

Internal Controls for Inventory and Equipment

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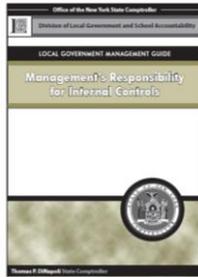
Division of Local Government and School Accountability



NYS COMPTROLLER
THOMAS P. DiNAPOLI

Learning Objectives

- Definition
- Responsibility
- Origins and Framework
- Inventory Controls
- Available Tools
- Audit Findings



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Definition

- “A process, affected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.”
 - Internal controls are activities or procedures designed to provide reasonable assurance that operations are “going according to plan.”

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Responsibility

- Who is responsible for implementing internal controls?
 - **Management** – Including the Governing Board
- Who is responsible for monitoring internal control compliance?
 - **Management** – Including the Governing Board
- Who is responsible for following internal controls?
 - **Everyone!**

Origins and Framework

- The Committee of Sponsoring Organizations (COSO) of the Treadway Commission
- Five Elements of Internal Controls
 - Control environment
 - Risk assessment
 - Control activities
 - Communication
 - Monitoring

Control Environment

- “TONE AT THE TOP”
 - The governing board sets the proper tone for the control environment when it establishes and communicates a code of ethics, requires ethical and honest behavior from all employees, observes the same rules it expects others to follow, and requires appropriate conduct from everyone in the organization.

Control Environment

- Communicating expectation for properly handling inventory and equipment.
- Requiring employees to adhere to legal and policy requirements for maintaining inventory records and usage of equipment.
- Performing an adequate review of reports and physical counts completed by employees, including management.

Risk Assessment

- Identify those events, conditions or risks that could significantly affect the achievement of the organization's objectives.

Risk Assessment

- Opportunity
 - High theft assets, control over assets. Are the garage doors locked?
- Unfamiliarity
 - Newer programs or processes. Are employees aware?
- Complexity
 - Is the process simplified? Known roles?

Risk Assessment

- Change
 - Turnover in positions, new equipment needs.
What happens when management changes?
- Rapid Growth
 - Fast growth without increased staff/resources. Do employees have what they need to accomplish the job?

Understand the Risk

- Fraud Triangle – Pressure, Rationalization and Opportunity
- Focus on what you can control – Opportunity
- Understand your process, ask questions and limit opportunity.
- Break inventory into two categories:
 - Consumable
 - Capital assets

Inventory and Equipment Risk

- Theft
- Abuse
- Missing equipment
- Incomplete inventory records
- Inaccurate reporting to the Governing Board
- Unauthorized disposition
- Life cycle planning

Inventory Process

- Documenting the acquisition process.
- Safeguarding the asset.
 - Deployment process
- Recording in the accounting records.
 - Capital thresholds
- Maintaining asset records.
- Reporting the activity to the Governing Board.
 - Inventory counts and checks
- Documenting the disposition process.
- Planning

Determine Risks by Asking Questions

- Who prepares the inventory?
- Will inventory recording errors be detected?
- Can inventory be stolen without detection?
- Can equipment be taken home?
- What are the physical access controls?
- How are fuel pumps monitored?
- What happens with surplus equipment?
 - Scrap material?

Control Activities

- Policies and procedures designed by management to help ensure that the organization's objectives and goals are not negatively impacted by internal or external risks.

Inventory Control Activities

- **Directive Controls:**
 - Job description, ethics policy, personnel policy, capital asset policy, vehicle policy, surplus policy
- **Preventative Controls:**
 - Segregation of duties, restricted access
- **Detective Controls:**
 - Reconciliations, physical inventories, budget vs. actual reports, board audit of claims
- **Corrective Controls:**
 - Employee training, management assessment

Understand the Need for Controls

Equipment

Policy Considerations

8-1-1 The governing board should adopt a written policy that sets forth guidelines and procedures for establishing and maintaining controls over equipment. Subject to statutory requirements,¹⁷ the policy should:

- Identify the major types of equipment and the persons or positions responsible for physically safeguarding these assets
- Establish a dollar threshold (or minimum cost) below which equipment will not be inventoried because of cost-benefit considerations
- Describe the types of inventory records that should be maintained and the persons or positions responsible for maintaining these records
- Require that the physical control over assets and the maintenance of inventory records be divided among different departments when possible
- Require that periodic physical inventories be conducted to compare inventory records to actual assets.

Reason for Control

Developing a formal written policy establishes guidelines for managers to follow when implementing procedures to safeguard equipment from misuse or theft.

¹⁷ See e.g., Highway Law section 142(3), which requires the town superintendent of highways to annually make a written inventory of all machinery, tools, implements and equipment and to deliver the inventory to the town board on or before September thirtieth of each year.

Understand the Need for Controls

Safeguarding Procedures

8-2-1 Mark or label all equipment as property of the local government. For more sensitive items, such as those susceptible to theft, tags with individual serial numbers should be affixed to the equipment and detailed records should be maintained. Label and/or tag equipment before it is placed into service.

Reason for Control

Generally, all equipment purchased must be placed under some level of control and safeguarding. For the larger, more cumbersome equipment such as desks and cabinets, the items should be identified with a tag showing that it belongs to the local government. The records should show the total number of items in particular areas of responsibility. For more sensitive items, tags with individual serial numbers should be affixed to equipment and detailed records should be maintained. Placing equipment into service prior to tagging increases the risk that the asset has not been recorded in the inventory records and that accountability for the equipment will not be established.

8-2-2 Assign responsibility for small, high-dollar value equipment such as laptops, projectors, and specialized hand tools to a specific employee. Safeguard highly portable equipment in limited access cabinets or storerooms when not in use.

Reason for Control

Small equipment and inventory are more easily lost or stolen. Making an employee accountable for their safeguarding and limiting access to these assets reduces the potential for loss or theft.

Understand the Need for Controls

Inventory Records

8-3-1 Equipment inventory records should contain descriptions, quantities, locations, dates of purchase and original cost; when appropriate, assign responsibility for the asset to a specific official or manager.

Reason for Control

Detailed equipment records make verification of the existence of the equipment easier and demonstrate to employees that management is monitoring equipment purchases and use, thereby deterring theft and misuse. Assigning responsibility to a specific employee holds that person accountable for safeguarding equipment.

8-3-2 Subject to statutory requirements, the preparation and maintenance of inventory records for equipment should be assigned to an individual who does not have custody of the equipment.

Reason for Control

If the same person has custody of an asset and also maintains the inventory records, an opportunity exists for falsifying the inventory listing to disguise the theft or loss of a valuable asset.

Understand the Need for Controls

Retirement/Disposal of Equipment

8-4-1 Retirement and/or disposal of equipment should be authorized and documented prior to the actual disposal of the items and their removal from the equipment inventory listing.

Reason for Control

Theft or other loss is easier to conceal if equipment can be removed from the records without prior written approval. In addition, prior approval ensures that only equipment that is unneeded, unusable, or obsolete is disposed of.

Understand the Need for Controls

Physical Inventory Procedures

8-5-1 Annually, a physical inventory of equipment assigned to each location should be made. The inventory should be documented.

Reason for Control

A physical inventory verifies the existence of equipment.

8-5-2 The physical inventory should be compared to the prior physical inventory of equipment and to the detailed property records. All material differences should be identified and reviewed by management.

Reason for Control

Comparing inventories year-to-year and to property records will identify missing equipment, equipment disposed of without authorization and untagged equipment.

8-5-3 A periodic verification of the inventory listing should be conducted by someone who does not have custody of the asset.

Reason for Control

If the employee responsible for safeguarding assets is also responsible for verifying their existence, an opportunity exists to disguise the theft or loss of valuable assets.

Understand the Need for Controls

Consumables

8-6-1 Consumable commodities such as gasoline, diesel fuel, copier paper, cafeteria foods, and supplies should be maintained in locked or controlled environments.

Reason for Control

Commonly used commodities such as the ones listed above are frequent targets for theft and misuse. By limiting access to these commodities, opportunities for theft are reduced.

8-6-2 The usage of gasoline and diesel should be tracked by vehicle and by the individual accessing the commodity. For stored gasoline and diesel, an electronic card system can be used to maintain accountability over the use of these commodities. In the absence of a card system, a manual record should be maintained of the dates and amounts of gasoline and diesel used, the vehicle receiving the fuel and whom it was pumped by.

Reason for Control

These commodities are highly transferable and, if they are not maintained in a controlled environment with accountability over their usage, their disappearance is difficult to track. Usage records, whether they are maintained manually or electronically, should also indicate who is using these commodities.

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Understand the Need for Controls

Consumables

8-6-3 A reconciliation of fuel purchases, fuel usage, and fuel remaining on hand should be conducted periodically.

Reason for Control

A periodic reconciliation of purchases, usage, and fuel on hand will determine if significant amounts of fuel are unaccounted for.

8-6-4 For cafeteria supplies and goods, the cafeteria manager should maintain control over these commodities by limiting access to them. The cafeteria manager should also monitor the reordering of commodities to detect unusually high usage patterns.

Reason for Control

Restricting access to as few employees as possible will limit but not completely prevent the theft of food and cafeteria supplies. Monitoring reorder points for meats and other valuable food commodities may also help to detect excessive usage that may indicate the need for further investigation.

8-6-5 The disposal of expired or otherwise unusable food products should be properly authorized and documented by the cafeteria manager.

Reason for Control

Authorization and documentation discourages personnel from intentionally discarding usable inventory and then stealing the items.

Assessing Controls

- Continuously assess controls that may be in place and determining if they are working properly and are efficient and effective.
 - Assets are safeguarded at acquisition and deployment.
 - Assets are accounted for in inventory and accounting records.
 - Monitoring of records and inventory is performed.

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Information and Communication

- Each employee should:
 - Understand their role.
 - Understand how their actions relate to others.
 - Understand that they have a responsibility to communicate problems they notice.
- Information and communication **MUST** be allowed to flow in all directions.

Information and Communication

- Training opportunities
 - Annual
- Review of policies and procedures
- Addressing consequences
- Reporting of inaccuracies
- Exceptions

Inventory Information and Communication

- What forms must be completed and by whom?
- What happens if an employee violates the policy?
- What are scenarios of situations to avoid?
- How can you provide the best value to taxpayers?

Monitoring

- Monitoring determines whether or not policies and procedures are being followed.
- Monitoring identifies significant control deficiencies timely.

Monitoring

- Converting policies to actions
- Personnel policies, contracts and bargaining agreements
- No consequences
- Finding the cracks
 - Follow-up questions
 - Walking the spaces
 - See the evidence

Inventory Monitoring

- Management review of acquisitions.
- Reconciliations of acquisitions and dispositions to inventory records.
- Performing physical spot checks of inventory.
- Life cycle planning and review.

Don't take someone's word for it.

- Do not forget to ask follow-up questions and ask for evidence. **“Show Me... Let me see...”**

Available Tools



Available Tools

- CPA Audit Reports
- OSC Audit Reports
- Policy Manuals and Procedures
- Training
- Other Municipalities/Districts
- Associations

Audit Findings

- Missing assets and inventory
- Theft of scrap
- Lack of inventory records
- Lack of safeguards
- Inappropriate use

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Questions

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