notice or date received by agency?

___ ___ ___ b. Is the “B” Notice dated no later than 30 business days from the date of the CP2100 notice or the date received by the agency?

___ ___ ___ c. Is the outer envelope clearly marked “IMPORTANT TAX INFORMATION ENCLOSED” or “IMPORTANT TAX RETURN DOCUMENT ENCLOSED”?

___ ___ ___ d. Allowed the payee 30 calendar days to provide a newly signed Form W-9?

___ ___ ___ e. Kept the newly signed W-9 for the agency’s records and updated records with the corrected information received from the vendor?

___ ___ ___ f. Begun backup withholding on payments made to vendors who did not respond within 30 business days from the date of the CP2100?

13. If the CP2100 is the second notice received, has the agency:

___ ___ ___ a. Sent the second “B” notice and an optional reply envelope to the vendor within 15 business days from the CP2100 Notice or date received by agency?

___ ___ ___ b. Is the “B” Notice dated no later than 30 business days from the date of the CP2100 notice or the date received by the agency?

___ ___ ___ c. Is the outer envelope clearly marked "IMPORTANT TAX INFORMATION ENCLOSED" or "IMPORTANT TAX RETURN DOCUMENT ENCLOSED"?

___ ___ ___ d. Allowed the payee 30 business days from the date of the agency request to receive either SSA Form 7028, Notice to Third Party of Social Security Assignment from the SSA or a copy of IRS Letter 147C from the vendor?

___ ___ ___ e. Begun backup withholding on payments made to payees if SSA Form 7028 or IRS Letter147C was not received within 30 business days?

___ ___ ___ 14. Has the entity deposited funds withheld using the same rules as those used for employment taxes (IRS Circular E or IRS Forms 941) and filed IRS Form 945 Annual Return of Withheld Federal IncomeTax , by January 31 of the following year?

Office of the State Controller

Self-Assessment of Internal Controls

Tax/Payroll Compliance

Objectives and Risks

Agency ____________________________ Year-End _________

Objectives	Risks
All moving expense reimbursements, Educational Assistance Plan payments, and Fringe Benefits for employees are properly reported to the Internal Revenue Service with income tax and social security withholding applied if considered necessary.	• The tax system of the United States is one of voluntary compliance. If procedures designed to insure compliance are not being followed the fairness of the system could be compromised. • The entity may erroneously include/exclude moving expense reimbursements from gross income.
All employees are properly classified as an independent contractor, a common law employee, a statutory employee, or a statutory nonemployee for tax reporting and withholding requirements.	• The tax system of the United States is one of voluntary compliance. If procedures designed to insure compliance are not being followed the fairness of the system could be compromised. • Agency may classify an employee incorrectly for reporting and withholding purposes. • Agency may submit incorrect tax forms based on erroneous classifications.
All procedures for identifying a worker as an employee or independent contractor are in written form. These procedures have been reviewed by authorized personnel and approved in accordance with established policies and procedures.	• Inadequate procedures for determining independent contractors. • Agency files contain inadequate information for proper reporting. • Change in agency personnel could cause a failure to properly account for and report withholding as required by law.

Office of the State Controller

Self-Assessment of Internal Controls

Tax/Payroll Compliance

Payroll Compliance-Educational Assistance Plan Payments

EDUCATIONAL ASSISTANCE PLAN

The Office of State Personnel (OSP) is responsible for administering the educational assistance plan for the State of North Carolina. The policy is set forth in the OSP Personnel Manual and outlines the situations in which it is permissible to pay for or reimburse the employee for expenses incurred in furthering the employee's education or improving their job skills. The tax status of educational assistance payments is determined by reference to the Internal Revenue Code Section 127 and the applicable IRS Regulations. The tax status of the Educational Assistance has been an unsettled issue for several years. Therefore, caution should be used when making decisions as to whether an item is subject to taxation or not.

Gross income of an employee does not include amounts paid or expenses incurred by the employer for educational assistance to the employee if the assistance is furnished pursuant to a program which is described as follows:

1. A separate written plan of an employer for the exclusive benefit of his employees to provide these employees with educational assistance.
2. The program shall benefit employees who qualify under a classification set up by the employer and found by the Secretary of Labor not to be discriminatory in favor of employees who are highly compensated or their dependents.
3. The program must not provide eligible employees with a choice between educational assistance and other remuneration includible in gross income.

Payment by the employer may include expenses incurred by or on behalf of an employee for their education. This includes, but is not limited to, tuition, fees, and similar payments, as well as, books, supplies, and equipment. Payment may not include expenses incurred by or on behalf of an employee for tools or supplies retained by the employee after completion of a course of instruction, or meals, lodging, or transportation.

The term "educational assistance" does not include any payment for, or the provision of any benefits with respect to, any course or other education involving sports, games, or hobbies unless such education involves the business of the employer or is required as part of a degree program. The phrase "sports, games, or hobbies" does not include education that instructs employees on how to maintain and improve health so long as such education does not involve the use of athletic facilities or equipment and is not recreational in nature.

Education (under an educational assistance plan) is not limited to courses that are job related or part of a degree program. It also does not matter whether the education paid for or provided under a plan is furnished directly by the employer, either alone or in conjunction with other employers, or through a third party such as an educational institution.

In addition to the **Code Section 127, Educational Assistance Plan** exclusion**, IRS Regulation 1.162-5** provides that there should be no tax consequences to recipient of education expense reimbursements at the graduate **or** undergraduate level as long as the following rules are met:

1. The education maintains or improves skills required by the individual in his employment or other trade or business. Examples include refresher courses, current developments and continuing education courses.

2. The education meets the express requirements of the individual's employer, of the requirements of applicable law or regulations, imposed as a condition to the retention by the individual of an established employment relationship, status, or rate of compensation. Requirements must be imposed for a bona fide business purpose of the employer.

The following educational expenses are not deductible by the employer as an ordinary and necessary business expense as defined by IRS Regulation 1.162-5. However, these expenses may be nontaxable to the employee as an allowable under Code Section 127.

1. Education to meet minimal educational requirements of the job.

2. Qualifies the individual for a new trade or business. A change of duties does not constitute a new trade or business if the new duties involve the same general type of work as is involved in the individual's present employment.

LIMITATION OF BENEFITS

To the extent that they do not exceed $5,250 for the tax year, employee benefits provided under an employer's nondiscriminatory educational assistance plan are not includible in the employee-recipient's gross income. This includes both graduate and undergraduate courses.

REPORTING RULES FOR EDUCATIONAL ASSISITANCE PLANS:

Any employer maintaining an educational assistance plan for tax years beginning after 1984 must file an information return with respect to the program as prescribed by regulations. The return must include:

1. The number of employees of the employer;

2. The number of employees of the employer to participate under the plan;

3. The number of employees participating under the plan;

4. The total cost of the plan during the year;

5. The name, address, and taxpayer identification number of the employer and the type of business in which the employer is engaged; and

6. The number of highly compensated employees of the employer, including those eligible to participate in the plan and those actually participating in the plan.

Office of the State Controller

Self-Assessment of Internal Controls

Tax/Payroll Compliance Cycle

Payroll Compliance-Educational Assistance Plan Payments

Control Policies and Procedures

Agency ____________________________ Year-End _________

A. Documentation

Yes No N/A

___ ___ ___ 1. Is there a formal plan of organization under which responsibilities are assigned to identify an employee as having received Educational Assistance Plan payments?

Name of person responsible: _______________________________

Title: ____

___ ___ ___ 2. Does the agency have written instructions available for responsible agency personnel to use as a guide for consistent and accurate application of State and Federal policies on Educational Assistance Plan payments?

B. Recording and Execution of Transaction and Events

Yes No N/A

___ ___ ___ 3. Does the agency restrict educational assistance payments to those courses that are required by the employer to maintain or improve skills required by the individual in his/her employment?

___ ___ ___ 4. Is the tax status of courses reimbursed by the agency reviewed, and for those courses identified that might lead to a higher status or rate of pay for the employee, is the status of the Code Section 127 exclusions checked for availability so that a determination of whether or not the payment must be taxed to the employee?

Office of the State Controller

Self-Assessment of Internal Controls

Tax/Payroll Compliance Cycle

Payroll Compliance-Determination of Employment Relationship
for Tax Reporting and Withholding Requirements

EMPLOYEE VERSUS INDEPENDENT CONTRACTOR

Generally an employee relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which it is to be accomplished. That is, an employee is subject to the will and control of the employer not only as to **what** shall be done but **how** it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which their services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer but not necessary in every case, are the furnishing of tools and the furnishing of a place to work to the individual who performs the services. In general, if an individual is subject to the control or direction of another merely as to the result, he is an independent contractor. An individual performing service as an independent contractor is not as to such services an employee under the usual common law rules. Individuals such as physicians, lawyers, dentists, veterinarians, construction contractors, public stenographers, and auctioneers, engaged in the pursuit of an independent trade, business or profession in which they offer their services to the public are independent contractors and not employees.

TYPES OF EMPLOYMENT RELATIONSHIPS

There are four common types of employment relationships recognized by the Internal Revenue Service. These relationships are as follows:

1. A common law employee;
2. An independent contractor
3. A common statutory employee; or
4. A statutory nonemployee.

INDEPENDENT CONTRACTOR

Individuals who follow an independent trade, business or profession are generally not employees. This category includes lawyers, contractors, subcontractors, accountants, auctioneers, etc. who offer their services to the general public. The general rule of thumb is that an individual is an independent contractor if you, the employer, have the right to control or direct only the result of the work and not the means and method used to accomplish the result. You do not have to withhold or pay income or social security taxes on payments you make to independent contractors. Usually they will be sent a Form 1099-MISC at the end of the year if the payments made during the year aggregate to more than $600. Backup withholding may be required if the independent contractor does not furnish a Federal Identification Number.

COMMON LAW EMPLOYEE

Under the old common law rules, every individual who performs services that are subject to the will and control of an employer, as to what must be done and how it must be done, is an employee. If you have an employee relationship, it makes no difference how it is described. Consequently, it does not matter if the employee is called an employee, agent, or independent contractor. It does not matter how the payments are measured, how they are made, or what they are called. Also, it does not matter if the employee is full-time, part-time, or an employee hired for a short period.

Two of the usual characteristics of an employer-employee relationship are that the employer has the right to discharge the employee and the employer supplies the tools and a place to work. In an employee relationship, it does not matter if the employee is full-time or part-time and there is no distinction between classes of employees, i.e. managers, supervisors or other types of personnel. Income taxes and social security will have to be withheld on payments made to common-law employees. In addition, the agency is responsible for the employer's portion of the FICA and must make contributions to the Employment Security Commission or to the Trust Fund set up to cover payments to eligible unemployment compensation recipients. Common-law employees will receive a Form W-2 at the end of the calendar year for all compensation received during the year.

STATUTORY EMPLOYEE

A statutory employee is an individual who works for you but is not an employee within the meaning of common law employee as described above. The types of statutory employees are:

1. An agent or someone who is paid on commission.

2. A full-time life insurance sales agent who works primarily for one insurance company.

3. An individual who works at home on materials or goods which you, the employer, supply and which must be returned to you, the employer or someone you specify.

4. A full-time traveling or city salesperson that works on the employer's behalf and turns in orders from wholesalers, retailers, contractors, or operators of various establishments. The work performed must be the salesperson's principle business activity.

Federal income taxes on payments made to statutory employees to do not have to be made. Social security, however, must be withheld. Payments must be made for unemployment compensation purposes for categories (1) and (4) above. A statutory employee will receive Form W-2 at the end of the year.

STATUTORY NONEMPLOYEE

Statutory nonemployees include direct sellers and licensed real estate agents. Direct sellers are individuals who engage in selling in the home or at a place of business other than in a permanent retail establishment. Payments for services to these individuals are related to sales or other output rather than to number of hours worked. Income taxes on payments made to statutory nonemployees do not have to be withheld or paid. Statutory nonemployees will receive a Form 1099-MISC at the end of the year.

PART-TIME WORKERS

For income tax withholding, social security, and federal unemployment tax purposes, there are no differences between full-time, part-time, and employees hired for short periods. It does not matter whether the worker has another job or has the maximum amount of social security tax withheld by another employer. Income tax withholding may be figured the same way as for full-time employees.

COMMON MISCLASSIFICATION FOR A GOVERNMENTAL EMPLOYEE

One of the major differences between a governmental employer and a private sector employer is the presence of budgetary constraints. While a private employer may develop a budget to assist in the planning and operation of its business, this budget does not become the binding legal document that it becomes for a governmental employer. It is the effort to remain within the constraints of the budget process that can possibly cause a misclassification of workers for FICA and FITW purposes. The following are examples of the problem areas an agency may encounter:

- An employee may retire and return to work under a personal service contract to assist in the training of the replacement, to help out during a busy time, or on a permanent part-time basis. Although not a budgeted position, this worker may still be your employee for FICA and FITW purposes.

- Due to an increased work load, there may be a need to hire workers although a budgeted position may not be presently available. Sometimes this is done with the intent of placing the worker in a budgeted position at such time as it is approved or becomes available. The worker may still be an employee for purposes of FICA and FITW.

- When a critical position is about to become vacant through retirement, transfer, or for whatever reason, it is sometimes necessary to find a replacement and have the replacement trained before the position actually becomes available. Although the worker is not in a budgeted position while working under a personal service contract, the replacement may still be and employee for the purposes of FICA and FITW.

- When an employee is on extended leave for medical (including maternity), educational, military or for other purposes, it may be necessary to have his/her work performed by a temporary worker. In the past, the worker providing backup service has often been paid under a personal service contract. While

- acceptable for budgetary purposes, this may not be correct for purposes of FICA and FITW.

- It may be necessary to contract with a worker to provide a service that would normally be provided by an employee, except for the fact the State's salary schedule is not satisfactory to attract qualified personnel. In this instance the contracted worker may be an employee for purposes of FICA and FITW.

When reviewing the status of a personal service contract, the substance of the relationship with the person involved will be the controlling factor when in conflict with the actual form of the contract. Therefore, even though the worker's contract contains statements to the effect "this is not to be considered an employee relationship," "worker acknowledges he is responsible for all applicable taxes," or "worker is to be considered an independent contractor," etc., will not take precedence if, under the common law factors, the State exercises sufficient control over the worker to establish an employment relationship.

Office of the State Controller

Self-Assessment of Internal Controls

Tax/Payroll Compliance Cycle

Determination of Employment Relationship for Tax Reporting
and Withholding Requirements

Control Policies and Procedures

Agency ____________________________ Year-End _________

A. Documentation

Yes No N/A

___ ___ ___ 1. Is there a formal plan of organization under which responsibilities are assigned for identifying a worker as an employee or independent contractor?

Name of person responsible: _______________________________

Title: ____

___ ___ ___ 2. Does the agency have written instructions available for responsible agency personnel to use as a guide for consistent, accurate determination of employment relationship?

B. Recording and Execution of Transaction and Events

Yes No N/A

___ ___ ___ 3. Does they agency contract with workers to provide personal services, other than employees in regular budget positions?

___ ___ ___ 4. For contracted workers, has an effort been made to determine whether an employment relationship possibly exists with such worker?

___ ___ ___ 5. Where the agency has found to have entered into an employment relationship with a worker, have the payments been reported to the worker on a Form W-2 with all applicable taxes withheld?

___ ___ ___ 6. Is all applicable personnel action performed?

Name of person responsible: ________________________________

Title: ____

___ ___ ___ 7. Has consideration been given to the benefits that should be given to workers reclassified as employees under the IRS's Common Law factors?

___ ___ ___ 8. Are efforts being made to place reclassified workers in a budgeted position (temporary full-time, part-time, etc.)?

Office of the State Controller

Self-Assessment of Internal Controls

Tax/Payroll Compliance Cycle

Payroll Compliance-Fringe Benefits

FRINGE BENEFITS

IRS Code Section 132, Certain Fringe Benefits provides an exclusion from taxation for fringe benefits which are provided as a:

1. no-additional cost service;
2. qualified employee discount;
3. working condition fringe;
4. de-minimis fringe;
5. a qualified transportation fringe; and
6. a qualified moving expense reimbursement.

Code Section 132(j) limits the benefits of Code Section 132 by stating that to the extent that the fringe benefit is of a type the tax treatment of which is covered by other code sections, Code Section 132 will not apply. Code Section 106 addresses employer-provided health insurance; Code Sec. 119, meals and lodging furnished for the convenience of the employer; and Code Section 127 covers educational assistance.

IRC Section 132(h)(9) further states that it will apply to educational expenses not covered by Section 127 only to the extent such amounts are considered a working condition fringe benefit. A “working condition fringe benefit” is described as any property of service provided to the employee of an employer to the extent that, if the employee paid for the property or service, the amount paid would be allowed as a deduction under Code Section 162 or 167.

AUTOMOBILE EXPENSES

The Internal Revenue Code requires the value of the personal use of an employer provided vehicle that does not qualify as non-taxable fringe benefit to be included in the employee’s taxable wages as shown on his/her Form W-2.

G.S. 143-341 requires every individual who uses a State-owned passenger motor vehicle, pickup truck, or van to drive between his official work station and his home to reimburse the State for these trips at a rate to be computed by the Department of Administration. This rate should approximate the benefit derived from the use of the vehicle as prescribed by the Internal Revenue Code and shall be made a payroll deduction. The outline below sets forth the IRS valuation rules for the personal use of an employer provided vehicle. In addition to the reimbursement required of the personal use of State owned vehicles, the Internal Revenue Code requires employees and State officials receiving reimbursements in excess of the allowable Federal cents per-mile-rate for the business use of their personal vehicle to include this amount in the recipients W-2. For the 2009 calendar year the allowable Federal cents per mile rate is 55 cents per mile.

AUTOMOBILE EXPENSES AS A NONTAXABLE FRINGE BENEFIT

There are four general situations in which the use of an employer provided vehicle will result in a **non-taxable** fringe benefit to the recipient/employee:

1. The vehicle is used 100% for business reasons.

2. The value of the personal use is so small that accounting for it is unreasonable or administratively impractical.

3. The employer maintains a written policy against the employee's personal use of the car and other specified conditions are met.

4. The employer maintains a written policy that restricts the use of the car to commuting and other specified conditions are met. Under this alternative, an amount determined by reference to the Special Valuation Rules must be included in the employee's taxable wages.

If the employee's use of the car does not fall within one of the above situations, then the value of the personal use must be computed by the employer and included in taxable wages as shown on Form W-2 or the employee should reimburse the employer for the personal use.

GENERAL VALUATION RULE

Under the general valuation value is defined as what the cost would be to a person leasing from a third party under the same or comparable terms in the same geographic area. Unless the employee can prove that the same or comparable vehicle could have been leased on a cents-per-mile basis, the value of the availability of the vehicle cannot be determined by using the cents-per-mile rate, but must be determined based on a comparable lease.

SPECIAL VALUATION RULES

There are three special valuation rules that relate to automobile usage:

1. Automobile lease valuation rule;

2. Vehicle cents-per-mile valuation rule; and

3. Commuting valuation rule.

If one of the special rules listed above has been properly used, the employee must include in income the value determined under the above rule minus any reimbursement that the employee has paid to the employer. If one of the special valuation rules is being used, the employee must be notified of the election by January 31 of the calendar year for which the election will apply or 30 days after the first benefit is applied, whichever is later.

AUTOMOBILE LEASE VALUATION RULE

The annual lease valuation of an automobile is figured as follows:

1. Determine the FMV of the automobile as of the first date the automobile is available for personal use.

2. Using the IRS Annual Lease Value Table, read down column 1 until reaching the dollar range within which the FMV of the automobile falls. Then read across to column 2 to find the corresponding annual lease value.

SAFE HARBOR VALUATION RULE

The Safe harbor value may be used as the FMV of the automobile. For an automobile that is owned by the State the safe harbor value is the retail value of the automobile listed in a nationally recognized publication that regularly reports new or used automobile retail values.

The IRS Annual Lease Value Table includes the FMV of maintenance and insurance for the automobile. The annual lease values do not include the FMV of the fuel the State provides, regardless of whether the fuel is provided in kind or reimbursed. Fuel provided should be valued at cost or at 55 cents per mile for all miles driven by the employee.

The lease values calculated under these rules are based on a four-year lease term. The annual lease values will generally stay the same for the period that begins with the first date used for the automobile and ends on December 31 of the 4th full calendar year following that date. If the vehicle is not available for a full year then the lease value should be prorated based on the portion of the year it was available.

VEHICLE CENTS-PER-MILE VALUATION RULE

If an employee is provided with a vehicle that is either reasonably expected to be used regularly in a trade or business throughout the calendar year or satisfies the Mileage Rule requirements, the value of the benefit provided is the standard mileage rate multiplied by the total miles the employee drives the vehicle for personal purposes. For 2009, this rate is 55 cents per mile for all miles. The standard mileage rate must be applied to personal miles independent of business miles.

A vehicle meets the mileage rule in a calendar year if:

1. It is actually driven at least 10,000 miles in that year; and

2. it is used during the year primarily by employees.

The vehicle is considered used primarily by employees if employees use it consistently for commuting. If the vehicle is not owned or leased during part of the year, the 10,000 mile requirement is reduced proportionately to reflect the periods when the vehicle was owned or leased.

The cents-per-mile rate includes the FMV of maintenance and insurance for the vehicle. For miles driven in the United States the cents-per-mile rate includes the FMV of fuel provided. If fuel is not provided, the rate may be reduced by no more than 55 cents per mile.

Use the cents-per-mile valuation rule to value the miles driven for personal purposes. To figure how much to include in an employee's income, multiply the number of personal miles driven by the employee by the appropriate cents-per-mile rate.

Do not use the cents-per-mile valuation rule to determine the value of the use of an automobile if the FMV of the automobile on the first date on which the automobile is made available to employees for personal use exceeds the sum of the maximum recovery deductions allowable under section 280F(a)(2) of the Code for the first 5 tax years in the recovery period for an automobile first placed in service during a calendar year after 1986. The maximum recovery deductions referred to under section 280F(a)(2) is $12,060.

COMMUTING VALUATION RULE

The value of the commuting use of an employer-provided vehicle is $1.50 per one-way commute for each employee who commutes in the vehicle. Use this value to figure commuting value if the employer and employees meet all of the following criteria:

1. The vehicle is owned or leased by the employer and provided to one or more employees for use in a trade or business;

2. For bona fide noncompensatory business reasons, the employee is required to commute to and from work in the vehicle;

3. There is an established written policy under which the employee may not use the vehicle for personal purposes, other than for commuting or de minimis personal use (such as a stop for a personal errand on the way between a business delivery and the employee's home);

4. Except for de minimis personal use, the employee does not use the vehicle for any personal purpose other than commuting; and

5. The employee that is required to use the vehicle for commuting is not a control employee.

For employees of the agencies/universities of the State entity a control employee means:

1. Elected Official;

2. State agency/department official appointed by the governor; or

3. An employee with an annual compensation above $75,000 per year, indexed for inflation.

STATE VEHICLE USAGE BY A NON-EMPLOYEE

Non-employees who use State vehicles for official State business are subject to the same rules and regulations as State employees. The use of State vehicles is not reportable on 1099 Returns.

MEMBERSHIPS IN COUNTRY CLUBS OR OTHER SOCIAL CLUBS

Effective January 1, 1994, no business deduction from income can be taken for dues or memberships paid to any club organized for business, pleasure, or other social purposes. This includes athletic, country, luncheon, sporting, airline and hotel clubs. Memberships must be held in the name of the college, institution, or foundation and its use restricted to business purposes to avoid taxation to the employee.

TICKETS TO ENTERTAINMENT OR SPORTING EVENTS

If the tickets do not fall under de minimis benefits as being "occasional tickets to theater or sporting events," the value is subject to withholding of federal income and employment taxes.

Office of the State Controller

Self-Assessment of Internal Controls

Tax/Payroll Compliance Cycle

Payroll Compliance-Fringe Benefits

Control Policies and Procedures

Agency ____________________________ Year-End _________

A. Documentation

Yes No N/A

___ ___ ___ 1. Is there a formal plan of organization under which responsibilities are assigned to identify an employee as having received Fringe Benefits?

Name of person responsible: ________________________________

Title: ____

___ ___ ___ 2. Does the agency have written instructions available for responsible agency personnel to use as a guide for consistent and accurate application of State and Federal policies on Fringe Benefits?

___ ___ ___ 3. Does the agency maintain written policies against the employees' personal use of State vehicles?

B. Recording and Execution of Transaction and Events

Yes No N/A

___ ___ ___ 4. If the employee's use of a State vehicle does not fall within one of the four general situations in which the use of an employer provided vehicle will result in a non-taxable fringe benefit to the employee, is the value of the personal use computed and included in the taxable wages as shown on Form W-2?

___ ___ ___ 5. Are non-employees who use State vehicles for official State business subject to the same rules and regulations as State employees?

___ ___ ___ 6. If tickets to entertainment or sporting events given to employees do not fall under de minimis benefits as being "occasional tickets to theater or sporting events," has the appropriate amount of federal income and employment taxes been withheld?

___ ___ ___ 7. Are membership dues in country clubs or other social clubs paid on behalf of an employee included in the taxable income of the employee?

Moving Expenses Policy

MOVING EXPENSES FOR YEARS BEGINNING IN 1998
Qualified moving expenses paid to a third party, such as a moving company, on behalf of the employee, and services furnished in kind to the employee will not be reported on the W-2. Qualified moving expense reimbursements an employer pays directly to an employee will be reported in Box 12 of Form W-2 and identified using Code P. All non-qualified (taxable) moving expense will continue to be included in wages in Box 1 of Form W-2, whether or not paid directly to a third party. They are subject to income tax withholding and social security and Medicare taxes.

TAXATION OF MOVING EXPENSES UNDER OSBM REIMBURSEMENT POLICY
The following is a clarification of which moving expense reimbursements made under the State's Budget Policy are subject to inclusion in the employee's taxable wage and which payments are not considered compensation.

The agency must take care not to tax employees for State subsistence at the new duty station when the facts and circumstances indicated that the employee's old dwelling had not been abandoned and the employee's living expenses are being duplicated so that it could be argued that the employee was traveling away from home overnight. Expenses for travel while away from home on business overnight are not taxable to the employee if the expense substantiation rules are followed. The tax treatment of travel while away from home on business is set forth in IRS Regulation 1.162-2(f). A short discussion of these rules is included so that agencies can make a more informed determination of when to tax the 40 business days of subsistence payments that are available under the State's moving expense reimbursement policy.

Moving Expenses:
Internal Revenue Code Section 217 allows a deduction for moving expenses paid or incurred during the taxable year in connection with the commencement of work by the employee. Moving expenses are defined as the reasonable cost of moving household goods and personal effects from the former residence to the new residence, and of traveling from the former residence (including lodging, but not meals) to the new residence.

No deduction is allowed for moving expenses unless the employee's new principal place of work is at least 50 miles farther from his former residence than was his former place of work, or if he had no former principal place of work, is at least 50 miles from his former residence. Also, the employee must either be a full-time employee at the new general location for at least 39 weeks following the start of work at the new location, or during the 24 month period immediately following his arrival in the general location of his new principal place of work, he is a full-time employee or is self employed during at least 78 weeks, of which not less than 39 weeks are during the 12-month period referred to previously. The 50 mile or 39 week rule does not apply if the employee is unable to satisfy the conditions due to death, disability or involuntary separation.

In general, the move must occur in connection with the commencement of work at the new location and must be incurred within one year from the time the taxpayer begins work at the new location. Moving expenses may be deductible after this one-year period if the taxpayer can show that circumstances prevented the taxpayer from incurring the expense of moving within the one-year period.

Qualified moving expenses under Code Sec. 132(g) are excludable from the gross wages and wages for income and employment tax purposes to the extent paid for or reimbursed by the employer, whether paid for directly or through reimbursement. The employer is required to treat the qualified moving expenses as excludable from wages unless he has actual knowledge that the employee deducted the qualified expenses in a prior year or will not meet the distance requirement or the 39/78 week test.

Expenses of Travel Away From Home:
For travel expenses to be excludable from the employee's income, they must be incurred while, (1) away from home, (2) and in pursuit of a trade or business. IRS Regulation 1.162-2(f) sets forth three objective factors that are to be used to determine if an individual's home is truly his tax home. The factors are:

1. whether the individual performs a portion of his business in the vicinity of the abode while he is using the abode for lodging;
2. whether the individual's living expenses are duplicated because his business requires him to be away from the area; and
3. whether the individual has (a) not abandoned the vicinity in which his historical place of lodging and his claimed abode are both located, (b) has a member of his family currently residing at the claimed abode, or (c) uses the abode frequently for purposes of lodging

If the individual satisfies all three of the above criteria, the individual's abode will be treated as his tax home. If the individual satisfies two of the three criteria, then all the facts and circumstances will be considered in determining if the claimed abode is the tax home. If at least two of the three criteria are not satisfied, the individual will be classified as an itinerant who has a tax home wherever he works. Since an itinerant never leaves his tax home, he is not entitled to deductions for travel expenses.

Conversely, any employer reimbursement of travel expenses would be includable in the employee's wages, subject to employment taxes.

When employees work away from home it is sometimes impractical for them to return home at the end of the work day. When this occurs, the employee's travel expense reimbursements (meals and lodging) are not taxable if the period of work away from home is temporary. Should the period of work become indefinite, travel expenses are considered compensation because the employee is considered to have changed the location of his tax home to his work location. Any employment that actually exceeds one year is treated as indefinite. The inclusion in income applies to all expenses reimbursed, not just those reimbursed after one year.

Differences Between Office of State Budget and Management's Moving Expense Reimbursement Policy and Expenses Allowable Under the Internal Revenue Code: North Carolina General Statute 138-8 authorizes the Office of State Budget and Management (OSBM) to set a policy for the reimbursement of State employees who are required to relocate their duty station, when that relocation is deemed to be in the best interest of the State. That policy, as it presently exists, conflicts in several instances with what is allowable under the Internal Revenue Code. It is important to note that the definition of taxable versus non-taxable moving expenses, per the IRC, has changed numerous times since 1993.

OSBM policy allows for the movement of household and personal goods. The weight limitations stated in that policy are not found in the IRC, so that additional cost borne by the employee in connection with the household move should be allowable as an itemized deduction to the employee on his/her tax return. The tax treatment of insurance, appliance connections, mobile home set up cost, etc. per OSBM policy would normally not be taxable compensation since it would qualify as moving household goods (personal property), unless other IRC requirements for the move are not met by the employee.

OSBM policy allows for travel and subsistence to the employee for the cost of travel in locating a new residence for a maximum of three trips at the statutory rate (presently $.55/mile for round trips under 60 miles and $.32/mile in excess of 60 miles. The IRC does not allow the reimbursement of travel for house-hunting purposes. The house-hunting mileage reimbursement is taxable compensation to the employee. Subsistence and lodging paid while looking for a new home is taxable compensation to the employee.

For the day of the move, OSBM policy allows for mileage, subsistence for meal cost for each family member, and overnight lodging. The IRC does not allow for the tax free reimbursement of meal expenses incurred while moving. Therefore, all meal subsistence reimbursements for the day of the move are taxable compensation to the employee. Mileage paid in excess of the $.24/mile (moving mileage rate for 2009) would also be taxable compensation. The overnight lodging reimbursement is not taxable income.

OSBM policy allows for the payment of subsistence at the new duty station for a period not to exceed five days a week and mileage for one-round trip per week from the employee's current residence to the new duty station, not to exceed 40 business days. IRC Section 217 rules require that all per diem reimbursements be included in the taxable wage of the employee, subject to employment taxes. While the general rule of Section 217 is that payments of subsistence will be taxable compensation to the recipient, IRC Regulation 1.162-2(f) (see above) sets forth criteria that must be met in order to exempt business travel expenses from taxable wages. When at least two of the three stated criteria are met by the employee, for instance where the employee's living expenses are duplicated and family members are still living in the claimed abode, it is our opinion that the facts and circumstances would indicate that the employee, for IRC purposes, would qualify for being in overnight travel status and the subsistence would be a non-taxable fringe benefit, excludable from taxable wages under IRC 132(g). When two of the three Reg. 1.162-2(f) criteria are no longer being met, the subsistence for the 40 business days would be taxable compensation. This is also true for the one-round trip mileage reimbursement. Please note, the applicable mileage rate for overnight travel while on business is $.55/mile for 2009, not the $.24/mile moving mileage rate.

Office of the State Controller

Self-Assessment of Internal Controls

Tax/Payroll Compliance Cycle

Payroll Compliance-Moving Expense Reimbursement

Control Policies and Procedures

Agency ______________________________ Year-End _________

A. Documentation

Yes No N/A

___ ___ ___ 1. Is there a formal plan of organization under which responsibilities are assigned to identify an employee as having received moving expense reimbursements?

Name of person responsible: ______________________________________

Title: ____

___ ___ ___ 2. Does the agency have written instructions available for responsible agency personnel to use as a guide for consistent and accurate application of State and Federal policies on moving expense reimbursements?

B. Recording and Execution of Transaction and Events

Yes No N/A

___ ___ ___ 3. Does the agency reimburse moves made as a result of internal promotions, and/or changes in assignments involving the transfer of employees for the advantage and convenience of the employing agency?

___ ___ ___ 4. If moving expense reimbursement were paid to or on behalf of an employee, were the taxable amounts includable in the gross wages and non-taxable payments included on the Form W-2 as an informational item of the employee?

___ ___ ___ 5. Did the entity review the requirements of the 50 mile/39 week test to verify if these requirements were met by each employee paid or reimbursed for moving expenses?

___ ___ ___ 6. If the 50 mile/39 week test was not met by an employee, was the payment or moving expense assistance included in taxable income with social security and income taxes withheld?

___ ___ ___ 7. Were all non-taxable moving expense reimbursements reported to the payable system as informational items on the employees' W-2 Forms?

___ ___ ___ 8. For all payments other than the move of household goods, lodging, and transportation on the day of the move, did the agency include in taxable wages and withhold FICA and income taxes?

Office of the State Controller

Self-Assessment of Internal Controls

Internal Control Cycle – Not Applicable

The *(name of cycle)* cycle does not apply to the *(name of the agency)* for the following reasons:

State reasons why the cycle is not applicable to the agency.

Office of the State Controller

Self-Assessment of Internal Controls

Example of Inadequate Internal Control

Section: E-Accounts Receivable

Page: E-5 **Procedure:** 25a

Problem noted:
One employee performs both the billing and collecting of accounts receivable processes at the agency. The agency has a limited number of employees.

Corrective action taken:
The accounts receivable employee will perform the billing of accounts receivable. The cash receipts employee will collect the accounts receivable. The accounting supervisor will review the billing and collecting and post to the general ledger. Due to the size of the agency, this is the most cost effective action to take to obtain stronger internal controls.

OR

The billing and collecting accounts receivable process will be redistributed among the accounting personnel to allow for segregation of duties.

Effective date: Next billing cycle.