Office of the State Controller
Risk Mitigation Services

INTERNAL CONTROL QUESTIONNAIRE

June 30, 2007

Robert L. Powell
State Controller

State of North Carolina
Office of the State Controller

Michael F. Easley, Governor | Robert L. Powell, State Controller

April 30, 2007

MEMORANDUM

TO: Boards and Commissions

FROM: Robert L. Powell
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, 2007. This year we have removed the Major Financial Assistance Cycle -as it would not be applicable to Boards and Commissions. Several sections include new and updated questions. 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, 2007.

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.ncosc.net/sigdocs/sig_docs/documentation/policies_procedures/sigSelfAssessment_of_Internal_Contr.html

Questions concerning the ICQ should be directed to Eve-Simone Pastor, OSC Risk Mitigation Services, at (919) 981-7448.

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, 2007. 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 July 31, 2007 via fax or mail to:

Eve-Simone Pastor
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
- Risk Assessment
- 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
- Major Financial Assistance Cycle

Within each cycle, except the control environment and risk assessment, five internal control breakdowns 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:

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

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
- Compliance 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.

Compliance Monitoring

Compliance 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 compliance monitoring must be a function internal to state government. Such internal compliance monitoring can occur within the following formal activities:

- Internal Audit Activities
- Self - Assessment of Internal Control Questionnaires
- Internal Control Compliance Reviews (performed by OSC)

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
- Compliance 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.

Responsibilities

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. <u>SEPARATION OF DUTIES</u>

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. <u>SUPERVISION</u>

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. <u>ACCESS TO AND ACCOUNTABILITY FOR ASSETS</u>

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 employees through actions and words.	• Employees unaware of internal control. • Lack of approved policies and procedures to be followed by personnel.
Organizational structure units are clearly defined to perform the necessary functions and determine that appropriate reporting relationships have been established.	• Organization chart will not be 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 and procedures to operate in the manner intended.	• 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. • Duplication of functions by 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 can not communicate expectations to the organizational units. • Unusual transactions or events will not be detected. • Management can not determine if goals are being achieved.
Organizational checks and balances provide authority for certain functions that minimize the potential for waste, fraud, abuse of mismanagement.	• The organizational units will 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 _________

A. Integrity and Ethical Values

Yes No N/A

___ ___ ___ 1. Are there written policies and internal operating procedures that have been approved by the governing body or top management?

___ ___ ___ 2. Does the agency have a code of ethical conduct that has been made available to all employees?

___ ___ ___ 3. Have transactions been executed in accordance with integrity and ethical values/codes?

___ ___ ___ 4. Are procedures documented, kept current and readily available for use by all employees?

B. Commitment to Competence

___ ___ ___ 5. Are responsibilities clearly defined in writing and communicated?

___ ___ ___ 6. Does management understands the knowledge and skills required to accomplish tasks?

___ ___ ___ 7. Does management get involved in training?

C. Management's Philosophy and Operating Style

___ ___ ___ 8. Does management use budget, spending plans, etc. to review the agency's performance?

___ ___ ___ 9. Are principal accounting records and accounting employees at all locations under the supervision of the principal accounting officer?

___ ___ ___ 10. Does management actively follow-up on complaints from customers/clients?

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

___ ___ ___ 12. Are the budget system and the planning process integrated?

___ ___ ___ 13. Are periodic (monthly, quarterly) reports on the status of actual to budget performance prepared and reviewed by top management?

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

___ ___ ___ 15. Are operations made in accordance with statutes governing the public entity?

___ ___ ___ 16. Is the internal control structure supervised and reviewed by management to determine if it is operating as intended?

___ ___ ___ 17. Does the agency compare its actual performance with its goals and objectives?

___ ___ ___ 18. Does the agency have a functioning internal audit staff to review the operations of the agency?

___ ___ ___ 19. Does the internal audit staff report to an official independent of the operations under review

D. Organizational Structure

___ ___ ___ 20. Are there written policies and procedures for all major areas of the organization?

___ ___ ___ 21. Are procedures reviewed annually for possible updating?

___ ___ ___ 22. Is there an organization chart clearly defining the lines of management authority and responsibility?

___ ___ ___ 23. Is the organization chart current and accurate?

___ ___ ___ 24. Does the organization chart enhance work performance?

___ ___ ___ 25. Are all the agency's operations centralized or decentralized?

___ ___ ___ 26. If decentralized, is monitoring of the areas adequate?

E. Assignment of Authority and Responsibility

___ ___ ___ 27. Has management provided resources to ensure compliance with grant requirements and federal and state laws?

___ ___ ___ 28. Are sufficient training opportunities to improve competency and update employees on new policies and procedures available?

___ ___ ___ 29. If known areas of knowledge are limited, has help been enlisted from peers, auditors or outside consultants to identify alternatives and suggest solutions?

___ ___ ___ 30. Have managers been provided with clear goals and direction from the governing body or top management?

___ ___ ___ 31. Are responsibilities divided so that no single employee controls all phases of a transaction?

F. Human Resource Policies and Practices

___ ___ ___ 32. Are competent personnel recruited?

___ ___ ___ 33. Are accurate, up-to-date-position descriptions available?

___ ___ ___ 34. Are managers and employees held accountable for satisfactory completion of performance elements?

___ ___ ___ 35. Do all supervisors and managers have at least a working knowledge of the State's personnel policies and procedures?

___ ___ ___ 36. Does each supervisor and manager have a copy or access to a copy of the State's personnel policies and procedures?

___ ___ ___ 37. Does management ensure compliance with the department's personnel policies and procedures manual concerning hiring, training, promoting, and compensating employees?

___ ___ ___ 38. Has management established backup plans for sudden or significant changes in personnel?

___ ___ ___ 39. Are supervisors readily available to help personnel with non-routine problems?

___ ___ ___ 40. Do the internal auditors meet the minimum qualifications for the positions they hold?

___ ___ ___ 39. Are external audits performed on a periodic basis?

Office of the State Controller

Self-Assessment of Internal Controls

Risk Assessment

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 employees through actions and words.	• Employees unaware of internal control. • Lack of approved policies and procedures to be followed by personnel.
Organizational structure units are clearly defined to perform the necessary functions and determine that appropriate reporting relationships have been established.	• Organization chart will not be 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 controls and procedures to operate in the manner intended.	• 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. • Duplication of functions by 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 can not communicate expectations to the organizational units. • Unusual transactions or events will not be detected. • Management can not determine if goals are being achieved.
Organizational checks and balances provide authority for certain functions that minimize the potential for waste, fraud, and abuse of mismanagement.	• The organizational units will not perform responsibilities therefore the potential for waste, fraud and abuse could occur.

Office of the State Controller

Self-Assessment of Internal Controls

Risk Assessment

Control Policies and Procedures

Agency ______________________________ Year-End __________

Yes No N/A

___ ___ ___ 1. Are there written policies and internal operating procedures to identify and react to changes that can have an adverse effect on the organization?

___ ___ ___ 2. Are written mission or value statements established and communicated throughout the agency?

___ ___ ___ 3. Are objectives, risks, and controls documented?

4. How frequently are objectives, risks, and controls evaluated?

____

___ ___ ___ 5. Are objectives established for key areas (i.e. operations, financial reporting, compliance, etc.)?

___ ___ ___ 6. Are objectives periodically measured against actual results?

___ ___ ___ 7. Is a specific person or team responsible for risk assessment activities at the agency?

___ ___ ___ 8. Is a specific person or team responsible for fraud risk assessment activities at the agency?

___ ___ ___ 9. Has management identified and analyzed entity risks relating to change, such as high turnover, new technology, new regulations, restructuring, or rapid growth?

___ ___ ___ 10. Has management analyzed the potential monetary impact associated with financial and operational risks?

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

____

____

____

___ ___ ___ 12. Are cost benefit studies performed before committing resources to changes?

___ ___ ___ 13. Are external resources consulted as needed?

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. • General ledger data is in error.
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 and omission of a control procedure. • Transactions improperly included or excluded as a result of inadequate cutoff procedures. • Unauthorized or inappropriate journal entries. • Inadequate support for journal entries preventing a proper review and approval.
All necessary data for combination are obtained and processed in accordance with established policies and procedures.	• Absence of adequate procedures may result in misclassification of balances, improper combination, 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. • Financial reports released without approval of appropriate executive and legislative officials. • Damage to constituent and financial community relations. • Legal and regulatory requirements on publication of financial information not allowed.

Office of the State Controller

Self-Assessment of Internal Controls

Financial Reporting Cycle

Control Policies and Procedures:

Agency__________________________ Year-End _________

A. Control Activities / Information and Communication:

Yes No N/A

___ ___ ___ 1. Is there a formal plan of organization under which responsibilities for closing the general statements and financial statement worksheets are clearly defined?

___ ___ ___ 2. Is there a formal schedule with target dates for completing tasks associated with closing the general ledger and preparing financial statement worksheets?

___ ___ ___ 3. Are policies and procedures established concerning year-end cut-off of accounting transactions?

___ ___ ___ 4. Does the agency maintain documentation of written procedures covering the recording of transactions?

___ ___ ___ 5. Does this documentation contain a chart of accounts explaining what items are charged to each line account? Do relevant employees have access to this information?

___ ___ ___ 6. Does the agency maintain and follow procedures for record filing, retention, and disposition?

___ ___ ___ 7. Is it required that trial balances, adjustments and supporting workpapers be maintained to support the process of closing the general ledger and preparing financial statements and financial statement worksheets?

___ ___ ___ 8. Is certification required from operating units that information submitted for the preparation of the financial statements is correct?

9. Is informative disclosure required in the financial statements and the accompanying notes as follows:

___ ___ ___ a. Requiring the accumulation of information concerning commitments?

___ ___ ___ b. Requiring the accumulation of information concerning contingencies?

___ ___ ___ c. Requiring the accumulation of information concerning related party transactions?

___ ___ ___ d. Requiring the accumulation of information concerning accounting principles?

___ ___ ___ e. Requiring the accumulation of information concerning fund classifications?

___ ___ ___ f. Requiring the accumulation of information concerning subsequent events?

___ ___ ___ g. Requiring the accumulation of information concerning other accounting disclosures? (CAFR footnote worksheets for the State reporting entity).

___ ___ ___ 10. Are investments reconciled to control accounts at year-end?

___ ___ ___ 11. Are intra-agency transfers reconciled at year-end?

___ ___ ___ 12. Are intra-agency interfund receivables and payables reconciled at year-end?

___ ___ ___ 13. Are amounts designated for subsequent years' expenditure reconciled to budget authorizations?

___ ___ ___ 14. Are beginning fund balances or retained earnings reconciled to amounts reported in prior years?

___ ___ ___ 15. Are financial statements (or financial statement worksheets) reconciled to the general ledger before being transmitted to the State Controller?

___ ___ ___ 16. Are financial statements (or financial statement worksheets) reviewed by the chief financial officer for accuracy and consistency?

17. Are the following duties generally performed by different people:

___ ___ ___ a. Preparing and reviewing the financial statements?

___ ___ ___ b. Preparing and reviewing journal entries?

___ ___ ___ c. Accumulation of accounting information (inventories, estimates, etc.) and custody of related assets?

___ ___ ___ d. Preparing and reviewing worksheets and schedules supporting the accounting information?

___ ___ ___ e. Performing and reviewing reconciliations?

___ ___ ___ 18. Are worksheets and schedules attached to journal entry accounting code sheets and are they secured in a safe location?

___ ___ ___ 19. Do only authorized persons review departmental budgets?

___ ___ ___ 20. Is a knowledgeable individual assigned the responsibility to supervise the conversion from budget (cash) basis to GAAP basis of accounting?

___ ___ ___ 21. Are reconciliations of subsidiary ledgers to control accounts performed and reviewed by a responsible person?

___ ___ ___ 22. Are journal entries approved, including a review of supporting documentation?

___ ___ ___ 23. Are transactions subsequent to the balance sheet date reviewed for proper classification?

___ ___ ___ 24. Are revenue accounts reviewed to identify possible deferred revenue?

___ ___ ___ 25. Are investment earning calculations and accruals reviewed at year-end?

___ ___ ___ 26. Are fiscal agent statements reviewed for proper presentation and reconciled to the agency's records?

___ ___ ___ 27. Are accumulated leave records reviewed at year-end?

___ ___ ___ 28. Are capital asset inventory worksheets reviewed at year-end?

___ ___ ___ 29. Are accrual transactions reviewed to determine that expenditure or revenue recognition was proper?

___ ___ ___ 30. Are retained earnings or fund balances reviewed for restrictions/reservations at year-end?

___ ___ ___ 31. Are bank reconciliations reviewed at year-end?

___ ___ ___ 32. Are fund types reviewed to verify fund classifications?

___ ___ ___ 33. Is the mathematical accuracy of the financial statements verified at year-end?

B. Monitoring:

___ ___ ___ 34. Are overexpenditures and other differences between actual and budgeted amounts promptly investigated and resolved?

___ ___ ___ 35. 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?

___ ___ ___ 36. Does management consider the financial reporting impact of changes in computer programs?

___ ___ ___ 37. Has management instituted a process to identify and address changes in accounting and reporting procurements?

___ ___ ___ 38. Are only authorized persons allowed to alter or interpret an existing accounting principle or establish a new accounting principle? Have proposed changes been brought to the attention of OSC? (Relates also to question 46)

___ ___ ___ 39. Does management spot-check transactions, records, and reconciliation to ensure expectations are met?

___ ___ ___ 40. Are policies and procedure developed for changes in new systems or new way of doing duties?

___ ___ ___ 41. Are budgets compared to actual results and deviations followed up on a timely basis?

___ ___ ___ 42. Is information (i.e. findings, recommendations, etc.) provided by external auditors considered and acted upon in a timely manner?

___ ___ ___ 43. Are internal controls subject to a formal and continuous internal assessment process?

___ ___ ___ 44. Does management periodically evaluate the accuracy and timeliness of its information and communicate it to appropriate personnel?

___ ___ ___ 45. Does management review accounting estimates at least annually (depreciation, allowance for doubtful accounts, etc.)?

C. Accounting Standards

___ ___ ___ 46. Have qualified individuals reviewed recently promulgated accounting standards for proper implementation? This would include, if applicable, GASB Statement No. 40 and other significant standards. (Relates also to question 38)

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 staffs unsure of goals of the executive. • Absence of effective control over expenditures.
Obtain legislative or other required approval of expenditure and revenue plan for the period.	• Executive and legislative branches do not reach a common point of agreement on plan of expenditure and revenue. • Expenditure plan adopted with no apparent plan to raise required revenue.
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. • Lack of control over purchase commitments issued and their impact on budget.
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 __________

A. Control Activities / Information and Communication:

Yes No N/A

___ ___ ___ 1. Is there a formal organizational chart defining responsibilities for preparing, approving, changing and submitting the budget to the Office of State Budget and Management?

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

___ ___ ___ 3. Is a budget calendar prepared for the orderly preparation and submission of the budget?

___ ___ ___ 4. 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?

___ ___ ___ 5. Are initial budget submission developed and prepared by major departments and activity centers?

___ ___ ___ 6. Are interfund and interdepartmental transfers included in the budget?

___ ___ ___ 7. Are budgets that have been approved by grantors in connection with grant activity recorded in the accounting system?

___ ___ ___ 8. Is an encumbrance system used to ensure that actual expenditures do not exceed budgeted amounts?

___ ___ ___ 9. If an encumbrance system is used, is the outstanding purchase order file reconciled to the general ledger (Reserve for Encumbrances) monthly and on a timely basis?

___ ___ ___ 10. Are actual expenditures and revenues compared to budgeted amounts monthly and on a timely basis?

___ ___ ___ 11. Are budget revisions approved by an authorized person before being entered into the accounting system?

___ ___ ___ 12. Are restricted revenues segregated to ensure that the revenues are used only for restricted purposes?

___ ___ ___ 13. Are management's goals and objectives integrated into budget submissions?

___ ___ ___ 14. Are expenditure and revenue transactions reviewed to determine that coding is consistent with budget classifications?

___ ___ ___ 15. Are budget reports distributed, (or available on line, to operating departments as a management tool?

16. Are the following duties generally 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?

B. Monitoring:

___ ___ ___ 17. If applicable, is citizen input obtained through public hearings (primarily associated with budgets for federal programs)?

___ ___ ___ 18. Does the budget officer, or other properly authorized officer, review departmental budgets in relation to management's goals?

___ ___ ___ 19. Does the accounting department or budget officer submit approval as to availability of funds before the issuance of a purchase order or expenditure commitment?

___ ___ ___ 20. Are budgets prepared in sufficient detail (i.e. at operational responsibility level) to provide a meaningful tool with which to monitor subsequent performance?

___ ___ ___ 21. Are estimated revenues and appropriations recorded in sufficient detail in the accounting records for later comparison to actual amounts realized or incurred?

___ ___ ___ 22. 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; diverting cash receipts after recording non-compliance with the Cash Management Act.
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; underfooting or overfooting 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 __________

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. If annual payments are involved, do procedures exist to ensure that previous years' records are properly updated for new registrants and withdrawals?

___ ___ ___ 3. Do control procedures exist regarding the collection, timely deposit, and recording of collections in the accounting records at each collection location?

___ ___ ___ 4. Are checks identified on the deposit slip by maker and amount?

___ ___ ___ 5. Is the sequence number for the CMCS Certification of Deposit noted on the deposit ticket to confirm certification has been done in the system?

___ ___ ___ 6. Does the deposit slips used have an official depository bank number preprinted on the document?

___ ___ ___ 7. Are procedures in place to establish a proper cut-off of cash receipts at the end of the fiscal year?

___ ___ ___ 8. Are license and permit issuances reconciled to the cash receipts journal or bank deposits?

___ ___ ___ 9. Is a mail receipts log maintained for mail receipts?

10. Is the mail receipts log reconciled to:

___ ___ ___ a. The cash receipts journal?

___ ___ ___ b. Validation certification of deposit/deposit slips?

___ ___ ___ 11. If payments are made in person (seminars, workshops, etc.), are receipts for payment used and accounted for and balanced to deposits?

___ ___ ___ 12. Are pre-numbered receipts issued for all cash collections and are numbers of all receipts accounted for?

___ ___ ___ 13. Are logs of receipt book issuances maintained?

___ ___ ___ 14. Are petty cash/change funds at the minimum effective amount?

___ ___ ___ 15. Are all petty cash funds maintained on an imprest basis?

___ ___ ___ 16. Are unauthorized advances from petty cash funds to employees prohibited?

___ ___ ___ 17. Are all petty cash checks cashed promptly at the banks?

___ ___ ___ 18. Are petty cash vouchers or bills required for all petty cash disbursements and are they pre-numbered?

___ ___ ___ a. Are they signed by persons receiving cash?

___ ___ ___ b. Are they approved in writing by department head or other responsible official?

___ ___ ___ c. Are they properly supported by vendor receipts?

___ ___ ___ d. Are they typewritten or written in ink to preclude alterations?

___ ___ ___ 19. Are letters accompanying gifts, grants, donations, etc., retained as part of the permanent records?

___ ___ ___ 20. Are the authorization records of the depository banks up to date?

___ ___ ___ 21. Are receipts deposited as often as required by General Statutes?

22. Are the following duties generally performed by different people:

___ ___ ___ a. Custodian of the fund, reconciliation of the fund 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, placing a restrictive endorsement on the checks, balancing cash, closing cash registers, making a deposit, maintaining Accounts Receivable records and making General Ledger entries?

___ ___ ___ e. Collecting of licenses, fines, and inspections and making General Ledger entries?

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

___ ___ ___ g. Closing cash registers daily by a person not involved in cash collection?

___ ___ ___ 23. Are current year receipts compared to those for prior years and budgeted receipts, and are explanations of variations reviewed by senior officials?

___ ___ ___ 24. Is account distribution indicated on expense vouchers reviewed for reasonableness by accounting personnel?

___ ___ ___ 25. Are licenses and permits sequentially numbered and satisfactorily accounted for?

___ ___ ___ 26. Is there adequate physical security surrounding cashiering areas?

___ ___ ___ 27. Are employees prohibited from cashing personal checks at cashiering areas?

___ ___ ___ 28. Is cash receiving centralized to the maximum extent possible?

___ ___ ___ 29. Are all employees handling cash receipts adequately bonded?

___ ___ ___ 30. Are "audit tapes" retained for cash registers?

___ ___ ___ 31. Is a restrictive endorsement placed on incoming checks as soon as received?

___ ___ ___ 32. Are unused portions of receipt books required to be returned to the issuance location?

___ ___ ___ 33. Are petty cash vouchers effectively canceled at the time of reimbursement to the fund by an individual other than the custodian?

___ ___ ___ 34. Is a system of pre-numbered receipts with adequately controlled copies in use wherever practicable?

___ ___ ___ 35. Are cash receipts controlled at the earliest point of receipt?

___ ___ ___ 36. Are cash registers used in locations making sales of goods?

___ ___ ___ 37. Is petty cash kept in a locked place, where only the custodian has access?

___ ___ ___ 38. Are petty cash funds segregated from other cash?

___ ___ ___ 39. When funds cannot be deposited daily, are the funds transported to a centralized location at the end of the workday and secured overnight?

B. Monitoring:

___ ___ ___ 40. Do you have an OSC approved Cash Management Plan on file?

___ ___ ___ 41. Do you have an OSC approved Delegation of Disbursing Authority on file?

___ ___ ___ 42. 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?

___ ___ ___ 43. Are funds periodically counted by a person other than the custodian at unannounced times?

___ ___ ___ 44. Does management approve or spot check reconciliations?

___ ___ ___ 45. Are policies documented for changes in a new system or method for accounting for cash?

___ ___ ___ 46. Are timely corrective actions taken in cash discrepancies?

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 afforded the opportunity to divert revenue to 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. • With knowledge that there is no effective audit or review function, sales, income and other self-assessed taxpayers pay amounts less than required by law. • Revenue lost due to inadequate procedures or improper employee 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 to 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 retarded by delayed billing 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. • Tampering with account balances encouraged by knowledge that controls are ineffective. • 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 __________

A. Control Activities / Information and Communication:

Yes No N/A

___ ___ ___ 1. Is there a formal organizational chart defining responsibilities of preparing bills, recording their payment, collecting the accounts and follow up of accounts not paid?

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

___ ___ ___ 8. Do procedures exist to prevent the interception or alteration by unauthorized persons of billings or statements after preparation but before they are mailed?

___ ___ ___ 9. Does the agency have established policies and procedures concerning refunds of overpayments, issuance of billing adjustments?

___ ___ ___ 10. Are subsidiary accounts receivable and notes receivable records maintained?

___ ___ ___ 11. Are subsidiary accounts reconciled at least monthly with the general ledger control account?

___ ___ ___ 12. Are billings and/or statements prepared at least within the month of furnishing the goods or services?

13. 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?

___ ___ ___ 14. 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?

___ ___ ___ 15. Are all services or goods provided to individuals or other governmental units billed when goods are provided or services rendered?

___ ___ ___ 16. Are payment terms 30 days after billing, unless contractual requirements specify otherwise?

___ ___ ___ 17. Are individual receivable records posted only from authorized documents?

___ ___ ___ 18. Are data bases and, where appropriate, usage records accurately maintained to ensure that amounts due are billed correctly?

___ ___ ___ 19. Are charges for goods or services based on authorized rates and approved by the appropriate State/Federal authorities?

___ ___ ___ 20. Are statements of account balances mailed at least once a month?

___ ___ ___ 21. Has an allowance account been established for doubtful accounts to reflect the amount of the agency's receivables that management estimates will be uncollectible?

___ ___ ___ 22. Are accounts written off the agency's financial accounting records when all collection procedures have been exhausted without success?

___ ___ ___ 23. Are reasons for writing off an account adequately documented?

___ ___ ___ 24. After write off, does the agency continue to submit the account(s) to the Department of Revenue for debt setoff proceedings?

___ ___ ___ 25. Is the accounting department notified directly and in a timely manner of billings and collection?

___ ___ ___ 26. Are collections on accounts receivable deposited daily, rather than held for posting to detail records?

27. 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?

28. Are the following duties generally performed by different people:

___ ___ ___ a. Billing, collecting, and cash application 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?

___ ___ ___ 29. Do write-offs or adjustments have proper authorizations?

___ ___ ___ 30. Are all collections on accounts receivable posted to individual receivable accounts?

___ ___ ___ 31. Is access to the accounts receivable accounting system limited only to authorized individuals?

B. Monitoring:

___ ___ ___ 32. Are corrections and adjustments to cash receipts documented and approved by a manager?

___ ___ ___ 33. Are all non-cash credits, such as credit memos, allowances, and bad debts properly authorized?

___ ___ ___ 34. Are there controls to ensure that individuals with delinquent accounts are not receiving additional credit?

___ ___ ___ 35. 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?

___ ___ ___ 36. Is an aging schedule prepared monthly and is it reviewed by a responsible manager?

___ ___ ___ 37. Are delinquent accounts followed up?

___ ___ ___ 38. Are all legal remedies followed to collect write-offs or uncollectible accounts with the Attorney General?

___ ___ ___ 39. Are rates reviewed at least annually for billed services or goods?

___ ___ ___ 40. Are there procedures to adjust billings for new rates for billed services or goods?

___ ___ ___ 41. Are accounts periodically reviewed for propriety of transactions and balances by a person 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. • Quality of materials or services received or substandard.
All materials and services received agree with the original orders.	• Payment for materials or services not received. • Damaged or missing goods not reported. • Inferior quality of materials or services received.
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. • Inoperable budgetary control.

Office of the State Controller

Self-Assessment of Internal Controls

Purchasing/Accounts Payable Cycle

Control Policies and Procedures:

Agency ____________________________ Year-End __________

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 follow up of all purchases and accounts payable functions?

___ ___ ___ 2. Is a written policy established to ensure that the best possible price is obtained for purchases not made from state contract?

___ ___ ___ 3. If construction contracts are awarded, are bid and performance bonds as well as retainage required to assure performance?

___ ___ ___ 4. Are procedures established to identify, before purchase orders are issued, cost and expenditures not allowable under grant (federal/state) programs?

___ ___ ___ 5. 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 that the individual approving payment?

___ ___ ___ 6. Do procedures exist for processing invoices not involving materials or supplies (for example, lease or rental payments, utility bills)?

___ ___ ___ 7. Do procedures exist ensuring accurate account distribution of all entries resulting from invoice processing?

___ ___ ___ 8. Do procedures exist for disbursement approval and check-signing?

___ ___ ___ 9. Has the agency established procedures to ensure that all voided checks are properly accounted for and effectively canceled?

___ ___ ___ 10. Has an effective small purchase or emergency purchase policy been documented and implemented?

11. 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?

___ ___ ___ 12. Are payments made as close to the discount date as possible?

___ ___ ___ 13. Is splitting orders to avoid higher levels of approval prohibited?

___ ___ ___ 14. Is an adequate record of open purchase orders and agreements maintained?

___ ___ ___ 15. Are receiving reports prepared for all purchased goods?

___ ___ ___ 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. If an invoice is received from a supplier not previously dealt with, are steps taken to ascertain that the supplier actually exists?

___ ___ ___ 19. Are payments made only on the basis of original invoices and to suppliers identified on supporting documentation?

___ ___ ___ 20. Are the accounting and purchasing departments promptly notified of returned purchases, and are such purchases correlated with vendor credit advices?

___ ___ ___ 21. Is proper control maintained over vendor credit memos?

___ ___ ___ 22. Are signed checks delivered directly to the mail room, making them inaccessible to persons who requested, prepared, authorized or recorded them?

23. Are monthly reconciliations performed on the following:

___ ___ ___ a. All petty cash accounts?

___ ___ ___ b. All bank accounts?

___ ___ ___ c. All subsidiary accounts to the general ledger accounts?

___ ___ ___

24. Are the following duties generally 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 of them, and making entries to the general ledger?

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

___ ___ ___ 25. Is check signing limited to only authorized personnel?

___ ___ ___ 26. Are disbursements approved for payment only by properly designated officials?

___ ___ ___ 27. Are travel expenses for out-of-state, out-of-country, and excess allowances approved in advance?

___ ___ ___ 28. Are invoices (vouchers) reviewed and approved for completeness of supporting documents and required clerical checking by a senior employee?

___ ___ ___ 29. Is responsibility fixed for seeing that all cash discounts are taken and if applicable, that exemptions from sales, federal excise, and other taxes are claimed?

___ ___ ___ 30. Is the individual responsible for approval or check-signing furnished with invoices and supporting data to be reviewed prior to approval or check-signing?

___ ___ ___ 31. Are adjustments of recorded accounts payable or other liabilities properly approved?

___ ___ ___ 32. Are unused checks adequately controlled and safeguarded?

___ ___ ___ 33. Is it prohibited to sign blank checks in advance?

___ ___ ___ 34. Is it prohibited to make checks out to the order of "cash"?

___ ___ ___ 35. If facsimile signatures are used, are the signature plates adequately controlled and separated physically from blank checks?

___ ___ ___ 36. Are purchases of goods and services initiated by properly authorized requisitions bearing the approval of officials designated to authorize requisitions?

___ ___ ___ 37. Are all invoices received from vendors in a central location, such as the accounting department?

___ ___ ___ 38. Are purchase orders prenumbered and issued in sequence?

___ ___ ___ 39. 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?

___ ___ ___ 40. Are invoices and supporting documents canceled?

___ ___ ___ 41. Are changes to contracts or purchase orders subject to the same controls and approvals as the original agreement?

___ ___ ___ 42. Are there checks in the processing procedures to prevent or detect duplicate payments?

B. Monitoring:

___ ___ ___ 43. Are transfers or loans between funds approved by management?

___ ___ ___ 44. 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?

___ ___ ___ 45. Are purchase orders or contracts required to be approved by appropriately designated officials before issuance?

___ ___ ___ 46. Is a government representative or architect required to inspect construction projects before approval of payment?

___ ___ ___ 47. 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?

___ ___ ___ 48. Is the distribution of charges in the accounting department reviewed by a person competent to pass on the propriety of the distribution?

___ ___ ___ 49. Are debit balances in accounts payable and other liabilities reviewed and followed up?

___ ___ ___ 50. Are reasonable limits set on amounts that can be paid by facsimile signatures?

___ ___ ___ 51. Are all records, checks and supporting documents retained according to the applicable (state or federal) record retention policy?

___ ___ ___ 52. Does the accounting department record and follow up partial deliveries?

___ ___ ___ 53. Are P-card purchases reconciled monthly?

___ ___ ___ 54. Is this reconciliation performed by someone other than the card holder?

___ ___ ___ 55. Are all prescribed statewide policies and procedures regarding the use of P-cards followed?

___ ___ ___ 56. 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 __________

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. Are overtime wages or compensatory time adequately controlled?

___ ___ ___ 4. Is a policy established concerning overdrawn vacation or sick leave?

___ ___ ___ 5. Are personnel files maintained for all employees?

___ ___ ___ 6. Is nepotism or conflict of interest in employment prohibited?

___ ___ ___ 7. Are terminated employees interviewed as a physical check on departures and as a final review of the termination settlement?

___ ___ ___ 8. Are written termination notices required that properly document reasons for termination?

___ ___ ___ 9. Is overdrawn vacation or sick leave deducted when calculating final compensation upon termination?

___ ___ ___ 10. Are 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?

___ ___ ___ 11. Are appropriate time records maintained for all leave?

___ ___ ___ 12. Are individual employee leave records reconciled to appropriate records maintained for accumulated employee benefits (vacation, sick leave, etc.)?

___ ___ ___ 13. Are payroll costs charged to grants (federal and state) accurate for employee salaries charged to more than one program (using time records for state agencies or budget estimates for colleges and universities)?

14. 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?

15. Are the following duties generally 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?

___ ___ ___ 16. Do all supervisors and managers have at least a working knowledge of the State’s personnel policies and procedures?

___ ___ ___ 17. Does each supervisor or manager have a copy or access to a copy of the policies and procedures manual?

___ ___ ___ 18. Are all changes in employment (additions and terminations), salary, wage rates, and payroll deductions properly authorized, approved and documented?

___ ___ ___ 19. Are vacation and sick leave approved by supervisors?

___ ___ ___ 20. Are hours worked, overtime hours, and other special benefits (on-call, shift premium) reviewed and approved by the employee's supervisor?

___ ___ ___ 21. Is compensatory time authorized, approved and recorded properly?

___ ___ ___ 22. Are completed payroll transmittals reviewed and approved by a responsible official before check processing?

___ ___ ___ 23. Are payroll registers reconciled to the payroll accounts in the general ledger?

___ ___ ___ 24. Is access to payroll/personnel files limited to authorized individuals?

___ ___ ___ 25. Are procedures in place to ensure that all keys, equipment, credit cards, etc. are returned by the terminating employee?

B. Monitoring:

___ ___ ___ 26. Are comparisons of gross pay of current to prior period payrolls reviewed for reasonableness by a knowledgeable person not otherwise involved in payroll processing?

___ ___ ___ 27. Is the distribution of dollars and (if applicable) hours of distribution subsystems balanced with the payroll registers, and reviewed by someone independent but knowledgeable of the payroll?

___ ___ ___ 28. Are unclaimed payroll checks returned to a custodian independent of the payroll department?

___ ___ ___ 29. Are background checks performed on individuals hired for sensitive positions?

___ ___ ___ 30. Is information on employment applications verified and are references contacted?

___ ___ ___ 31. Are all employees given a performance evaluation?

___ ___ ___ 32. 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 __________

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 and examined to see that they meet quality standards?

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

___ ___ ___ 6. Are written instructions given and explained to all personnel involved in the physical count of the inventory?

___ ___ ___ 7. Is there a proper cut-off of receipts and issues from inventory at year end?

___ ___ ___ 8. Is the accounting department notified (by issuing a receiving report) immediately upon the receipt of goods?

___ ___ ___ 9. Are entries to perpetual inventory records made timely upon the receipt of goods?

___ ___ ___ 10. Are receiving reports or vendor invoices used to record purchases to the perpetual inventory records?

___ ___ ___ 11. When issuing inventory, is the proper fund, purpose, and object charged in the general ledger?

12. Are the following duties generally 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. Are adjustments to inventory records approved by a properly designated official?

___ ___ ___ 16. Is there adequate physical security surrounding inventories?

___ ___ ___ 17. Is access to inventory locations limited?

___ ___ ___ 18. Is there enough insurance for significant inventories?

___ ___ ___ 19. Are all employees responsible for inventories adequately bonded?

___ ___ ___ 20. Does the person receiving the goods sign the requisition as evidence of receipt?

___ ___ ___ 21. Are the approved and completed requisitions kept on file?

22. 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?

___ ___ ___ 23. Are prenumbered tags used during the physical inventories count?

___ ___ ___ 24. Is access to the perpetual inventory records limited to authorized individuals?

B. Monitoring:

___ ___ ___ 25. Is a physical inventory taken at least annually?

___ ___ ___ 26. Are perpetual inventory balances reconciled against the general ledger control accounts at least annually?

___ ___ ___ 27. Does management periodically check inventory reports / records?

___ ___ ___ 28. Are deviations of reports followed up by management in a timely manner?

___ ___ ___ 29. 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 budgeted 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 __________

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. If there are any missing assets, is the Missing Asset Form completed?

___ ___ ___ 6. Are assets believed to be stolen or vandalized reported to the State Bureau of Investigation (SBI) according to state law?

___ ___ ___ 7. Are the Fixed Asset System and appropriate accounts reconciled monthly?

___ ___ ___ 8. Are construction records adequate to accumulate costs associated with constructed capital assets including force (in-house) labor and materials obtained from inventory?

9. 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 entity or to another agency?

___ ___ ___ 10. Are gains or losses properly recognized from disposals of capital assets in proprietary fund types.

___ ___ ___ 11. Are capital assets tagged when procured?

___ ___ ___ 12. Are the capital asset subsidiary accounts balanced to the capital asset control accounts monthly?

___ ___ ___ 13. Are property records reconciled periodically to property accounts?

___ ___ ___ 14. Are the beginning balances, additions, disposals and ending balances properly reflected in the notes to the financial statements?

___ ___ ___ 15. 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?

16. Are the following duties generally 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?

___ ___ ___ 17. Are all asset purchases and receipts approved by a designated person with proper authority?

___ ___ ___ 18. Are all disposals of property approved by a designated person with proper authority?

___ ___ ___ 19. If other than the Statewide $5,000 capitalization threshold, has agency management chosen and documented the threshold level in the Internal Policy/Procedure Book?

___ ___ ___ 20. Has the agency documented the inventory level below $5,000 that will be utilized?

___ ___ ___ 21. Are all assets tagged?

___ ___ ___ 22. Is someone assigned custodial responsibility by location for all assets?

___ ___ ___ 23. Is access to the perpetual capital asset records limited to authorized individuals?

___ ___ ___ 24. Is there adequate physical security surrounding the capital asset items?

___ ___ ___ 25. Is there adequate insurance coverage of the capital asset items?

B. Monitoring:

___ ___ ___ 26. 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?

___ ___ ___ 27. Is such insurance coverage independently reviewed periodically?

___ ___ ___ 28. Has the Internal Policy/Procedure Book been kept up to date with any changes in the agency, or agency philosophy?

___ ___ ___ 29. Is a physical inventory taken at least annually?

___ ___ ___ 30. 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?

___ ___ ___ 31. Are missing items investigated and reasons for them 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.	• Errors in output totals or details of files, reports or other documents as a result of application program coding errors or computer operator errors may not be detected. • 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 __________

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. Are the responsibilities of parties written in respect to:

___ ___ ___ a. Data collection?

___ ___ ___ b. Data transmittal?

___ ___ ___ c. Data conversion?

___ ___ ___ d. Data editing?

___ ___ ___ e. Error correction and control?

___ ___ ___ f. Processing and output control?

___ ___ ___ g. Data and report distribution?

___ ___ ___ 3. Are there adequate controls over the process of identifying, correcting, and re-processing data rejected by the computer program?

___ ___ ___ 4. Are procedures in place to ensure that all transactions are keyed in a timely manner?

___ ___ ___ 5. Is the data processed by the computer uniform, controlled and authorized?

6. Does the initiating department independently control data submitted for processing through use of:

___ ___ ___ a. A turn-around transmittal document?

___ ___ ___ b. Record counts?

___ ___ ___ c. Dollar totals?

___ ___ ___ 7. Are source documents retained for a sufficient period and in an adequate manner to permit identification with output records if the need arises?

___ ___ ___ 8. Are sufficient generations of files maintained to facilitate reconstruction of records?

___ ___ ___ 9. Is at least one generation maintained in a location other than the tape storage area?

___ ___ ___ 10. Is off-site computer file storage used?

___ ___ ___ 11. Are there provisions for retaining and/or copying master files, and is there practical means of reconstructing a damaged or destroyed file?

___ ___ ___ 12. Are documented backup procedures established with another compatible data center to cover a natural disaster or other emergency situation?

___ ___ ___ 13. Are responsibilities segregated to assure that no one individual has the ability to input data, process data, and review output data?

14. If a terminal is used to transmit or receive data, are:

___ ___ ___ a. Authorization codes required?

___ ___ ___ b. Separate codes assigned to each user of the system?

___ ___ ___ c. Transaction data logs used to provide a partial audit trail, including: originating terminal and message ID; transaction type code; time of day that the transaction is logged; and a copy of the transaction records?

___ ___ ___ 15. Is there a control in place to verify that the computer generated check number matches the number printed on the check?

___ ___ ___ 16. Is there a control in place to verify that the computer generated voucher number matches the number printed on the check?

___ ___ ___ 17. Are data files and programs protected against:

___ ___ ___ a. fire and other hazards?

___ ___ ___ b. unauthorized entry and/or use?

___ ___ ___ 18. If the processing center is involved with payroll operations, are adequate controls exercised over blank checks?

___ ___ ___ 19. Is there a security software package to restrict and control users' access?

___ ___ ___ 20. Is physical access to the computer center restricted?

___ ___ ___ 21. Is physical access to on-line terminals restricted?

___ ___ ___ 22. Does every user have a unique user-id/password?

___ ___ ___ a. Are user passwords kept secret from other users?

___ ___ ___ b. Are user passwords changed periodically?

___ ___ ___ c. Are users aware of the confidential nature of their passwords?

___ ___ ___ 23. When an employee is terminated, are the following precautions implemented immediately:

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

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

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

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

B. Monitoring:

___ ___ ___ 24. Is someone assigned to review output for general acceptability and completeness?

___ ___ ___ 25. Does management investigate security violations?

___ ___ ___ 26. Does management restrict users' access to the minimum level needed to perform job?

___ ___ ___ 27. Have procedures been documented for disaster control and recovery for both computer and manual operations?

___ ___ ___ 28. 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 ___________

A. Control Activities / Information and Communication:

Yes No N/A

___ ___ ___ 1. Do flowcharts exist that document investment processing and identify control procedures?

___ ___ ___ 2. Are there written policies and procedures that document the flow of investment processing and identify control procedures?

___ ___ ___ 3. Are policies and procedures established to ensure investment certificates are received or appropriately reflected in the custodial accounts?

___ ___ ___ 4. Are investment purchases recorded in the general ledger on the date traded?

___ ___ ___ 5. Is the documentation easily accessible to all persons needing it to perform their job?

___ ___ ___ 6. Are policies and procedures established to ensure the acquisition and disposal of investments are properly recorded?

___ ___ ___ 7. Are policies and procedures established to ensure investment income received is recorded properly?

___ ___ ___ 8. Does investment income earned get recorded on a timely basis?

___ ___ ___ 9. Are investment earnings credited to the proper fund?

___ ___ ___ 10. Is the acquisition and disposal of investments authorized by a person with approval authority?

___ ___ ___ 11. Are investment guidelines formally established and periodically reviewed?

___ ___ ___ 12. Have authority and responsibility been established for investment opportunity evaluation and purchase?

___ ___ ___ 13. Has the level and nature of approval required to purchase or sell an investment been established?

___ ___ ___ 14. Are the following duties generally performed by different people:

___ ___ ___ a. Cash flow management, investment transactions, safeguarding the investments, responsibility for them and recording them?

___ ___ ___ 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 function?

___ ___ ___ d. Monitoring investment market values and performance from those for 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?

___ ___ ___ 15. Does a governing body or statute restrict investments by type and/or amount ? Can officials override these restrictions with proper authorization?

___ ___ ___ 16. Are investment certificates and interest coupons sufficiently safeguarded?

___ ___ ___ 17. Are securities released from the vault only upon authorization of a person responsible for cash flow and for investment transactions?

___ ___ ___ 18. Is it necessary for more than one person to authorize the release of a security from safekeeping, or to have access to the safe deposit box or vault?

___ ___ ___ 19. Are individuals with access to securities bonded?

___ ___ ___ 20. Are securities transported by armored truck?

___ ___ ___ 21. Are all securities held or registered in the name of the agency or the State Treasurer if applicable?

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

___ ___ ___ a. Date of acquisition, identification and purchase amount or cost?

___ ___ ___ b. Physical location of item, i.e., safe deposit box, etc.?

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

___ ___ ___ d. Ownership by fund?

___ ___ ___ 23. Do procedures exist for reconciling the detail accounting records with the general ledger control?

___ ___ ___ 24. Do specific procedures exist for tracking maturing investments and interest payments?

___ ___ ___ 25. Is the investment program integrated with the cash management program and expenditure requirements?

___ ___ ___ 26. Are competitive bids sought for certificate of deposit purchases?

B. Monitoring:

___ ___ ___ 27. Is the classification of investments in the general ledger periodically reviewed? Are these classifications properly documented by management?

___ ___ ___ 28. Does a responsible official determine that the income earned is credited to the proper fund?

___ ___ ___ 29. In respect to question 15 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?

___ ___ ___ 30. Is the performance of the investment portfolio periodically evaluated by persons independent of investment portfolio management activities?

___ ___ ___ 31. Are appropriate personnel authorized to release securities from safekeeping authorized by the governing body?

___ ___ ___ 32. 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 broker?

___ ___ ___ 33. Does management periodically count securities and reconciled them to the records?

___ ___ ___ 34. Are periodic surprise counts of evidence of ownership made and reconciled to detail records and other controls?

___ ___ ___ 35. Are securities periodically inspected or confirmed from safe-keeping agents?

___ ___ ___ 36. Are periodic comparisons made between income received and the terms of the security or publicly available investment information?

Office of the State Controller

Self-Assessment of Internal Controls

Debt Cycle

Objectives and Risks

Agency ____________________________ Year-End _________

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. **Cycle is applicable only to organizations that can legally issue debt. This will exclude most state agencies and related entities.**	• 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. **This objective will not be applicable to most state organizations. Most entities will not have negotiable instruments**	• 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 __________

A. Control Activities / Information and Communication

**** **Question will probably be N/A**

Yes	No	N/A		
___	___	___	1.	Is there a formal plan of organization under which 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 policies established to ensure that the redemption of mature debt is correctly recorded as to amount and fund?

___ ___ ___ 12. Are policies 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 periodically?

16. If practical, are the following duties generally 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 require the signature of two responsible officials who are authorized signers and who are independent of each other?

___ ___ ___ 19. Is unissued debt kept in a vault which has limited access? ****

___ ___ ___ 20. Is debt issued only in the agency's name or in the State's name.?

___ ___ ___ 21. Are unclaimed interest checks on bonds kept under adequate physical control by a responsible employee? ****

___ ___ ___ 22. If fiscal agents are used for the payment of bonds and interest, does the agency receive periodic reports of bonds outstanding and unclaimed interest?

___ ___ ___ 23. Is the agency meeting the arbitrage rebate requirements for all tax-exempt financing?

B. Monitoring:

___ ___ ___ 24. Are redeemed bond coupons canceled and accounted for prior to payment of bond interest and reconciled to bond records by an independent employee? ****

___ ___ ___ 25. 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)?

___ ___ ___ 26. Does a responsible official determine that debt is retired from the appropriate revenue sources?

___ ___ ___ 27. Does a responsible official periodically determine whether the governmental unit is in compliance with agreement restrictions and report results to a higher authority?

___ ___ ___ 28. Does a responsible official review lease agreements in effect to identify and properly account for lease purchase transactions?

___ ___ ___ 29. Does a responsible official review use of proceeds from bonds sales to ensure that proceeds are used in accordance with legal requirements?

___ ___ ___ 30. If bonds and bond coupons are cremated by a fiscal agent, does the agency receive periodic reports accounting for bonds and bond coupons cremated?

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	Distributions from Pensions, Annuities, and Retirements	All Amounts	January 31	February 28

	Retirement				
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, <u>Notice to Third Party of Social Security Assignment</u> 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 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, <u>Notice to Third Party of Social Security Assignment</u> 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 <u>Annual Return of Withheld Federal IncomeTax</u> , 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?

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.)?

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 2007 calendar year the allowable Federal cents per mile rate is 48.5 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 5.5 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

2007, this rate is 48.5 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 5.5 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 13 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 $.485/mile for round trips under 60 miles and $.25/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 $.20/mile (moving mileage rate) 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 $.485/mile for 2007, not the $.20/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. Did the agency furnish a completed IRS Form 4782, Moving Expense Information form to the employee to assist the employee in preparation of his/her individual tax return?

___ ___ ___ 8. Were all non-taxable moving expense reimbursements reported to the payable system as informational items on the employees' W-2 Forms?

___ ___ ___ 9. 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 accounting system of the (*name of the agency*). *State reasons why the cycle will not be applicable to the entity.*

Office of the State Controller

Self-Assessment of Internal Controls

Example of Inadequate Internal Control

Section: E-Accounts Receivable

Page: E-42 **Procedure:** 31a

Problem noted:

One employee performs the billing, collecting and posting of accounts receivable at the entity. The entity has a limited number of employees.

Corrective action taken:

The accounting employee will perform the billing and posting of accounts receivable. The secretary for the fiscal division will collect the accounts receivable. The supervisor will review the billing and posting. Due to the size of the entity, this action is the most cost effective action taken to obtain stronger internal controls.

Effective date:

Next billing cycle.

Example of Inadequate Internal Control

Section: E-Accounts Receivable

Page: E-45 **Procedure:** 22a

Problem noted:

One employee performs the billing, collecting and posting of accounts receivable at the entity.

Corrective action taken:

The duties among the accounting personnel will be redistributed to allow the billing, collecting and posting of receivables to be performed by different personnel.

Effective date:

Immediately.