

Big firm capability. Small firm personality.

# THE BONADIO GROUP

CPAs, Consultants & More

## Town of Prospect, Connecticut

*Independent Internal Control  
Risk Assessment Report*

*Risk Assessment for the years ended  
June 30, 2014 through June 30, 2019*

.....  
877.917.3077 | bonadio.com |    

.....  
Albany | Batavia | Buffalo | Dallas | East Aurora | NY  
Metro Area | Rochester | Rutland | Syracuse | Utica

July 29, 2021

Town Council  
Town of Prospect  
36 Center Street  
Prospect, Connecticut 06712

Dear Council Members:

The following is a report of our risk assessment for the Town of Prospect, Connecticut (the "Town"). Bonadio & Co., LLP was engaged by the Town Council to perform a risk assessment and internal controls consulting services on the Town's Internal Controls and Financial Policies.

The purpose of the risk assessment is to provide the Town with a review of internal controls in place to prevent and detect fraud, ensure financial reporting is accurate and that Town assets are safeguarded.

The content of this report is intended to provide the Town with the baseline information necessary to understand the risks and if deemed necessary develop, approve and implement improvements.

In performing our engagement, we relied on the accuracy and reliability of information provided by Town personnel. We have not audited, examined or reviewed the information, and express no assurance on it. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This consulting engagement report is intended solely for the information and use of Administration, the Town Council, and other applicable employees within the Town and is not intended to be and should not be used by anyone other than those specified parties.

We appreciate the opportunity to prepare this Independent Risk Assessment for the Town of Prospect, Connecticut and are available to assist you in carrying out other any improvements. We are also available to answer your questions anytime.

Very truly yours,  
BONADIO & CO., LLP



Timothy J. Doyle, CPA  
Partner



# Executive Summary

In 2020, the Town of Prospect, Connecticut's Town Council appointed Bonadio & Co, LLP as the Town's internal audit consultants to perform a risk assessment of its internal controls and financial policies for the years ended June 30, 2014 through 2019 and, if necessary, to assist in the development and implementation of improvements noted in the report.

This report focuses on the risk assessment of internal controls of the Town's operations, financial reporting policies, procedures and functional activities.

Our interviews with Town Administration and personnel were directed toward gaining an understanding of the Town's control environment and related risks in each internal control area, from the perspective of management's responsibility for controlling such risks. Using this information, we assessed the risk (low, moderate or high) present in each area. A summary of this risk assessment by control cycle is included on the pages that follow.

Key findings include;

- The Town has not developed formal documented policies for many of its internal controls.
- In many instances, documentation of internal controls performed are not in place to demonstrate that the control procedures were performed, who performed the control and when it was performed.
- The Town has a relatively small staff performing its controls. In many instances, there are segregation of duties conflicts that may be alleviated through a combination of reassignment of tasks or monitoring activities.
- There is little training of staff in accounting and internal controls.

# Risk Assessment and Internal Audit Strategy

---

## Objective

The objective of this risk assessment is to gain an understanding of the internal controls and financial policies of the Town during the years ended June 30, 2014 through 2019 (the testing period) and assess their overall risk and report on the risk factors noted as well as opportunities for improvements. We relied on interviews with Town Administration and personnel, observations, external audit reports, review of board minutes, status of prior audit findings and recommendations and Town policies and amendments. Additionally, we performed walkthroughs on selected significant transactions

## Risk Assessment Performed

We conducted our risk assessment of key areas and transactions in order to assess risk for each of the significant transaction cycles and functional responsibilities. This information will be shared and discussed with the Town Council and Administration to identify high-risk areas that may need further review.

Throughout our interviews and testing, we discussed controls as they stand today and what changes have occurred during the testing period. Our testing of those controls included a sample of transactions that spanned the testing period.

We utilized an interview approach in performing the Town's risk assessment. We identified key risk areas or circumstances that could significantly prevent the Town from effectively achieving its goals. Each risk was evaluated as to whether its potential effect would be **low, moderate, or high**. We obtained an understanding of Administration's and the Town Council's attitude, awareness and actions concerning internal control. We assessed the "tone at the top" regarding internal control and developed our risk assessment accordingly.



# Risk Assessment and Internal Audit Strategy

## Transaction Cycles and Functions Subject to Risk Assessment

We determined the control objectives, risk, and control activities associated with each of the following transaction cycles or functions identified to determine the nature, timing and extent of internal auditing procedures necessary for conducting the internal audit work.

The following transaction cycles and functional responsibilities were reviewed:

- Revenues, billings and receivables
- Cash receipts and banking
- Capital assets
- Payroll and human resources
- Purchasing and cash disbursements
- Information Technology
- Debt Activities
- General ledger and financial reporting

In addition, we assessed the adequacy of accounting policies and governance through audit inquiries, observations and discussions with Administration and other Town personnel.

The concept of materiality is intrinsic to the risk assessment of the Town. The areas of the Town that deal with more significant dollars or a higher volume of transactions may score as higher risk. The scope is primarily risk-based and is organized around the Town's major internal control cycles. Inherent risk relates to the environment both in and around the Town and therefore, the Town has less influence on these risks. Control risk relates to the Town's internal controls and demonstrate the level at which the controls are designed and operating to lower the Town's overall risk, whereby a low control risk demonstrates that the Town's controls are well designed and operating effectively to lower risk.



# Risk Assessment and Internal Audit Strategy

---

## Summary of Testing Procedures Performed:

Below is a summary of the procedures we performed to determine our assessment of the risks related to the Town's internal controls and financial policies:

### Bank Reconciliations — We performed the following:

- Haphazardly selected 10 bank reconciliations and reviewed for the following:
  - The bank reconciliation was prepared
  - The bank reconciliation was prepared timely
  - The bank reconciliation was reviewed timely
  - There was evidence of who prepared bank statement and who reviewed the bank statement.
  - Proper segregation of Duties

### Cash Receipts Testing — We performed the following:

- Haphazardly selected four property tax deposits, four grant receipts, one building permit fee deposit and one receipt related to police overtime work performed. We reviewed for the following:
  - The population of cash receipts provided was complete
  - *For tax receipts:*
    - Confirmed the amount of cash and checks received for the sample reconciles to the tax management system
    - Deposit slips were accurately completed and there was notation by the preparer that the deposit slip agrees to the tax management system.

- Verified that funds related to tax receipts were maintained in a separate bank account and that the bank account is reconciled on a monthly basis
- *For grant receipts:*
  - Agreed the amount received to the grant supporting documentation and/or invoice.
- *For the building permit:*
  - Agreed the deposit to the manual tracker (building inspector reports)
  - Verified that funds related to building permit fee were maintained in a separate bank account and that the bank account is reconciled monthly

### Cash Disbursements Testing

- Haphazardly selected 10 cash disbursements from the entire listing of checks paid. We reviewed for the following:
  - Review purchase orders for proper approval by ordering department head or Mayor
  - Review invoice received for indication that goods were received, and invoice approved for payment.
  - Trace the check to the warrant listing and consider appropriateness of expense coding.
  - Trace to cancelled check to determine that amount, payee and signature are appropriate.

# Risk Assessment and Internal Audit Strategy

---

## Summary of Testing Procedures Performed (Continued):

### Payroll Testing

- Haphazardly selected 10 employees from list of payroll checks during the scope period, eight for regular payroll and two for police overtime. We reviewed for the following:
  - Compared timesheet hours to hours paid and reviewed for proper approval of the timesheet from supervisor and Mayor, where applicable
  - Reviewed payroll check register for Mayor's review and approval.
  - Reviewed board approval of employee contracts
- Haphazardly selected 2 employees to review termination procedures.

### Testing of Debt

- Haphazardly selected 3 debt issuances during the covered time period. We reviewed for the following:
  - Reviewed board minutes noting approval of the debt.
  - Reviewed bid documentation for debt issuance.

### Testing of Capital Assets –

#### We have performed the following:

- Haphazardly selected 10 capital projects managed by the Town during the scope period. We reviewed for the following:
  - The Town maintains a list of invoices and expenses that support the final value of the asset.
  - Invoices and supporting documentation are retained to support the costs that make up the capital asset.
  - Determined whether the costs related to capital projects were subject to a bidding process, where applicable.

### Financial Reporting review —

#### We have performed the following:

- We provided the 2019 and 2020 year-end issued financial statements for the Town of Prospect to our Process Excellence/Quality Assurance group to identify financial reporting improvements for the Town and its auditors going forward.

### IT review (by Inquiry Only) —

#### We have performed the following:

- Our IT compliance group met with Town management and the Town's IT service provider to discuss the current status of the IT infrastructure and the related policies and controls in place. Based on this review and other observations noted during our interviews with Town management we identified opportunities to enhance the IT control environment.

# Risk Assessment Summary

---

The pages that follow summarize our evaluation of each of the transaction cycles and functional responsibilities we considered.

The attached appendix provides background and definitions to the risk categories used.



# Risk Assessment Summary

Audit Area	Risk Assessment			
	Inherent	Control	Materiality	Overall
Revenues, Billings and Receivables	Low	High	High	Moderate

**Contributing factors in our Risk Assessment**

**Factors contributing to our assessment of Inherent Risk**

**Factors that lower Inherent Risk**

- The nature of these transactions in a local government tends to be larger non-cash amounts that are largely predictable and therefore have a lower susceptibility to error or fraud
- No known prior period misstatements
- Limited need for judgement in accounting transactions

**Factors that increase Inherent Risk**

- No significant factors

**Factors contributing to our assessment of Control Risk**

**Factors that lower Control Risk**

- No significant factors

**Factors that increase Control Risk**

- Policies and procedures related to the receiving and recording of the multiple streams of revenues are not formally documented. **Observation #002**
- Certain personnel perform duties within the internal control environment that do not provide an adequate segregation of duties. **Observation #007**
- During our walk through of the internal controls that related to taxes received that are subsequently recorded in the Town’s tax collection software, we noted that these controls were not consistently applied and were not documented in a manner that demonstrates that the control occurred. **Observation #001 and #005**

# Risk Assessment Summary

Audit Area	Risk Assessment			
	Inherent	Control	Materiality	Overall
Cash Receipts and Banking	Moderate	High	Moderate	High

**Contributing factors in our Risk Assessment**

**Factors contributing to our assessment of Inherent Risk**

**Factors that lower Inherent Risk**

- Personnel have been performing the duties for several years and receive training
- Limited need for judgement in accounting transactions

**Factors that increase Inherent Risk**

- Cash is collected by the Tax Collector, Town clerk and others. The nature of cash transactions present additional risks and therefore have a higher susceptibility to error or fraud
- Fraud was noted during scope period – Money was stolen from bank accounts and were not identified timely.

**Factors contributing to our assessment of Control Risk**

**Factors that lower Control Risk**

- No significant factors

**Factors that increase Control Risk**

- Policies and procedures related to the bank reconciliation activities are not formally documented. **Observation #002**
- During our walk through of the internal controls that related to the Town’s bank reconciliations, we noted that these controls were not consistently applied and were not documented in a manner that demonstrates that the control occurred. **Observation #001 & 005**
- We observed instances where Town personnel held multiple internal control responsibilities that were incompatible under a system with proper segregation of duties. Segregating the duties of custody, reconciliation/recording and authorization mitigate the risks of error or fraud. **Observation #007**

## Risk Assessment Summary

Audit Area	Risk Assessment			
	Inherent	Control	Materiality	Overall
Capital Assets	Low	High	High	High

### Contributing factors in our Risk Assessment

#### Factors contributing to our assessment of Inherent Risk

##### Factors that lower Inherent Risk

- The nature of these transactions in a local government tends to be larger amounts that are largely observable and therefore have a lower susceptibility to error or fraud
- No known prior period misstatements
- Limited need for judgement in accounting transactions

##### Factors that increase Inherent Risk

- No significant factors

#### Factors contributing to our assessment of Control Risk

##### Factors that lower Control Risk

- No significant factors

##### Factors that increase Control Risk

- We noted instances where the Town was unable to locate and provide supporting documents (bidding documents, invoices, and other similar support.) **Observation #003 & 005**
- During our walk through of the internal controls that related to the Town's Capital Assets, we noted that these controls were not consistently applied and were not documented in a manner that demonstrates that the control occurred. **Observation #003**
- The Town does not perform a periodic fixed asset physical inventory. **Observation #003**
- Fixed Asset controls related to financial reporting and accounting are generally executed at or near year end by a third-party consultant

## Risk Assessment Summary

Audit Area	Risk Assessment			
	Inherent	Control	Materiality	Overall
Payroll and Human Resources	Mod	High	High	High

### Contributing factors in our Risk Assessment

#### Factors contributing to our assessment of Inherent Risk

##### Factors that lower Inherent Risk

- No known prior period misstatements
- Limited need for judgement in accounting transactions
- Personnel have been performing the duties for several years

##### Factors that increase Inherent Risk

- Payroll expenditures represent a significant amount of a local government's total expenditures
- Fraud occurred – Money was stolen from the payroll account and was not noted timely

#### Factors contributing to our assessment of Control Risk

##### Factors that lower Control Risk

- No significant factors

##### Factors that increase Control Risk

- During our walk through of the internal controls for payroll and human resources activities, we noted that these controls were not consistently applied and were not documented in a manner that demonstrates that the control occurred. **Observation #001 and #005**
- During our walk through of the internal controls that related to the payroll and human resources activities, we noted instances where the Town was unable to locate and provide supporting documents such as timesheets, payroll registers and other similar support. **Observation #005**
- The Town currently has no internal controls or monitoring activities related to additions, deletions or updates to the employee master file. **Observation #008**
- Policies and procedures related to the activities surrounding termination of employees are not formally documented. **Observation #002**

# Risk Assessment Summary

Audit Area	Risk Assessment			
	Inherent	Control	Materiality	Overall
Purchasing and Cash Disbursements	Low	Med	High	Med

**Contributing factors in our Risk Assessment**

**Factors contributing to our assessment of Inherent Risk**

**Factors that lower Inherent Risk**

- Personnel have been performing the duties for several years
- Limited need for judgement in accounting transactions
- Limited complexity related to the processes and procedures

**Factors that increase Inherent Risk**

- No significant factors

**Factors contributing to our assessment of Control Risk**

**Factors that lower Control Risk**

- No significant factors

**Factors that increase Control Risk**

- While a purchasing policy is in place, (dated April 2011), it does not include detailed policies and procedures on the review and approval of day-to-day disbursements, clear documentation on when a purchase order is required to be executed prior to purchasing goods and services or policies on managing the vendor master file. **Observation #002**
- The Town currently has no internal controls or monitoring activities related to additions, deletions or updates to the vendor master file. **Observation #002**
- There is no formal process in place to determine which vendors are required to submit W-9 forms to the Town. Currently, it does not appear that W-9s are requested or retained. This presents a significant risk related to recent IRS audits of municipalities relating to subcontractor vs. employee designations. **Observation #002**

# Risk Assessment Summary

Audit Area	Risk Assessment			
	Inherent	Control	Materiality	Overall
Information Technology (IT)	High	High	High	High

**Contributing factors in our Risk Assessment**

**Factors contributing to our assessment of Inherent Risk**

**Factors that lower Inherent Risk**

- No significant factors

**Factors that increase Inherent Risk**

- Services are outsourced
- Information Technology laws, regulations and activities are complex in nature
- Organizational “tone at the top” – Unauthorized use of the Town’s Computers was known and deemed acceptable

**Factors contributing to our assessment of Control Risk**

**Factors that lower Control Risk**

- No significant factors

**Factors that increase Control Risk**

- Policies and procedures related to Information Technology activities are not formally documented. **Observation #004**
- During our walk through of the internal controls that related to the Town’s Information Technology activities, we noted that these controls were not consistently applied and were not documented in a manner that demonstrates that the control occurred. **Observation #004**
- During our inquiries relating to the internal controls that related to the Town’s Information Technology activities, we noted that controls relating to access to the Town’s network, vendor management., operating systems expirations, user access rights and security incidents are either not in place or not regularly performed. **Observation #004**
- The Town does not regularly perform technical security testing, such as penetration testing, vulnerability assessments, or social engineering. **Observation #004**

# Risk Assessment Summary

Audit Area	Risk Assessment			
	Inherent	Control	Materiality	Overall
Debt Activities	Low	Low	Moderate	Low

**Contributing factors in our Risk Assessment**

**Factors contributing to our assessment of Inherent Risk**

**Factors that lower Inherent Risk**

- The Town’s debt is comprised of short-term non-complex debt transactions.
- Limited need for judgement in accounting transactions
- Limited complexity related to the processes and procedures

**Factors that increase Inherent Risk**

- No significant factors

**Factors contributing to our assessment of Control Risk**

**Factors that lower Control Risk**

- We reviewed three of the seven debt agreements the Town entered into during the scope period and noted that each was approved by the Town Council, and each had supporting documentation for the bidding process.

**Factors that increase Control Risk**

- No significant factors

# Risk Assessment Summary

Audit Area	Risk Assessment			
	Inherent	Control	Materiality	Overall
Financial Reporting	High	High	Moderate	High

**Contributing factors in our Risk Assessment**

**Factors contributing to our assessment of Inherent Risk**

**Factors that lower Inherent Risk**

- No significant factors

**Factors that increase Inherent Risk**

- Significant amount of accounting and internal control was performed by prior external auditor, both when he was the external auditor and later as a consultant.
- The Town relies heavily on the financial statement auditors for accounting and reporting matters and does not attend regular training to ensure they understand the governmental accounting and reporting standards.

**Factors contributing to our assessment of Control Risk**

**Factors that lower Control Risk**

- No significant factors

**Factors that increase Control Risk**

- During our reading of the June 30, 2020 audited financial statements, we noted areas for improvement relating to accounting and reporting under generally accepted accounting principles. These observations are fully described in our findings and recommendations section of the report. **Observation #006**

# Internal Audit Work Plan

The internal audit work plan summarized below, illustrates possible audits for the 2021-2023 fiscal years for approval by the Town Council. The results of this assessment will be the basis for identifying possible internal control and financial policy priorities in future years. These priorities should be reviewed by the Town Council and Administration and readjusted accordingly, if necessary. Included in the summary are identified high-risk areas, and other areas that may be deemed significant.

Business Cycle Area	2021-2022	2022-2023	2023-2024
Payroll, Benefits, Taxes and Related Areas – IRS Compliance	X		
Information Technology – Penetration testing, Policy review, training			X
Policies and procedures review	X		
Financial Reporting – GASB 87 Leases		X	
Financial Reporting – GASB 84	X		
Fixed Inventory Review and Physical Count		X	

## Recommendation

We recommend the Town Council and Administration, select an area or areas from the aforementioned areas for testing in the fiscal year 2022. Additional areas may include department or program specific areas to test in the categories above.



# Findings and Recommendations

---

During the current risk assessment update, we identified the following findings and recommendations.

These recommendations represent our observations in connection with the risk assessment services performed.

**Bonadio has the resources and would be happy to assist you with any of these recommendations.**



## Findings and Recommendations

---

### Internal control activities lacking observable review

#### Observation #001

During our walkthrough of internal controls in certain scope areas, we noted that certain control activities were not consistently applied and/or were not documented to confirm that control occurred. See examples below:

**Cash Receipts:** We selected 10 samples of cash receipts for testing, including taxes, grants, and police special duty charges to third parties. Based on our review of the documentation provided, we noted the following:

- Per discussion with Management, all taxes received are reconciled to the amounts recorded in the tax collection software daily. For four of the 10 selections, which were related to tax deposits, we were not provided evidence of this reconciliation or that this control took place.

**Bank Reconciliations:** We selected 10 month-end bank reconciliations and noted the following:

- One of the 10 reconciliations requested was not provided
- Of the nine reconciliations received, there was no evidence that the bank reconciliations were performed timely, and there was no sign-off by someone independent of the reconciliation preparer to document that the reconciliation was reviewed by someone independent of the process.

**Payroll:** Based on our review of the Payroll process, we noted the following:

- The Town was not able to provide payroll registers for individual pay periods detailing gross wages, deductions and tax withholdings. Additionally, we were not provided evidence of a review of the payroll registers by someone independent of processing payroll.
- Two of the 10 payroll samples selected were related to overtime for hourly employees. One timesheet was not provided, and for the other timesheet, there was no evidence of review and approval.

#### Recommendation

The Town should implement an internal control policy and procedure detailing the documentation expectations related to the review and approval of key control documents. The review and approval should be documented and performed by someone independent of executing the related processes or transactions.

## Findings and Recommendations

---

### Formalized Standard Operating Procedures

#### Observation #002

Based on our discussions with Town management and review of information provided, it was noted that the Town does not have its policies and procedures that are in place formally documented in a standard operating procedure. While this matter relates to all financial activities, we have further documented specific considerations relating to Information Technology and Capital Asset matters in the pages that follow.

#### Recommendations

The Town should document all internal control processes and procedures that are currently in place. The Town should then formalize the identified policies and procedures into a standard operating procedure documents. This is important to inform the employees of the Town what the expectation of their role is and to provide guidance in the case of employee turnover. The policy should include:

- Objective (i.e. what is the purpose of the policy?)
- Description of the process covered in the policy
- Risks that the policy addresses
- Clearly identify roles and responsibilities within the policy (including, who is responsible to execute the controls related to the policy, who is responsible to review and approve that the process was properly and accurately performed, how the review and approval should be documented and evidenced, and the timeliness of which these control processes should be executed.)

## Findings and Recommendations

---

### Capital Asset Controls

#### Observation #003

Based on our discussion with the Town's management, all accounting and financial reporting controls related to Capital Assets are handled by the Town's third-party consultant. Per discussion, these controls occur towards year-end in preparation for the year-end audit. Based on the materiality of the net capital assets to the Town, the Town should strengthen its' controls around fixed assets.

Additionally, during our walkthrough of the capital asset activities, we noted that one dump body truck was recorded as a fixed asset in 2019 financial statements; however, the truck was not completed until March 2020.

#### Recommendations

The Town should consider creating a formalized standard operating procedure identifying the financial and operational controls that should be followed for the recording and managing of fixed assets. The formalized policy should include, but not limited to, the following:

- Clear delineation of roles and responsibilities
- Controls related to the recording of fixed asset additions (overall and including the determination of construction-in-progress vs. an asset addition)
- Depreciation requirements
- Mandatory fixed asset physical counts on periodic basis
- Controls around the maintenance of the fixed asset ledger
- Controls around safeguarding the asses
- Policies in place for the disposal of assets (including how a disposal should be recorded, the process to determine a sales price (if asset is sold), and the approval process for disposition of the asset))

## Findings and Recommendations

---

### Information Technology

#### Observation #004

During our discussions with the Town management and the third-party vendor who assists the Town with IT Management, we noted multiple control gaps in the IT environment for the Town. Some of the key issues noted were:

- Multiple users sharing the same log-in information into the Town's computers and financial systems
- Multiple users having access to the same e-mail address
- No documented policies on Disaster Recovery, Business Continuity, Breach Notifications, Physical Access, User Access (granting, modifying, terming), and others
- There is not an IT risk assessment performed on a consistent basis
- Technical security testing is not performed regularly (i.e. penetration testing, vulnerability testing, or social engineering)
- There is not a Security Incident Response Plan in place

#### Recommendations

The Town should consider performing a complete IT risk assessment, which would include:

- A review and update of current documented IT policies in place to ensure that all relevant and applicable IT controls are identified and address in a comprehensive IT policy document
- Developing a periodic technical security testing program to address potential security risks
- Implement a periodic monitoring control to ensure that user access is appropriately set up in Town's financial systems. The control should focus on identifying segregation of duties risk and inappropriate access.
- Develop a Security Incident Response plan that will track and monitor security incidents

## Findings and Recommendations

---

### Retention of Supporting Documentation

#### Observation #005

During the course of our engagement, we requested supporting documentation to corroborate and support management's representations. The Town was not able to provide some of our requested items timely or did not provide the information at all. Some examples of the items that we requested but were not provided by the Town are as follows:

#### Revenues, Billings and Receivables

- Four selections related to the daily reconciliation of cash receipts to tax deposits were not provided.

#### Cash Receipts and Banking

- One of our 10 selected bank reconciliations were not provided

#### Capital Assets

- Competitive bidding documents for eight of the 10 Capital Asset additions selections were not provided
- Purchase agreements and invoices for two of the 10 Capital Asset additions selections to support the cost and terms of the purchase were not provided
- Cancelled check or leasing/debt agreement for four of the 10 Capital Asset additions selections to support the amount recorded as an asset in the financial statements were not provided

#### Payroll and Human Resources

- Payroll registers for individual payroll periods detailing gross wages, deductions and tax withholdings were not provided.
- Documentation to show the review of the payroll registers by someone independent of the individual processing payroll was not provided.
- The timesheet for one of two hourly employees selected for testing was not provided

#### Recommendations

The Town should consider implementation of a documented retention policy that specifically addressed where documentation supporting key financial controls and operating decisions are retained, who has access to the information and the length of time for which the documentation should be retained (either in-house or in storage).

## Findings and Recommendations

---

### Financial Reporting

#### Observation #006

Based on our review of the 2019 and 2020 year-end audited financial statements we noted several instances to consider for improvement in future reporting periods.

Our review of the financial statements noted the following opportunities for improvement:

- **Management Discussion and Analysis (the “MD&A”)** - the AICPA’s State and Local Government COVID-19 FAQ recommends language in the MD&A regarding COVID-19 and how the pandemic impacted the Town’s operations.
- **Statement of Net Position** – GASB 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position* required a change in terminology that has not been adopted in the Town’s financial statements. The standard required that the Town updated its Net Position classification to state “Net investment in capital assets” instead of “Invested in capital assets, net of related debt”.
- **Fund Balance Sheet** – Under the modified accrual basis of accounting the proper terminology in the funds for the line item “prepaid expenses” is “prepaid expenditures”.
- **Statement of Revenues, Expenditures and Change in Fund Balances** – Debt service should be broken out into principal and interest expenditures under generally accepted accounting principles.
- **Fiduciary Funds** – Per GASB 34, *Basic Financial Statements* – and *Management’s Discussion and Analysis – for State and Local Governments*, the Fiduciary Fund’s assets should equal liabilities, and the net position should be zero. The Statement of Fiduciary Net Position for the Town shows a balance in the Town’s Financial Statements. (recently released GASB 84 will significantly change the presentation of these type funds going forward).
- **Due to/Due from other Funds and Transfers** – On the balance sheet, page 7, due from other funds is \$751,538 and due to other funds is \$752,094, a difference of \$556. Normally any residual due to/from other funds would relate to and be reported in the Statement of Fiduciary Net Position. However, we noted that it is not broken out on this Statement. On page 8, the transfers out is (\$201,249), and the transfers in of \$199,234 and \$2,015 are on the Proceeds from Debt Obligations line instead of the Transfers from other Funds Line. Per FN 8, the proceeds should be \$900,000, not \$1,101,249.
- **Note 8 – Long Term Liabilities** – The specifics of the Town’s debt agreements should be reviewed to determine if the debt would qualify as Direct Borrowing under GASB 88, *Certain Disclosures Related to Debt*, which was effective June 15, 2018. Additional disclosures would be required in the Town’s notes to the financials if the debt qualifies as direct borrowing.

#### Recommendations

The Town should consider discussing these findings with the current financial statement auditor who completes the year-end audited financial statements. Additionally, the Town should provide training to its staff on government accounting and reporting.

## Findings and Recommendations

---

### Finance and Accounting Personnel

#### Observation #007

Clearly defined responsibilities - Based on the current structure in place for the Town, it is not always clear who is responsible for the different financial and accounting activities for the Town. Some of the key financial controls are performed by the Mayor, some by the Office Manager, and some by a third-party consultant, among others. The Town does have a Job Description manual in place that addresses the designation of responsibilities for some areas. However, these descriptions should be revisited to include specifics of the financial reporting controls (i.e. balance sheet reconciliations and financial reporting controls). This information may be referenced to the standard financial operating policies and procedures, once created.

Segregation of duties – Segregation of Duties (SOD) is a basic building block of sustainable risk management and internal controls for an organization. The principle of SOD is based on shared responsibilities of a key process that disperses the critical functions of that process to more than one person or department. Without this separation in key processes, fraud and error risks are far less manageable. During our testing, we noted several instances where individuals had authorization, recording, reconciliation and custody duties.

Training – During our interviews, we noted that other than the Town tax collector and Town Clerk, there was little to no training on government accounting and reporting.

#### Recommendations

The Town should consider creating a Controller level position (either FT or PT, depending on the need) to have responsibility over the Town's financial and accounting procedures. If the position is created, job descriptions and standard financial operation policies and procedures should be updated to clearly designate the position's roles and responsibilities (as well as those positions that would report up into the position.) Additionally, the Town should prepare a segregation of duties schedule for all key controls to ensure that responsibilities are segregated. For instances where proper segregation is not reasonable, additional monitoring activities should be put in place.

## Findings and Recommendations

---

### Human Resources / Payroll Activities

#### Observation #008

Based on discussions with the Town's management and information we requested, we noted the following:

- Several payroll registers that we requested were not provided
- There is no formal termination policy in place to outline the process to follow and forms to be completed outlining that the responsibilities of both the Town and the Terminated employee.
- There is no control in place that to review changes made to the payroll master file (additions, terminations, changes to personal information)
- For one of the two timesheets selected to test payroll related to hourly employees, there was no evidence of the review and approval of the hours noted in the timesheet by the employee's supervisor. The other timesheet selected for testing was not provided by the Town.

# Appendix

---

- Definition of Internal Control
- Risk Assessment
- Internal Audit Process

## Appendix

---

### Definition of Internal Control

Internal control is a management process 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 reflects certain fundamental concepts:

Internal control is an ongoing process.

- Internal control is performed and maintained by the actions of the organization's personnel. It is not merely policy manuals and forms, but people functioning at every level of the organization.
- Internal control is geared to achieve objectives in several overlapping categories- Operations, Finance, and Compliance.
- Internal control can be expected to provide only reasonable assurance to the organization's administration and governing board regarding achievement of operational, financial reporting, and compliance objectives.

Effective administration of a strong internal control environment involves proper planning, execution, and ongoing monitoring of activities. Internal control is a tool used to protect the organization's assets from intentional or unintentional loss.



### Risk Assessment

Risk assessment is defined as the identification and analysis of relevant risks in the achievement of the objectives, forming the basis for determining how the risks should be managed. Risk assessment is one of the five elements of internal control, which are described in the appendix of this report. The other components include control environment, control activities, information and communication, and monitoring. Objective setting is necessary for assessment.

Control activities are closely related to the risks in the organization. Examples of control activities are policies, authorization, financial information reconciliations, asset verifications, and appropriate segregation and delegation of duties within the business operations of the organization. Control activities are either preventive or detective in nature and need to be evaluated as to benefits to the organization and/or associated costs to the organization.

Risk arises out of uncertainty, from either internal or external sources. As a result of pursuing or not pursuing a particular course of action, there is the possibility of economic/financial loss or gain, physical damage, injury or delay. Risk is defined as the chance of something happening that will have an adverse impact upon the achievement of objectives.

There will always be some risk involved in anything an individual chooses. The choice is between the actions we dare to take, given the level of risk we will accept and the level of remediation we will attempt to treat.

Risk has two key elements: the likelihood of something happening and the consequences if it happens. The level of risk is the relationship between the likelihood of something happening and the consequences if it does. Action taken to address the level of risk must address the likelihood of the event occurring, or the consequences if it does occur, or both.

## Internal Audit Process

Although every audit and each organization is unique, the internal audit development process is similar for most engagements and normally consists of five stages:

- 1. Planning
- 2. Survey
- 3. Fieldwork
- 4. Reporting
- 5. Ongoing monitoring, follow-up and corrective action

These stages are described in more detail further in Section III. The active involvement of the organization’s personnel is critical at each stage of the process and involves a collaborative effort from departmental personnel. We realize a certain amount of time is diverted from regular routines as a result of Internal Audit activities. Therefore, one of our key objectives is to minimize the disruption of operations by performing the internal audit in a timely and efficient manner.



## Appendix

### Internal Audit Process (Continued)

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve the organization's operations, policies, procedures and internal controls. Internal auditing is a critical element of assisting in accomplishing the organization's objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

An internal audit is generated within the organization, including all departments, at the direction of the organization's board of governance for the purpose of appraising, examining, or evaluating:

1. Financial transactions for accuracy and compliance with the organization's policies
2. Financial and operational procedures for adequate internal controls
3. Timeliness, reliability and appropriateness of the organization's records and reports
4. The level of compliance with required internal policies and procedures, state and federal laws and government regulations

Management or program reviews designed to improve departmental operations and procedures

#### A) Five Elements of Internal Control

This report focuses on the internal audit function and risk assessment of the organization. For purposes of reporting on internal controls, we must understand the following elements:

- Control environment
- Risk assessment
- Control activities
- Information and communication
- Monitoring



## Appendix

---

### Internal Audit Process (Continued)

#### B) Control Environment

The control environment sets the cultural tone of compliance for the organization, influencing the control consciousness of its personnel. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values and competence of the organization's personnel; management's philosophy and operating style; the way management assigns authority and responsibility and organizes and develops its personnel; and the attention and direction provided by the board of governance.

#### C) Risk Assessment

Every organization faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. 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 managed. Because economic, industry, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.

## Appendix

---

### Internal Audit Process (Continued)

#### D) Control Activities

Control activities are the policies and procedures that help ensure that the administrative directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the organization's objectives for compliant activities. 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 operating performance, security of assets and segregation of duties.

#### E) Information and Communication

Pertinent information must be identified, captured and communicated in a form and timeframe that enable the personnel to carry out their responsibilities. Information systems produce reports, containing operational, financial and compliance-related information, that make it possible to run and control the programs of the organization. They deal not only with internally generated data, but also information about external events, activities and conditions necessary for informed program decision-making and external reporting. Effective communication also must occur in a broader sense, flowing down, across and up to the organization's levels. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information to the oversight body. There also needs to be effective communication with external parties, such as the general public, vendors and suppliers, regulators and others.

## Appendix

---

### Internal Audit Process (Continued)

#### F) Monitoring

Internal control systems need to be monitored, a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Known internal control deficiencies should be reported, with serious matters reported to the administration and the board of governance.

There is both synergy and linkage among these five components, forming an integrated system that reacts dynamically to changing conditions. The internal control system is intertwined with the organization's operating activities and exists for fundamental educational reasons. Internal control is most effective when controls are built into the infrastructure and are a part of the essence of the organization. "Built in" controls support quality and empowerment initiatives, avoid unnecessary costs and enable quick response to changing conditions. There is a direct relationship between the objectives, which are what an organization strives to achieve, and components, which represent what is needed to achieve the objectives of its educational programs. All components are relevant to each objectives category. When looking at any one category, the effectiveness and efficiency of operations, for instance, all five components must be present and functioning effectively to conclude that internal control over operations is effective.

The internal control definition, with its underlying fundamental concepts of a process, affected by people, providing reasonable assurance, together with the categorization of objectives and the components and criteria for effectiveness, and the associated discussions, constitute this internal control framework.

## Appendix

---

### Internal Audit Process (Continued)

#### Management Responsibility

All levels of management are responsible for accomplishing and adhering to the organization's Mission Statement by achieving the organization's goals and objectives through effective and efficient use of resources and compliance with applicable laws, regulations and policies.

- Specific areas of responsibility include:
- Maintaining a high ethical tone throughout the organization.
- Assessing and managing the organization's business operation risks.
- Developing cost effective internal controls over all operations.

The internal audit process and function can assist management in discharging these responsibilities by providing an independent and objective evaluation of existing internal controls over the business operations. The internal audit can also help management develop improved controls and processes over operations. However, management always retains control over their own operations and ultimate responsibility for their performance.

#### Employee Responsibility

Internal controls are the responsibility of all of the organization's employees. Individual employees of the organization have the responsibility for maintaining work performance in a productive and conscientious manner. In the normal course of work, employees should be aware and alert for activities or situations, which pose actual or potential risks of loss, harm or misuse of assets, or obstruction to the attainment of the organization's goals.

Individuals and department heads should commit to the principles of internal controls and support programs and activities, which strengthen systems and practices and implement any corrective action determined necessary. Individuals and department heads are responsible for development, maintenance, documentation, and supervision of internal controls.

### Internal Audit Process (Continued)

#### Role of the Internal Auditor

The key role of internal audit is to provide the board of governance, audit committee, and administration with an independent and objective evaluation of internal controls over key business activities. This means we put a priority on reviewing the validity of financial and other management information, compliance with applicable laws, regulations and policies, and how organization operations can be more effective and efficient.

The internal audit function can provide a variety of management assistance services to both administration and the board of governance. It is important to understand the services and roles of the internal auditor. Assistance services include:

- **Financial Reviews (normally done in conjunction with external auditors)** — These are "traditional" audits of financial records, such as accounts receivable or payable. The objective is to determine the accuracy of financial records and adherence to appropriate internal control procedures. Results will be communicated to administration and the board of governance and usually incorporated in the external auditor's report on the financial statements.
- **Operational or Compliance Reviews** — These are projects directed by the organization's administration and the internal auditors, based on perceived business and operational risks. The focus is on assessing specific processes and identifying cost effective ways to improve internal controls, efficiency, and effectiveness. Examples would be reviewing a capital project for compliance with contract terms bidding process or evaluating the internal controls over a purchasing process. Written audit reports are prepared, discussed with the organization's administration and staff, presented to the Audit Committee, if applicable and then submitted to the board of governance for approval.

## Appendix

---

### Internal Audit Process (Continued)

#### Role of the Internal Auditor (Continued)

- **Management Assistance** — For projects with organization-wide impact or of high importance to the organization, consulting assistance may be provided to help design plans and achieve effective implementation. Assistance might take the form of facilitating problem solving techniques, flow charting processes, or performing program-based costing analyses and financial budgetary and actual comparisons. Status reports, in various formats, depending on the project, would be provided to the management and the board of governance. “Best practices” may be discussed and implemented.
- **Technical Research** — Internal auditors can assist with questions dealing with the organization’s policies, Federal, State and Local laws, regulations and policies, accounting and internal controls, and general practices.
- **Investigations** — At the direction of the board of governance or the request of management, the internal auditor may investigate suspected cases of unethical behavior, including fraud, theft, and abuse of position. Depending on the facts uncovered, such cases may be referred to management, an Audit Committee, the Board, or legal authorities for further action.

Our focus is on the processes and how to make them best work to achieve the board of governance's and the administration's strategic goals and objectives. If there are issues, we identify the business risks and their roots causes and work with the organization's administration, Audit Committee and Board to develop and implement cost effective solutions.

# THE BONADIO GROUP

---

CPAs, Consultants & More