



Auditors' Workshop
Vermont League of Cities & Towns
&
Vermont State Auditor's Office
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Auditors' Workshop
Overview

- Role of Town Auditor
- Importance of Clarity and Specificity in the Town Auditors' Report
- Practical Approach

Role of Town Auditor Audit Concept

Audit exists because interested individuals or groups are unable for one or more reasons to obtain for themselves the information or reassurance they require.

An audit is a mechanism to monitor conduct and performance and to secure or enforce accountability.

Role of Town Auditor Evolution of Auditing

- Pre-industrial revolution (pre-1840)
- Industrial revolution (1840's – 1920's)
- 1920's – 1960's
- Post 1960's

Role of Town Auditor

Evolution of Auditing, cont'd

Where does this leave Town Auditors?

Vermont statutes direct which accounts to examine and the financial reports that must be presented. Silent with regard to extent of testing and the form and content of the auditors' report.

Use judgment to determine extent of testing and write the report so that town residents may understand what was tested and the extent of the testing conducted.

Importance of Reporting

- Communicates the objective of the examination, identifies the accounts and reports reviewed, the procedures performed, conclusion about the validity of the town's/school district's financial position and findings, if applicable.
- Clear statements regarding the objective(s), the scope and methodology of the procedures conducted and the assurance being provided over the town's financial position

Importance of Reporting

Example 1

- We have examined the finances as presented to us by the Town Treasurer. We have verified stated cash balances, inspected certificates of deposit, loan documents, and investment account statements. Checks have been written according to statements and warrants. **The town's current assets are correctly stated in the Summary of Town Accounts, the Inventory of Real Estate, the Inventory of Road Equipment and the Volunteer Fire Department Accounts Report.**

- We have examined the finances as presented to us by the School District representative. We have verified stated cash balances and inspected certificates of deposit. Checks have been written according to statements and warrants. **We believe the reports presented here represent the financial position of the School District on June 30, 2009, and give an accurate account of the funds during the school year.**

Observations about possible procedures, based upon information in report

- Confirmed account balances with banks, tested bank and investment account reconciliations, reviewed cash rollforward
 - Read loan documents and compared detail loan listing (presents loan re-payment schedule) to amount recorded in the trial balance and vouched loan payments per accounting system to authorizations for payment and actual payment as shown in bank statements.
 - Compared all expenditures to an invoice or other document showing reason for payment and to warrants to ensure appropriate authorization.
 - The procedures don't seem to extend to all of the assets listed in the various reports so it isn't easy to see how town auditors determined that the assets were correctly stated (i.e. delinquent taxes receivable were listed on General Fund Balance Sheet, but weren't discussed in the report)
- School report – similar observations, particularly given the complexity of the reported statements

Importance of Reporting

Example 2

- In accordance with Section 1681 of Title 24, V.S.A., we have examined the accounts and records of the town. **To the best of our knowledge, the financial statements and reports show the financial activity and financial position of the Town for the calendar year ended June 30, 2009.**

Observations about possible procedures, based upon information in report

- Reader may infer from report language that all accounts and records were subject to detail examination (we have examined the accounts and records). Not entirely clear what is meant by "the financial statements and reports show the financial activity and financial position" – not a conclusion about the presentation.
- For example: (1) Total revenues of \$1,495,135 are reported in the General Fund. Property taxes – gain understanding of controls over property tax billing/collection cycle. Obtain and review a detail report that agrees to amount reported in the general ledger. Select a sample of tax bills to verify that appropriate rates were billed to residents. Vouch selection of proceeds. (2) Report of inventory of town property – validation of existence of the property and equipment (original purchase documentation and conduct physical inspection to verify existence and still in use)

Importance of Reporting Example 3

- We, the Auditors, have this day, January 14, 2010, completed an audit of the books of the various Town Officers and **find all books accurate and correct.**

Observations about possible procedures, based upon information in report

- Very high level of assurance - reader may infer from report language that all accounts and records were subject to extensive testing.

Importance of Reporting Example 4

- We have audited the financial statements, accounts and records of the Town, Town Clerk, and the Cemetery Commission which are included in this annual report. **In our opinion, the above reports fairly present their financial position as of December 31, 2009.**

Observations about possible procedures, based upon information in report

- Language may be based on a typical opinion issued by a public accounting firm.
- Scope and methodology not entirely clear
- Use of the phrase "fairly presents"

Importance of Reporting

Objective

- We conducted our work according to 24 V.S.A. 1681 – 1684, which, among other things, require that we examine and adjust the accounts of all town and town school district officers and all other persons authorized by law to draw orders on the town treasurer. In particular, for the Town of XX, these accounts are as follows: (list of all town and town school district accounts).
- Our objectives were to (1) validate the correctness of the town and school district accounts, (2) detect fraud or errors in these accounts and (3) verify the financial condition of the town and school district as reported in (list of reports) as of and for the year ended December 31, 2010.

Importance of Reporting

Scope and methodology

- To accomplish these objectives, we obtained an understanding of the operation of the town's government, including internal controls over financial transactions. In particular, we reviewed the town's charter and interviewed town officials to gain an understanding of the town's operations. In particular, we reviewed the town's accounting system, cash handling procedures and segregation of duties. To verify the existence and period end balance of the cash and investment accounts, we confirmed the period end balances with the bank, reviewed and tested reconciling items for 5 monthly bank reconciliations during the year and 5 monthly investment account reconciliations. In addition, we performed a cash proof for all accounts with greater than \$xx of activity during the year ending 12/31/10. A cash proof consists of
- We also verified the existence and reported value of the town equipment and buildings. Our procedures included, selecting all equipment with value > xx and obtaining the original invoice, ensuring the equipment was being depreciated in accordance with the town's policy and performing a physical examination of the equipment to verify its existence and that it was in operation.
- Receivables
- Debt
- Revenue

Importance of Reporting

Conclusion

- Based on the procedures we performed,

Importance of Reporting

Findings

Approach

Overall Concepts

- Independence and objectivity
- Planning & gaining an understanding of internal control
- Scope & methodology
- Test procedures

Approach

Independence

Maintain levels of integrity, objectivity and independence. A conflict of interest can create an appearance of impropriety that can undermine confidence in the auditor.

- Recognize that the chief function is to serve the best interests of the municipality in a manner that is independent in fact and appearance.
- Accept as a personal duty the responsibility to conduct the examination to the best of their ability and with fairness, impartiality, efficiency, and effectiveness.
- Demonstrate the highest standards of personal integrity, truthfulness, honesty, and fortitude in all activities in order to inspire confidence and trust in the process.
- Avoid any interest or activity that is in conflict with the conduct of the official duties.
- Respect and protect privileged information to which there is access in the course of official duties.

Approach Planning

- Planning
 - Gain understanding of the municipalities operations
 - Which town officer(s) performs financial operations?
 - What and how frequently is financial information provided to the select board?
 - What are the revenue sources?
 - What are the trust funds and which town official manages them?
 - Review financial reports included in prior year(s) annual reports
 - Review budget to actual reports for the prior year and the period under audit
 - Consider whether there have been significant changes in operations during the period under audit (i.e. has the municipality issued a bond, implemented a local option tax, or commenced a tax incentive financing district)
 - Consider factors external to the town which may impact the towns financial results (i.e. has there been significant market turmoil which might negatively impact the town's investment accounts)

Approach Internal Control

- Consists of all the methods and measures used by a municipality to monitor assets, prevent fraud, minimize errors, verify the correctness and reliability of accounting data, promote operational efficiency, and ensure that established managerial policies are followed.
- One of the most understood reasons for a policy for internal control procedures is to **protect assets**, cash being the most obvious.
 - Other objectives are to ensure reliability of financial reporting and compliance with applicable laws and policy objectives.

Approach

Internal Control, cont'd

- Some basic techniques to **protect assets** are to make timely deposits, store cash in a safe place, and segregate duties. For example, the same person should not be allowed to authorize a transaction, record the transaction or maintain custody of the asset resulting from the transaction.
- To ensure the **reliability of financial reporting**. Are duties properly assigned and segregated? Are account reconciliations done on a regular basis? Is someone independent of the preparation of the reconciliation reviewing it?
- To ensure **compliance with applicable laws and policy objectives**. The governing body needs to identify these laws, institute policies, establish controls, and document compliance.

Approach

Internal Control, cont'd

Some activities that should be used by the towns for monitoring are periodic reconciliations, verifications, and analytic reviews. Some examples of these are:

- Reconcile the cash reported in accounting records with the balance reported on bank statement;
- General ledger accounts (such as taxes receivable) should be reconciled to related amounts reported in subsidiary ledgers (individual tax payer accounts);
- Undertake a physical inventory and compare with accounting records;
- Compare budget to actual for revenues and expenses.

Approach Scope & Methodology

The understanding of municipal operations (i.e. the universe of financial operations) gained in planning and considering internal controls should be used to determine the scope of testing and the approach to testing

Approach Checklist

Refer to handouts

Miscellaneous & Questions

- **Single Audit Act**
 - If the municipality expended federal assistance in excess of \$500,000 it may be required to have an audit under the requirements in Governmental Auditing Standards or the Single Audit Act (*OMB Circular A-133*). Check with the federal granting authority regarding the type of audit necessary.

Appendix A
INTERNAL CONTROL QUESTIONNAIRE

Town of _____

Date _____

NOTE: A "NO" answer denotes a weakness which must be fully explained.

<u>General</u>	<u>Yes</u>	<u>No</u>	<u>N/A</u>	<u>Remarks</u>
1. Are officials' and employees' duties reasonably fixed as to responsibilities?	___	___	___	_____
2. Is the town in compliance with state statutes covering incompatible offices?	___	___	___	_____
3. Is a procedures or policy manual in place?	___	___	___	_____
4. Is insurance coverage reviewed periodically by qualified individuals to determine adequacy?	___	___	___	_____
5. Does the comprehensive liability policy include liability coverage for all officials and employees?	___	___	___	_____
6. Is a budget system (including monthly or quarterly budget reports) used for watching income and expenses?	___	___	___	_____
7. Are cash projections made?	___	___	___	_____
8. Are all employees/officials who handle town funds covered by surety and/or performance bonds?	___	___	___	_____
<u>Financial Records</u>				
1. Are detailed cash receipts journals maintained?	___	___	___	_____
2. Are detailed cash disbursements journals maintained?	___	___	___	_____
3. Are selectboard records (if separate records other than orders are kept) reconciled with treasurer's records monthly?	___	___	___	_____
4. Are accounting records kept up to date and balanced monthly?	___	___	___	_____
5. Is a chart of accounts used?	___	___	___	_____
6. Are records properly guarded from fire, theft and manipulation?	___	___	___	_____

Appendix A INTERNAL CONTROL QUESTIONNAIRE

	<u>Yes</u>	<u>No</u>	<u>N/A</u>	<u>Remarks</u>
<u>Cash Receipts</u>				
1. Is receipt of currency adequately controlled until deposited or remitted to the treasurer?	—	—	—	_____
2. Have safeguards been provided to prevent officials or employees from cashing checks payable to the town?	—	—	—	_____
3. Are all monies received by the town turned over intact daily to the person who makes bank deposits?	—	—	—	_____
4. Are funds received over the counter controlled by counter receipts?	—	—	—	_____
<u>Purchasing</u>				
1. Are selectboard orders: <ul style="list-style-type: none"> • Required for all purchases? • Signed by a majority of the board? 	—	—	—	_____
2. Are purchasing, receiving, and disbursing functions entirely separate?	—	—	—	_____
3. Are there adequate procedures for controlling the receiving of all goods and services purchased?	—	—	—	_____
4. Are materials and supplies inspected for condition and counted when received?	—	—	—	_____
5. Does the processing of invoices for payment include a mathematical check of footings, extensions, and discounts?	—	—	—	_____
<u>Cash Disbursements</u>				
1. Are all cash disbursements, except petty cash items, made by check?	—	—	—	_____
2. Are prenumbered checks used?	—	—	—	_____
3. Is a controlled, mechanical check protector used?	—	—	—	_____
4. Are all investments, except trust funds, approved by the selectboard?	—	—	—	_____
5. Is petty cash handled through a fixed amount account?	—	—	—	_____

Appendix A
INTERNAL CONTROL QUESTIONNAIRE

	<u>Yes</u>	<u>No</u>	<u>N/A</u>	<u>Remarks</u>
<u>Payroll</u>				
1. Are personnel records (including wages, salaries and deductions) maintained for all employees?	___	___	___	_____
2. Are salary and wage rates formally approved in the selectboard's minutes?	___	___	___	_____
3. Are methods of accumulating time and recording absences satisfactory?	___	___	___	_____
4. Are payroll deductions properly approved and controlled?	___	___	___	_____
5. Are withholding taxes remitted properly?	___	___	___	_____
<u>Property and Equipment</u>				
1. Are schedules of fixed assets maintained?	___	___	___	_____
2. Are periodic inventories taken and compared with the schedules of fixed assets?	___	___	___	_____
<u>Notes and Investments</u>				
1. Are schedules maintained of all borrowing and investing activities?	___	___	___	_____
<u>Grand List and Tax Records</u>				
1. Is a system used (ideally a tax map) to be certain that all taxable property is included in the grand list?	___	___	___	_____
2. Does the delinquent tax collector turn all receipts over to the treasurer so that the collector's fees can be entered into the town's books as wages?	___	___	___	_____
3. Does the town have adequate follow-up policies with delinquent taxpayers?	___	___	___	_____
4. Does someone other than the tax collector (delinquent and current) reconcile taxes?	___	___	___	_____
<u>Enterprise Funds</u> (water, sewer, etc.)				
1. Do accounting practices for enterprise funds follow guidelines listed above for all other town funds?	___	___	___	_____
2. Is the follow-up on delinquent accounts adequate?	___	___	___	_____

Appendix A
INTERNAL CONTROL QUESTIONNAIRE

Comments on procedures/areas of weakness:

Recommendations:

Internal control review completed by:

Date:

Documentation of work

Appendix B
AUDIT CHECKLIST

Town _____

Period Covered _____

GENERAL PROCEDURES

Date & Initials

- 1. Read prior year's audit notes. _____
- 2. Read minutes of town's annual/special meetings; trace budget to minutes of meeting(s) to determine proper authorization. _____
- 3. Read minutes of selectboard's meetings to check for items which affect town's financial condition:
 - a. Salary rates and changes.
 - b. Ordinances and resolutions adopted.
 - c. Approval of tax anticipation borrowing.
 - d. Transfers or loans between funds.
 - e. Grant applications.
 - f. Sale and purchase of major equipment.
 - g. Discussion of contingent liabilities – e.g., lawsuits. _____
- 4. Examine and schedule surety bonds for town officials; determine adequacy of coverage; prepare conclusion. _____
- 5. Send letters to area banks for confirmation of account and loan balances. _____

Petty Cash

- 1. Count petty cash fund. _____
- 2. Reconcile to amount authorized for fund. _____
- 3. Test a sample of reimbursements to petty cash fund. _____

Cash Receipts Journal

- 1. Test accuracy – foot, cross foot. _____
- 2. Trace totals to ledger or to financial statement. _____
- 3. Agree to supporting documentation – remittance advices, bills, etc. _____
- 4. Trace to postings in subsidiary ledgers, e.g., grand list, water receipts cards or ledger, etc. _____
- 5. Trace deposits to bank statements. _____
- 6. Agree all large state and federal revenues to the confirmation letter to make sure that the money has been received and recorded by the town. _____

Appendix B
AUDIT CHECKLIST

Date & Initials

Grand List

1. Check totals on listers cards with amount entered on grand list. _____
2. Trace from building permits and land transfer records to make sure any resulting changes are reflected in the grand list. _____
3. Recalculate individual tax levies. _____
4. Check math accuracy. Do a total calculation: total of grand list \times approved rate. _____

General Fixed Assets

1. Complete an inventory for general fixed assets. _____
2. Prepare a list of general fixed assets to be included in town report (or request that such a list be prepared). _____

Cash Disbursements Journal

1. Test accuracy. _____
2. Choose sample of disbursements; trace to invoices. (Account for all check numbers before choosing a sample.) _____
3. Agree to cancelled checks. _____
4. Agree to signed board orders. _____
5. Check to any other required approval (e.g., department head, manager). _____
6. Check account distribution. _____

Payroll Journal

1. Trace rate of pay for authorization. _____
2. Recalculate gross pay. _____
3. Check account distribution. _____
4. Agree to cancelled checks. _____
5. Agree to signed board order. _____
6. Agree to other authorization if required. _____
7. Check to be certain that withholdings are being done properly and *remitted*. _____

Appendix B
AUDIT CHECKLIST

Date & Initials

Cash

1. Review reconciliation: agree "balance per banks" to statement or confirmation. _____
2. Review reconciliation: agree "balance per books" to ledger or checkbook balance. _____
3. Verify deposits in transit and outstanding checks to deposits and checks clearing with the next statement. _____
4. If serious weakness in internal control, consider cash proof: agreeing bank activity to book activity for one month, several months or one year. _____
5. Complete a transfer test (all transfers recorded in same year). _____
6. Check savings and CD activity; verify reasonableness of interest income. _____

Delinquent Taxes Receivable

1. Foot list. _____
2. Trace to grand list. _____
3. Confirm with taxpayers directly (can be done on sample basis). _____
4. Review reconciliation: beginning balance plus delinquent bills sent to collector minus receipts minus abatements equals ending balance. Verify all elements of the calculation. _____
5. Compare delinquent tax receipts each month to entries in the delinquent tax receivable list. _____

Other Accounts Receivable

1. Trace to bills. _____
2. Check subsequent receipts. _____
3. If material, confirm with debtors. _____

Accounts Payable

1. Agree to bills. _____
2. Review subsequent disbursements. _____
3. Confirm balances with known vendors. _____

**Appendix B
AUDIT CHECKLIST**

Date & Initials

Trust Funds

- 1. Make sure that they are complying with trust agreements. _____
- 2. Check investments; examine securities. _____

Financial Statements

- 1. Trace numbers to ledger or journal totals. _____
- 2. Check to be certain that all required statements are presented. _____
- 3. Check math. _____
- 4. Complete an analytical review. Compare revenues and expenditures to budget. Get explanations for variances. Analyze accounts with unusual balances. _____
- 5. Make sure that any required disclosures are presented in report, e.g.:
 - a. Basis of accounting.
 - b. Any lawsuits, etc.
 - c. Anything that might affect the financial future of the town. _____

Miscellaneous Procedures

- 1. Verify the amounts paid to the school. _____
- 2. Agree all interfund payables/receivables. _____

Def

Remarks/Comments on Procedures:

Audit completed by:

Date:

Yes No N/A

7 Do the cash and investment balances in the general ledger match the Treasurer's reconciled bank balances?

How often are they reconciled?

- _____ Monthly
- _____ Quarterly
- _____ Annually

8 Is a copy of the Treasurer's monthly bank reconciliation reports provided to the bookkeeper?

9 Does the person who maintains the general ledger also:

- Sign (authorize) checks?
- Control unused check stock?
- Prepare bank reconciliations?
- Handle incoming receipts?

10 Does the general ledger track receivable balances for:

- Property taxes?
- Water?
- Sewer?
- Other (identify): _____

If not, how are receivables tracked?

11 Does the general ledger track accounts payable?

If not, how are payables tracked?

12 Are general ledger receivable balances reconciled to the Tax Collector's detail receivable lists (if applicable)?

How often?

- _____ Monthly
- _____ Quarterly
- _____ Annually

13 Does the general ledger system provide budget versus actual expenditure reports?

14. If yes, to whom are the budget versus actual reports distributed?

How often?

- Daily _____
- Weekly _____
- Monthly _____

15. Are computer back-ups of the general ledger performed?

How often?

If yes, where?

Yes No N/A

14 Are general ledger adjusting journal entries made? _____

If yes, are they approved by anyone other than the preparer? _____

Name and title of person who approves: _____

15 Are computer back-ups of the general ledger performed? _____

How often?

- _____ Daily
- _____ Weekly
- _____ Monthly

16 Are computer back-ups stored off site? _____

If yes, where? _____

Observations - Part 1. General Ledger & Financial Records

Comments on procedures or areas of weakness:

Recommendations:

General ledger section completed by:

Date: _____

Part 2. Treasurer/Cash

<u>Questions</u>	<u>Yes</u>	<u>No</u>	<u>N/A</u>
1 Does the Treasurer maintain a cash book to track all receipt and disbursement activity for all cash accounts? If no, explain: _____ _____ _____	_____	_____	_____
2 Does the Treasurer's cash book document the remittances from departments and deposits to the bank? If no, explain: _____ _____ _____	_____	_____	_____
3 Does the Treasurer's cash book document vendor/payroll disbursement manifests (check run) numbers and amounts? If no, explain: _____ _____ _____	_____	_____	_____
4 Do month-end cash book balances match actual bank reconciliation balances? If no, explain: _____ _____ _____	_____	_____	_____
5 Are monthly bank statements as of the last day of the month?	_____	_____	_____
6 Are bank reconciliations prepared each month, within a month of the statement date, for each cash account? If no, explain: _____ _____ _____	_____	_____	_____
7 Who prepares bank reconciliations? _____ Name Title			
8 Are monthly bank reconciliations documented, signed, and retained?	_____	_____	_____

Yes No N/A

9 Are monthly bank reconciliations reviewed and signed off by anyone in addition to the preparer?

If yes, by whom?

Name

Title

10 Is a copy of the monthly bank reconciliation report provided to the bookkeeper?

11 Who is authorized to transfer money between or out of the municipality's bank accounts?

Name

Title

Name

Title

Name

Title

12 Who has the authority to sign (authorize) checks?

Name

Title

Name

Title

Name

Title

13 Do any signature stamps exist?

If yes, are they stored in a secure location?

Are there procedures in place for its use?

14 Is a check signing machine used?

If yes, is it locked and the key stored in a secure location?

Who has access to the signature stamp or machine? _____

15 Is a log maintained to track the chronological sequence of all check numbers issued and voided?

16 Who is responsible for making bank deposits?

Name

Title

Name

Title

Name

Title

- | | <u>Yes</u> | <u>No</u> | <u>N/A</u> |
|--|------------|-----------|------------|
| 17 Are undeposited receipts held in a secure location? | _____ | _____ | _____ |
| 18 Does the Treasurer reconcile total annual Tax Collector receipt remittances (turnovers) to the Tax Collector's records?
(if applicable)
Is that documented? | _____ | _____ | _____ |
| 19 Does the Treasurer reconcile total annual Town Clerk receipt remittances (turnovers) to the Town Clerk's records?
(towns only)
Is that documented? | _____ | _____ | _____ |
| 20 Does the Treasurer reconcile total annual governing body receipt remittances (turnovers) to their records?

Is that documented? | _____ | _____ | _____ |
| 21 Has the municipality adopted (and annually updated) an investment policy? | _____ | _____ | _____ |
| 22 Document other non-general fund cash accounts maintained by the Treasurer (e.g., conservation commission, police revolving, celebration accounts, etc.) | _____ | _____ | _____ |

Account Name	Who authorizes payments?	Reported in general fund?
_____	_____	_____
_____	_____	_____
_____	_____	_____

Part 2. Treasurer/Cash Testing

Yes No N/A

Year End Bank Reconciliations

Obtain year-end documented bank reconciliations and test the following:

1 Do "balances per bank" match actual bank statement balances? _____

2 Do "deposits in transit" appear on the following month's bank statement? _____

If no, explain: _____

3 Were "deposits in transit" posted as receipts in the year-end general ledger cash accounts? _____

4 Do "outstanding checks" match a detail list of actual outstanding checks? _____

5 Is the last outstanding check posted as a disbursement in the year-end general ledger cash account? _____

6 Are other reconciling items appropriately documented? _____

Explain other reconciling items: _____

Obtain 3 other months of documented bank reconciliations and test the following:

7 Do balances per bank match actual bank statement balances? _____

8 Do depositis in transit appear on the following month's bank statement? _____

Cash Book

9 Do year-end balances in the cash book match the actual bank statement reconciliations? _____

10 Trace xx vendor and xx payroll disbursement entries in cash book to actual "orders" (warrants) signed by the majority of the governing body (e.g., Board of Selectmen, Village Commissioners, School Board)

Traced to
Approved Order
(Manifest)?

	Date of Order	Order Number	Amount	
Vendor	_____	_____	\$ _____	_____
Vendor	_____	_____	\$ _____	_____
Payroll	_____	_____	\$ _____	_____
Payroll	_____	_____	\$ _____	_____

Yes No WA

Date	Order Number	Vendor	Amount
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

11 Trace xx deposit entries in cash book to actual bank statement deposits and to corresponding departmental remittances.

Date of Deposit	Amount	Traced to Actual Bank Statement deposit?
_____	\$ _____	_____
_____	\$ _____	_____
_____	\$ _____	_____
_____	\$ _____	_____

Other Bank Accounts

12 For "other non-general fund" cash accounts, select three months of bank statements.

Do all year end general ledger cash balances match corresponding bank reconciliations? Yes No N/A

Select a random sample of xx disbursements from the general ledger and trace to supporting vendor invoices.

<u>Date</u>	<u>Check Number</u>	<u>Vendor</u>	<u>Amount</u>
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

Observations - Part 2. Treasurer

** Consider performing a Proof of Cash, if concerns exist regarding lack of segregation of duties or other issues have been noted.

Comments on procedures or areas of weakness:

Recommendations:

Treasurer section completed by: Date: _____

Part 3. Tax Collector (if applicable)

<u>Questions</u>	<u>Yes</u>	<u>No</u>	<u>N/A</u>
1 What software system is used to track receivables? (ex. Quickbooks; Excel; Peachtree; BMSI, etc.) _____			
2 Were reports from the receivable software system used to prepare the report for the town's annual report? If yes, were these reports retained?	___	___	___
3 Document frequency of cash outs (close out, receipt proof) and deposits: ___ Daily ___ Weekly ___ Monthly ___ Other (describe) _____			
4 Are cash out proofs documented on a form and signed by the preparer? If no, explain: _____ _____	___	___	___
5 Is the cash out form reviewed/approved by anyone else? If yes, who? _____	___	___	___
6 Are receipts remitted to the Town Treasurer at least weekly? If no, explain: _____ _____	___	___	___
7 Are computer backups of the tax receivable system performed? If yes, how often? ___ Daily ___ Weekly ___ Monthly Are the backups stored off site?	___	___	___
8 Is there a deputy? Name of Deputy? _____			

9 How often is the Tax Collector's Receivable Report prepared?

- Monthly
- Quarterly
- Annually

10 Who has posting capability to the Tax Collector's receivable system?

Name

Title

Name

Title

Name

Title

11 Does the Tax Collector maintain any bank accounts?

Yes No N/A

Part 3. Tax Collector Testing (if applicable)

Tax Collector's Report

Yes No N/A

1

Test activity of the Tax Collector report.

A Beginning uncollected receivable balances agree to the amount reported in the prior year town report?

___ ___ ___

B Tax commitments proven to actual warrants approved by the governing board (e.g., Board of Selectmen) for each type of tax (e.g., municipal property taxes, local option, water/sewer)?

___ ___ ___

C Abatements proven to list of actual abatements issued?

___ ___ ___

D Remittances (collections) proven to general ledger receipt records?

___ ___ ___

E Conversion to lien amounts proven to list of actual liens taken?

___ ___ ___

F Ending uncollected receivable balances proven to actual list of receivable accounts?

___ ___ ___

G Have all prior year uncollected property taxes receivable been lienied?

___ ___ ___

If no, why? _____

Cash Out Records

2 Select a sample day to test the Tax Collector's cash out/deposit records:

A Does the above selected remittance form document include the following?:

Date? _____

Breakdown of receipts by type and levy year? _____

Breakdown of currency and checks? _____

A total of the receipts? _____

Signature of preparer? _____

Signature of reviewer? _____

___ ___ ___

___ ___ ___

___ ___ ___

___ ___ ___

___ ___ ___

___ ___ ___

Yes No N/A

B For the day selected, is there a batch of duplicate tax stubs or cash register tape to prove the:

Breakdown of receipts by type and levy year?

Breakdown of currency and checks?

Total receipts?

___ ___ ___
___ ___ ___
___ ___ ___

C For the day selected, is the total receipt amount/deposit in agreement with an actual deposit reported on a bank statement?

___ ___ ___

D For the day selected, is the total receipt amount/deposit in agreement with a "day sheet" (list of receipts by customer) to prove customer accounts were posted/credited properly?

___ ___ ___

Abatements

3 From the list of actual abatements issued, select three abatements for testing:

Date Taxpayer Amount

Date Taxpayer Amount

Date Taxpayer Amount

Is there an actual abatement form signed by a majority of the Board of Selectmen or assessors for each abatement?

___ ___ ___

Were any abatements on the list issued to known related parties (e.g., members of the Board of Selectmen, town employees, relatives)?

___ ___ ___

If yes, _____

Tax Collector Cash Account

4 If the Tax Collector maintains a checking account, obtain bank statements for three random months:

Months selected: _____

Were all disbursements made during these three months payable to the Town?

___ ___ ___

Were remittances to the Town made timely?

___ ___ ___

Were bank statements reconciled to cashbook balances?

___ ___ ___

Observations - Part 3. Tax Collector

Comments on procedures or areas of weakness:

Recommendations:

Tax collector section completed by: Date: _____

Part 4. Trustees of Trust Funds (if applicable)

<u>Questions</u>	<u>Yes</u>	<u>No</u>	<u>N/A</u>
1 Do the Trustees maintain individual historical records for each trust fund?	---	---	---
2 Have the Trustees reviewed and adopted an investment policy?	---	---	---
3 Document how year-end trust funds are invested:			
			# of Actual Bank Accounts
• Checking account			_____
• Passbook accounts			_____
• Certificates of deposits			_____
• Other (describe _____)			_____
• Other (describe _____)			_____
• Other (describe _____)			_____
4 Do Trustees maintain journal accounting records to track all receipt and disbursement activity?	---	---	---
5 Were disbursements based only on approved vouchers?	---	---	---
6 Were disbursements made to individuals or organizations other than the municipality?	---	---	---

If yes, explain: _____

Part 4. Trustees of Trust Funds Testing

Reports

Yes No N/A

7 Do beginning balances reported match the prior year end balances reported in the town's annual report?

___ ___ ___

If no, explain problems/discrepancies encountered:

8 Do "new funds created" for established trust funds (e.g., capital reserve, expendable trust funds) match expenditures/ transfers reported in the current year general fund general ledger?

___ ___ ___

If no, explain:

9 Do "withdrawals" from established trust funds (e.g., capital reserve, expendable trust funds) match revenues/transfers reported in the current year general fund general ledger?

___ ___ ___

If no, explain:

10 Do interest/investment income amounts appear reasonable?

___ ___ ___

If no, explain:

11 Were "end of year fair value" balances of the MS-10 proven to bank statements and/or investment portfolio reports?

___ ___ ___

If no, explain:

Observations - Part 4. Trustees

Comments on procedures or areas of weakness:

Recommendations:

Trustees section completed by: Date: _____

Part 5. Town Clerk (if applicable)

<u>Questions</u>	<u>Yes</u>	<u>No</u>	<u>N/A</u>
1 Does the Town Clerk maintain a cashbook to record receipts?	___	___	___
2 Does the cashbook include the following information:			
• Date of receipt	___	___	___
• Type of receipt	___	___	___
• Customer name	___	___	___
• Permit number	___	___	___
• Amount received	___	___	___
• Breakdown of currency or check	___	___	___
• Subtotals whenever deposits are made	___	___	___
3 Are paid motor vehicle permits filed alphabetically by name?	___	___	___
4 Does the Town Clerk maintain a checking account?	___	___	___
– If yes, are bank statements as of the last day of the month?	___	___	___
– If yes, is the checking account reconciled to the cashbook monthly?	___	___	___
5 Are receipts remitted to the Treasurer at least weekly?	___	___	___
6 Are invoices presented to the Treasurer for reimbursement of allowable clerk fees?	___	___	___

Part 5. Town Clerk Testing (if applicable)

- 1 Compare total annual receipts per the Town Clerk's cashbook with the Town's general fund general ledger revenue records for the following:

	<u>Per Clerk Cashbook</u>	<u>Per Town General Ledger</u>	<u>Variance</u>
Motor Vehicle Permits	_____	_____	_____
Boat registrations	_____	_____	_____
Dog licenses	_____	_____	_____
Marriage licenses	_____	_____	_____
Other (describe) _____	_____	_____	_____
Other (describe) _____	_____	_____	_____
Other (describe) _____	_____	_____	_____

If variances exist, explain cause:

- 2 Select a deposit reported in the Town Clerk's cash book:

	<u>Date Selected</u>	<u>Amount</u>	<u>Yes</u>	<u>No</u>	<u>N/A</u>
A Does the date and amount match an actual bank statement deposit?	_____	_____	___	___	___
B Does the breakdown of cash and checks as reported in the cashbook match the actual bank deposit ticket?			___	___	___
C Do the entries in the cashbook for the date selected actually total (foot) the amount of the above deposit?			___	___	___
D Select xx entries in the cashbook for the above deposit and trace to the actual file of paid permits. Does all the information in the cashbook agree with the actual paid permits?			___	___	___

Observations - Part 5. Town Clerk

Comments on procedures or areas of weakness:

Recommendations:

Town Clerk section completed by: Date: _____

Fraudsters who can't resist the lure of easy money won't get away with their crimes if you employ the powerful proof-of-cash method to draw them out and reel them in.

*Truth, like gold, is to be
obtained not by its growth,
but by washing away from
it all that is not gold.*
- Leo Tolstoy

Russell has an online gambling habit and not a lot of money to support it. But he's got a plan; he's going to embezzle from his company. He just has to figure out how he'll do it.

Fortunately, he's really close to the money. He's been the bookkeeper for a mid-sized electronics distribution company for more than seven years. Russell and his assistant manage most of the accounting functions.

Russell quickly rules out stealing from the standard stream of customer income. Tammie, the owner of the business, is no auditor, but she would notice if he manipulated any of those large customer payments. Russell considers his alternatives and finally settles on an area he thinks no one will detect - and no one does for more than a year and a half. By the time the company discovers Russell's crimes, it's \$150,000 poorer.

A hired CFE eventually uncovered Russell's clever embezzlement scheme with the powerful "proof-of-cash" tool - an excellent addition to any CFE's arsenal for finding evidence of hidden or missing activity affecting the cash accounts.

Though this case is fictional, it shows the use of a valuable tool for CFEs.

CASH IS KING

The ACFE's 2010 "Report to the Nations on Occupational Fraud and Abuse" (RTN) found that 90 percent of all cases in the study were asset misappropriation schemes. Cash is frequently a preferred target in these schemes.

In many cash theft cases - which can include skimming, larceny, and fraudulent disbursements - it's very difficult to detect the fraud when the theft is a result of unrecorded transactions. However, a CFE must be alert, prepared, and continually looking beyond the obvious.

The proof-of-cash method will isolate and identify specific unrecorded transactions. It proves that all the receipts and payments at the bank agree with all the receipts and payments in the cash receipts and disbursements journals.

By Ken Stalcup, CPA, CFE, CFF

Exhibit 1					
TJF Electronics Inc.					
Check Register					
March 31, 2010					
Date	Check #	Description	Deposit	Payment	Balance
		Balance forward			2,270.00
3/8/2010		Smithville Telephone Systems	2,000.00		4,270.00
3/8/2010		Martin County Schools	1,000.00		5,270.00
3/15/2010		Electronics Warehouse		(150.00)	5,120.00
3/16/2010		Electronic Systems of Alabama		(5.00)	5,115.00
3/16/2010		Office Systems Inc.		(75.00)	5,040.00
3/17/2010		Bank of the South		(1,750.00)	3,290.00
3/20/2010		City of Dixon	2,000.00		5,290.00
3/22/2010	1007	Southern Gas Co.		(175.00)	5,115.00
3/30/2010		TRC Supply		(40.00)	5,075.00
3/31/2010		Electronics Warehouse	25.00		5,100.00
3/31/2010		U.S. Post Office		(18.00)	5,082.00
		Totals	5,025.00	(2,213.00)	

Exhibit 2			
TJF Electronics Inc.			
Bank Reconciliation			
Feb. 28, 2010			
	Per Books	Balance	Per Bank
Balance at 2/28/10	2,270.00		2,930.00
Outstanding checks / payments		1005	(100.00)
		1006	(560.00)
Reconciled balance	2,270.00		2,270.00

Exhibit 3			
TJF Electronics Inc.			
Bank Reconciliation			
March 31, 2010			
	Per Books	Balance	Per Bank
Balance at 3/31/10	5,082.00		5,215.00
Outstanding checks / payments			(150.00)
			(18.00)
Deposit in transit			25.00
Service charge	(10.00)		
Reconciled balance	5,072.00		5,072.00

TAMMIE IS SUSPICIOUS

Like many business owners, Tammie has a lot to manage. The economy has made her job more difficult. She's seen a decrease in orders and other income. She's particularly concerned about her cash flow.

Tammie recently received an anonymous tip that Russell has some personal financial difficulties. She's also overheard some heated exchanges during some of his recent telephone conversations. Maybe he was arguing with creditors or lenders? She has no proof, but she has a gut feeling that he might somehow be stealing money from the operations checking account.

Russell, who is middle-aged, has a solid accounting background. He and his assistant are responsible for preparing checks for the company as they receive approved invoices and check requests. Tammie is also involved in the process. She carefully reviews the supporting documents and signs all checks.

After the end of every month, Russell regularly reconciles the company's bank account to an electronic statement that he downloads from the bank's website. He uses a popular, off-the-shelf, computerized general accounting system to give Tammie updated reports and the daily account balance. He also gives her a check register and a cash receipts journal whenever she asks for it. Tammie has rarely seen anything that would cause her to question Russell's reports.

On the surface, everything appears OK. If the account detail reconciles to the electronic statements and there's no evidence of unusual transactions appearing on the check register and cash receipts journal, can there really be any problems? Is Tammie's gut feeling just a case of indigestion?

DECISIONS, DECISIONS

Russell has to find the perfect place from which to embezzle. Tammie frequently reviews not just the check register and cash receipts journal but the cash reconciliation and the balance.

During the annual external audit, the auditors always asked for the year-end cash reconciliation and did some testing in cash. So this wasn't going to be easy for Russell. He would have to find some quiet way to embezzle, or he'd have to give up his online gambling accounts.

The answer came to him as he was recording a miscellaneous refund. At the time, the company received rebates and refunds from vendors. Russell had always deposited and recorded the checks as soon as they were received and never thought

much about them before now.

But then he realized he could deposit these relatively small rebates and refunds into the operating account and never record the entries on the computer. Each amount was so small that if Tammie checked the balance she wouldn't be able to detect it. And he could always explain away small differences. He rationalized that there are always going to be differences because of outstanding checks and deposits in transit. Unlike customer accounts, which he recorded, balanced, and tracked, he'd simply record miscellaneous receipts as received.

This could work, he thought. All he had to do was deposit the next refund check into the cash account of the company's operating account as usual. But because he doesn't record the deposit, he knew he couldn't record expenditures either. And to keep things simple on the cash reconciliation, he secretly spent an amount on an online gambling site equal to that of the refund checks he deposited during the same month. He was able to embezzle funds successfully for more than a year.

TAMMIE HIRES A CFE

Tammie becomes more suspicious. She hires a CFE and asks him to check the following records:

1. Check register for March (Exhibit 1)
2. February cash reconciliation (Exhibit 2)
3. March cash reconciliation (Exhibit 3)
4. March bank statement (Exhibit 4)

These documents are summarized in a proof of cash in Exhibit 5 (page 54). The first column of Exhibit 5, "Beginning Balance," summarizes the February cash reconciliation. The last column, "Ending Balance," summarizes the March cash reconciliation.

The top row of the proof of cash in Exhibit 5 is taken from the March bank statement. The row titled "Actual book balance" near the bottom comes from the March check register.

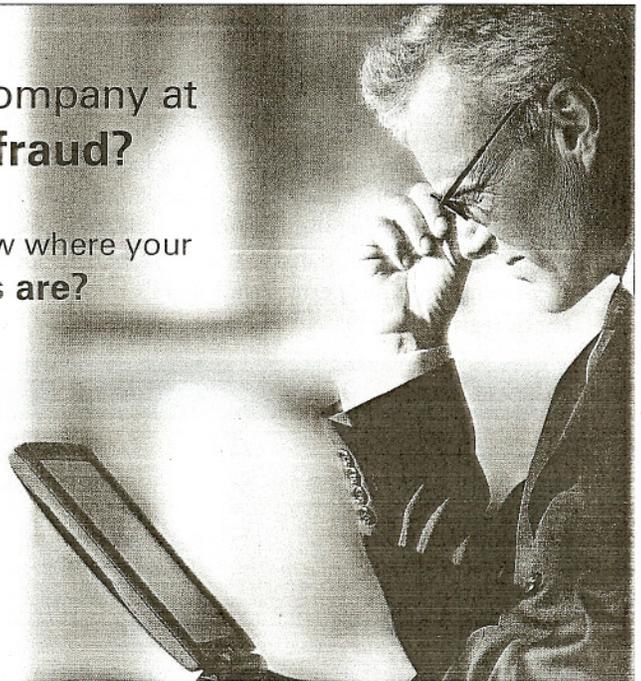
If everything adds up, across and down, the proof of cash is OK. There should be no difference between the amounts clearing the bank and the amounts recorded in the company's books on the bottom of the exhibit.

But let's say Russell receives a \$100 refund check and he decides to take it. He can't actually spend the refund check, so he has to

PROOF OF CASH continued on page 54

Is your company at risk for fraud?

Do you know where your fraud risks are?



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continued from page 23

deposit it into the company's operating bank account. However, instead of properly processing it, he conceals the deposit and never records it in the cash receipts journal. Later, during the same month, he forges a check and spends the \$100. He never records the \$100 disbursement either. At the end of the month, the bank reconciliation looks perfect, and there's no indication of any problem in the check register.

Exhibit 4				
CNP Bancorp		Bank Statement		
Account number 123456789		Statement date: March 31, 2010		
TJF Electronics, Inc.	Beginning balance			2,930.00
123 DeCallone Pkwy	Deposits (Credits)			5,100.00
Suite 456	Payments (Debits)			(2,815.00)
Anytown, Alabama 44444	Ending balance			5,215.00
Transaction details				
3/2/2010 Ck 1005	(100.00)	3/18/2010 ACH	(1,750.00)	
3/3/2010 Ck 1006	(560.00)	3/20/2010 Deposit	2,000.00	
3/9/2010 Deposit	3,000.00	3/23/2010 Ck 1007	(175.00)	
3/16/2010 ACH	(5.00)	3/30/2010 Ck 1008	(100.00)	
3/16/2010 ACH	(75.00)	3/31/2010 ACH	(40.00)	
3/17/2010 Deposit	100.00	Service charge	(10.00)	

CNP Bank - The bank that cares

Exhibit 5				
TJF Electronics Inc.				
Proof of Cash				
March 31, 2010				
	Beginning Balance	Receipts	Disbursements	Ending Balance
Balance per bank	2,930.00	5,100.00	2,815.00	5,215.00
Deposit in transit:				
Beginning of period	-	-	-	-
End of period		25.00		25.00
Outstanding checks:				
Beginning of period	(660.00)		(660.00)	
End of period			168.00	(168.00)
Service charge	-	-	(10.00)	10.00
Calculated book balance	2,270.00	5,125.00	2,313.00	5,082.00
Actual book balance	2,270.00	5,025.00	2,213.00	5,082.00
Difference	-	100.00	100.00	-

PROOF OF CASH EXPOSES FRAUD

Tammie wasn't able to see Russell's illegal activity, but the CFE sees a big red flag in the proof of cash. There's a glaring \$100 difference between the calculated balances and the actual balances at the bottom of Exhibit 5. The company has to resolve this error or irregularity. This particular difference between the actual and calculated balances indicates bank transactions that weren't recorded on the books.

A sum of \$100 was deposited but never recorded as a March receipt; it was spent but never recorded as a March disbursement. Looking at the March bank statement, Exhibit 4, it's now relatively easy to find the two unrecorded \$100 entries. Look at the deposit on March 17; it was never recorded in the check register. It's the same story for the payment clearing the bank statement on March 30; it was never recorded as a disbursement. Russell now has some explaining to do.

After the CFE found irregularities in one month, he expanded the scope of the examination to review data for the previous three years. He discovered that Russell had been embezzling miscellaneous receipts for more than a year and a half. The total losses for the company exceeded \$150,000.

LESSONS LEARNED

This case study is consistent with the results of the ACFE's 2010 RTN. The survey indicates that smaller businesses are prone to fraud. Fraud schemes typically go undetected, on average, for 18 months for all businesses in the study. The RTN shows that the median losses for small businesses caused by occupational fraud cases was \$155,000.

It's difficult to catch a thief who fails to record accounting entries. Ask the following:

- **Are all miscellaneous receipts properly recorded?** Or are miscellaneous receipts lower than expected or totally absent? In this case, Tammie would question Russell if large customer payments didn't show up in the cash receipts. However, Russell realized she wasn't likely to miss small, infrequent rebates and refund reimbursement checks. Be aware of the potential for these smaller, missing miscellaneous items.

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- Does anyone have overlapping, incompatible duties? If someone has the ability to initiate, record, and reconcile cash transactions, there's a serious failure to properly segregate duties. Never trust any one person to manage an entire process.
- Are you aware of pressures or incentives that might be affecting people who have access to assets? The 2010 RTN indicates that the two most common red flags are people living beyond their means and people experiencing financial difficulties.
- Does your business have an employee sophisticated enough to accomplish this embezzlement? A shipping clerk in the back of the warehouse isn't likely to have the ability to conceal this type of fraud. The bookkeeper or controller who can forge checks and reconcile the account can cover up a significant volume of questionable transactions. More than 30 percent of all fraud schemes involved the accounting department, according to the RTN.
- Are you listening to tips? If Tammie hadn't listened to the tips, would Russell still be secretly gambling away the company's money? Historically, tips are the single best initial detection method. Many eyes and ears collect information that's never printed on a report.

TRUTH HIDDEN IN DETAILS

This case study allows you to see the thought process an embezzler goes through to make this scheme work. As you can see, it's no easy task to uncover this form of unrecorded embezzlement. The proof-of-cash test is the best tool to use when you suspect this form of manipulation in a cash account, and it will help you discover the truth hidden in details. 🔍

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