INTERNAL CONTROL POLICY & MANUAL

Approved: July 24, 2017

Introduction

Internal control is a process of managing and monitoring operating, financial and compliance activities designed to provide reasonable, not absolute, 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

- Safeguarding of assets

For the purposes of this summary, the term internal control refers specifically to internal control over financial reporting.

Internal control is not one event or circumstance, but a series of actions and activities that are built into the management process of the Town of Charlotte. It serves as the first line of defense in preventing and detecting errors and fraud. When internal control is operating at its best, the Charlotte Selectboard will have reasonable assurance that:

- They understand the extent to which the Town's operating objectives are being achieved

- Financial reports are being prepared reliably

- Applicable laws and regulations are being complied with

- Assets are being safeguarded

This summary identifies five interrelated components which work together to create a process of control. Weak controls in one area can be offset by strong controls in another area. The five interrelated components of internal control are:

- Control Environment

- Risk Assessment

- Information and Communication

- Monitoring

- Control Activities

The relative strength of an institution's internal control depends in large part on the actions of management and how well individuals understand their responsibilities and how they relate to internal controls. Thus, internal controls need to be communicated and employees need to be trained and educated in order for them to be most effective. The following documentation describes the five components of internal control and demonstrates the internal controls that have been implemented by the Charlotte Selectboard as documented by their Financial Policies. This documentation will serve to both communicate and educate employees on the Charlotte Selectboard's internal control efforts.

Control Environment

The control environment is the general tone or climate regarding internal controls throughout an institution. The major themes of the control environment include governance, integrity and ethical values, management style/philosophy, accounting and business competencies, personnel policies and human resources. These elements are essential in the administration and monitoring of all other control components.

In general terms, the Town of Charlotte control environment is described in the following manner. The management philosophy of the Town of Charlotte will be directed by the Charlotte Selectboard. The administration at the Town of Charlotte will continually show its commitment to effective internal control by demonstrating ethical behavior (leading by example) and providing guidance to all board members, employees and committee members for proper behavior. This includes being proactive, accountable, honest, respectful, dependable, timely and using the Town of Charlotte resources efficiently. Further, the Charlotte Selectboard will be committed to competence. Therefore, appropriate human resource policies ensure that employees who are hired have the necessary knowledge, skills and experience to perform their function within the Town. Town employees will receive appropriate training and career development opportunities. The organizational structure is set up to provide for appropriate delegation of responsibility and authority as well as adequate supervision for operating activities at all levels. Additionally, the Town Auditors will be involved in activities with external auditors and will be independent of management. The Charlotte Selectboard has implemented the following specific controls which support their description of their control environment above.

Those charged with governance of the Town of Charlotte are actively involved and have significant influence over the Town's internal control environment and its financial reporting. They have also implemented active Town Auditors which operate under properly designed governance guidelines and handbooks. The Town Auditors meet frequently enough to address important oversight responsibilities and the members demonstrate a sufficient knowledge of the Town of Charlotte accounting and regulatory requirements. Frequent e-mails, telephone discussions and board/committee discussions are used to keep those charged with governance aware of key developments that may impact financial reporting. The Town Auditors meet directly with management and external auditors to address any questions that arise in their discussions with regard to accounting policies and accounting estimates.

Management, through its attitudes and actions, demonstrates character, integrity and ethical values which set the standard of conduct for financial reporting for the institution as a whole. Management, employees and others within the institution are made familiar with the Town's policies and practices

with regards to ethics and accepted business practices through a code of ethics and the use of a fraud policy, governance guidelines and management and staff manuals. As far as financial integrity is concerned, management sets realistic yet conservative budgets with which employees are expected to operate under.

Management regards the accounting function as a means for monitoring and exercising control over the entity's various activities and sets the tone that high-quality and transparent financial reporting is expected. An objective process, including discussions with staff, boards and external auditors, is used in selecting accounting principles and developing budgets. Management uses this process to assess internal controls and correct any known weaknesses in internal controls on a timely basis as well as educate employees on the importance of internal controls and raise their level of understanding of existing controls and any changes that have been implemented.

The Town of Charlotte is committed to competence in the requirements of particular jobs and in translating those requirements into knowledge and skills. Town employees have the competence and training necessary for their assigned level of responsibility. Before hiring new employees, management evaluates job descriptions and compares potential employees' knowledge, skills, abilities and credentials before making hiring decisions, especially for key positions. Appointed town employees are subject to periodic evaluations of job performance and competencies. Reference and background checks are performed, especially for individuals applying for positions with access to assets susceptible to misappropriation. Personnel Policies exist that educate employees on human resource policies and procedures which are updated at least on an annual basis. Employees are also monitored on an ongoing basis to evaluate employee performance and compensation. Employee turnover is monitored through the use of exit interviews with management and the reasons for turnover are evaluated.

Risk Assessment

Risk assessment is the ongoing process of identifying and analyzing relevant town risks that must be managed in order to meet the objectives set by the Selectboard. A precondition to risk assessment is the establishment of objectives. The financial reporting objectives set by the Selectboard relates to the preparation of reliable financial statements which are fairly presented in conformity with generally accepted accounting principles. Factors to consider with regards to identifying risks include: past experience to meet objectives, quality of personnel, regulations and the significance and complexity of the activity. Based on these considerations, the Town of Charlotte has implemented the following controls to ensure the continual assessment of risks within the institution.

The Selectboard evaluates risks and recognizes the potential for fraud in high-risk areas of the institution, including revenue recognition, accounting estimates and nonstandard journal entries. In their assessment of these high-risk areas, the Selectboard considers incentives and pressures, attitudes and rationalizations, as well as the opportunity to commit fraud and has implemented appropriate control activities to mitigate these risks. A fraud risk assessment is used annually to track fraud risk factors that have been identified by the institution. When such risks are identified, existing controls are examined to determine that appropriate actions have been taken to address them.

Information and Communication

Necessary information must be identified, captured and communicated in a form and time-frame that makes it possible for employees to carry out their responsibilities. Controls over information and communication are needed to ensure that this happens. The Selectboard has implemented several controls in this area to help guarantee that the board and management receive the documentation they need to make timely decisions. All personnel, particularly those in roles affecting financial reporting, receive a clear message from top management that both internal control over financial reporting and individual control responsibilities must be taken seriously and all employees receive adequate information to complete their job responsibilities.

Information relevant to financial reporting is identified, captured, processed and distributed within the parameters established by the institution's control processes to support the achievement of financial reporting objectives. The chart of accounts is adequate to maintain accountability and provide information on important reporting items such as permanently restricted, temporarily restricted and unrestricted resources, functional reporting of expenses, tracking of revenue and applicable expenses, tracking of costs and compliance with terms and conditions of grants. This data, and other data underlying the financial statements, are captures completely, accurately and timely, in accordance with the Town's policies and procedures and in compliance with laws and regulations. Operating information used to develop the accounting and financial information serves as a basis for reliable financial reporting and operating information is used as a source of accounting estimates.

Communication exists between management and those charged with governance so that both have relevant information to fulfill their roles with respect to governance and to financial reporting objectives. The effectiveness of those charged with governance is supported by timely communications and open communication channels exist.

Personnel have an effective and non-retributive method to communicate significant information, especially related to fraud and fraud risks. The whistleblower process built into the Town's Fraud Policy allows for anonymity for individuals who report improprieties and all reported improprieties are reviewed, investigated and resolved in a timely manner.

Monitoring

Monitoring is a process of assessing the quality of a system's performance over time. The Town of Charlotte's internal control is monitored informally through supervisory activities and reconciliations. The Town of Charlotte has external means of monitoring their controls as well. Independent Auditors annually provide suggestions for strengthening internal controls and identify to the Selectboard any deficiencies noted in the course of their fieldwork. The Selectboard does their best to evaluate findings of employees and the external auditors to determine and implement the best course of action to correct the control issues at hand.

Control Activities

Control activities are the policies and procedures that ensure necessary actions and are taken to mitigate risks. A policy establishes what should be done whereas procedures are actions by people to implement stated policies. The Town of Charlotte performs a wide range of control activities, including, but not limited to, top level review, authorizing, verifying, reconciling, segregating duties, restricting access to assets and appropriately documenting transactions and information processing. The following is documentation of the procedures used for several of the Town's important operating areas and/or identification of the key controls for each area.

<ins>Journal Entries</ins>

A journal entry is a mechanism for recording financial transactions in the general ledger. All journal entries must have both a debit and credit (referred to as double-entry system) and the total debits and the total credits in the journal must be equal. The Treasurer prepares and posts all journal entries and maintains a paper copy, along with supporting back up in a Posting Register Journal. The documentation includes the transaction date, account lines to be debited and credited, a description of the purpose of the journal entry, the period the entry affects, and any externally created documents that support the entry. Each month the Posting Register report for the month is given to the Selectboard to sign off on, acknowledge and approve the entries. The Posting Register reports are also provided to the Town Auditors to look over and use as support for conducting their monthly bank reconciliation reviews.

Key Controls:

1. The Treasurer prepares and posts all journal entries.

2. All journal entries are accumulated with supporting documentation by month, in the Posting Register Binder.

3. All journal entries are reviewed and approved each month by the Selectboard.

4. All journal entries are available to the Town Auditors for review and questions at any time and are used to compare with transactions in the monthly bank statements during their reconciliation review.

<ins>Budget</ins>

The Selectboard approves and finalizes the annual budget during their January meeting. The budget is approved for one year out. The budget preparation process begins in October of each year for the upcoming fiscal year (July 1-June 30). The Selectboard oversees the budget development process and all Department heads participate with providing recommendations to the Selectboard. The Town Treasurer and Town Administrator work closely with the Selectboard during the drafting process. Early in October, departmental budget sheets are distributed to the department heads to fill out and enter into the overall budget for review by the Selectboard. A series of budget drafts are produced and reviewed by the Selectboard over the course of the budget process. The budget is finalized by the end of January to be warned for March Town Meeting Day. The budget is discussed and may be amended off the floor at Town Meeting resulting in the finalized budget to be voted on by Australian ballot in April.

The Treasurer uploads the approved budget to the General Ledger by July 1st. At the end of each month, the Treasurer prepares an updated Budget Status report for review by the Selectboard and department heads. The Treasurer reports the year end financials to the Selectboard.

Key Controls:

1. The Selectboard approves the budget annually in January to be voted on off the floor at Town Meeting Day in March and finalized by Australian Ballot in April.

2. The Treasurer provides monthly budget status reports to the Selectboard and department heads to make sure the budget stays on track. The Selectboard approves any over spending of the budget throughout the year.

Cash Reconciliations

The Assistant Clerk/Treasurer prepares the bank reconciliations on a monthly basis. The Assistant Clerk/Treasurer is an authorized check signer but is not responsible for accounts payable, general ledger journal entries and does not have access to online bank accounts. NEMRC Account Reconciliation software is used when reconciling the accounts payable cash account to ensure all required reconciliation procedures are performed. The Town Auditors review the bank statements with the reconciliation reports to make sure all cleared checks, debits and credits on the bank statement are cleared on the reconciliation. The Auditors fill out a "Reconciliation Review Worksheet" provided by the Treasurer's office and attach it to the bank statement. Any questions or discrepancies that arise during the review can be noted on the worksheet along with the resolution.

Key Controls:

1. Bank reconciliations are prepared on a monthly basis by the Assistant Clerk/Treasurer who does not prepare accounts payable bills and is not responsible for general ledger journal entry.

2. Bank reconciliations are reviewed by someone other than the person preparing them.

3. Bank reconciliations are prepared within 5 days of receiving the bank statements.

4. A reconciliation checklist is used to review the reconciliation for the accounts payable cash account by the Town Auditors.

Cash Disbursements

The Treasurer receives and processes all Town invoices that have been initialed by department or committee heads and coded with the appropriate general ledger account. Regular monthly invoices such as for utilities, fuel oil and phone are coded and processed for payment by the Treasurer. Only "invoices" are accepted for payment, "statements" will be rejected. The accounts payable software will reject an invoice if it is a duplicate entry from a vendor. Treasurer stamps each invoice showing date invoice was paid and account line it was expensed to. Treasurer prepares a check warrant showing all invoices that were paid. A Posting Register report is generated after all bills have been processed and includes all journal entries posted to the general ledger. The Posting Register will also include any transfers made between special funds and the general operating account for expenditures posted outside of the general fund budget. The Selectboard reviews all invoices, signs off and approves all expenditures with the signing of the check warrant and the posting register report. After Selectboard approval, the Treasurer mails out the checks and all invoices are filed. The Posting Register Report is also generated at the close of each month showing all journal entries for the month for review and

Cash Disbursements (con't)

approval by the Selectboard. It is also made available for the Town Auditors for their review.

Vendors are set up by the Treasurer's office using a current W-9. Certificates of Insurance, Non-Employee Work Agreements and Contracts (when necessary) are kept on file in the Treasurer's office. The Vendor list is updated and purged annually by the Treasurer and is available for review by the Selectboard and Town Auditors. Payments processed through A/P for refunds or reimbursements to individuals do not require any documentation other than department or committee head approval.

Key Controls:

1. All invoices have documented approval from the appropriate department or committee head on the invoice.

2. The Treasurer processes all invoices with department approval, prepares all checks for payment.

3. Checks are released after the Selectboard has approved all invoices, associated check warrants and weekly posting register reports.

4. The Posting Register Report is also generated at the close of each month for Selectboard review and approval of all journal entries that have been made by the Treasurer. This report is reviewed by the Town Auditors when they review the monthly bank reconciliations.

5. The A/P software will reject any duplicate entry of an invoice from a vendor.

6. The Vendor List is updated annually by the Treasurer's office and is available for review by the Selectboard and Town Auditors.

Payroll

All employee timesheets are due in the Treasurer's office by Monday at 8 AM, on a bi-weekly basis. Each employee fills out their timesheet which is then given to their Department head or supervisor for approval before submission to the Treasurer's office. The Assistant Clerk/Treasurer rechecks all timesheets for errors and then posts all employee hours through the NEMRC software system. After posting all employees' hours, a Detail Posting Register report is generated to reconcile against individual timesheets. If the report agrees with all of the employee timesheets, the net payroll can then be calculated by the software. A Detail Posting Register report is generated after the calculation so employee deductions for taxes and benefits can be checked before payroll is processed. Employees receive either a paper check or they can opt for direct deposit. The direct deposit ACH file is created through the NEMRC software and processed through RBS Money Manager. The Treasurer validates the payroll file in the Money Manager program with a secure token and password. A payroll check warrant is generated for review and approval by the Selectboard.

The Assistant Clerk/Treasurer releases the file for payment with a separate secure token and password the following Tuesday after Selectboard approval. Selectboard approval is documented by the signature of the Selectboard Chair on the warrant. Checks are released for all employees on Wednesday, paper checks or direct deposit. The 941 taxes are paid electronically after payroll is released through EFTPS (Electronic Federal Tax Payment System) by the Assistant Clerk/Treasurer. The Treasurer posts the 941 payment in the general ledger.

Payroll (con't)

Employees of the Town of Charlotte are exempt, salaried; non-exempt, hourly or paid by stipend. This includes both appointed employees and elected officials. Stipends are paid for the Animal Control Officer, Health Officer, Park & Security Officer, Selectboard members and Delinquent Tax Collector.

Exempt Employees: All elected officials and employees who are salaried are exempt from the Fair Labor Standards Act. Elected officials and employees who are salaried submit a timesheet only to indicate vacation, sick, holiday and personal hours used; they are not required to submit hours worked. Elected officials paid on an hourly basis are required to submit a timesheet in the same manner as non-exempt employees in addition to vacation, sick, holiday and personal hours used. The Library Trustees approve the Library Director's timesheet before submission for payment.

Non-Exempt Employees: All hourly employees must complete and sign a timesheet. The employee then gives the timesheet to their supervisor to review and approve. Timesheets are due in the Treasurer's Office by Monday mornings at 8 AM. The timesheets that are handed in are for the two weeks prior that ended on the previous Friday.

Stipend: Employees paid by stipend are paid the last pay period of each month. Time sheets are not mandatory.

The Town Administrator prepares the offer letter to be sent to the potential new employee. The Town Administrator and Treasurer meet with the new employee to fill out all necessary paperwork such as the W4, I9 and benefit enrollment forms. The originals are kept in the employee files in the Treasurer's Office and are used by the Treasurer to set up each employee in the payroll software. The Treasurer makes all changes in the payroll module such as department change or change in hours or for changes in pay due to raises. All changes are documented electronically in the Employee Maintenance "Notes" within the payroll module.

Key Controls:

1. All new hires have an offer letter, W4, I9 and any benefit enrollment forms.

2. All hourly employee timesheets must be signed by the employee and their supervisor.

3. Payroll file validation and release is a 2-person process requiring separate secure tokens and passwords to complete.

4. The payroll warrants are reviewed and approved by the Selectboard. The signature of the Chair of the Selectboard on the warrant documents this review.

5. All payroll changes are documented electronically in the payroll module within Employee Maintenance for that individual.

Financial Reporting

The goal of the Treasurer's Office is to distribute accurate and timely financial statements to the Selectboard at least monthly and to Department heads as requested. Any transactions which appear erroneous must be reported to the Treasurer's Office for investigation and possible corrections. All correcting journal entries are adequately supported and approved. All journal entries are approved by the Selectboard, documented by their signature on the monthly Posting Register Report.

The Treasurer generates an updated Budget Status Report and Posting Register Report at least monthly

for the Selectboard. A Balance Sheet report is generated as requested for the status of the Town's special funds. The Treasurer meets with the Selectboard periodically to go discuss the financial reports and makes the Board aware of any problem areas in revenues and expenditures to ensure the Town remains fiscally sound.

The month-end, quarter-end and year-end close procedures and reporting are described in detail in the Treasurer's Policies & Procedures Manual. An independent audit is performed on a yearly basis of the Town of Charlotte's prepared financial statements. After the audit, the financial statements and related disclosures are approved by the Selectboard.

Key Controls:

1. Procedures and reporting requirements for month-end, quarter-end and year-end closing are detailed in the Treasurer's Policies & Procedures Manual.

2. An independent audit is performed annually.

3. The Selectboard reviews and approves the final year-end audited financials before they are released.

Tax, Thompson's Point Rent & Thompson's Point WW Sewer Billing

The narrative description for the process and procedures for these three separate billings can be found in the Treasurer's Policies & Procedures.

Tax Billing

Key Controls:

1. The tax rate calculation is prepared by the Treasurer and the Town Administrator. The tax rate is approved by the Selectboard.

2. Tax billing changes are documented electronically in the Tax Administration module. Taxes billed out are reconciled to taxes collected by the Treasurer and is available for review and approval by the independent auditor annually.

3. Calculations for recording deferred revenue are done by the Treasurer.

Thompson's Point Rent Billing

Key Control:

1. The Town Assessors provide the Fair Market Value for the lots. The Selectboard approves the tax rate annually. The rent calculation is based on the FMV X total tax rate X 105%.

2. The Treasurer inputs the data into the Rent Module for billing. Any billing changes are documented electronically in Tax Administration(Rent) and supported with:

   a. Assessor's change in valuation

3. Rent billed out is reconciled with rent collected by the Treasurer and available for review and approval by the independent auditor annually.

4. Calculations for recording deferred revenue are done by the Treasurer.

<u>Thompson's Point WW Sewer Bill</u>

Key Control:

1. The Thompson's Point Wastewater Operator reads all the meters and submits the readings to the Treasurer. The Treasurer uses the meter readings to update the gallon usage for each connection. The Thompson's Point Wastewater Committee creates the budget annually and approves the fees for sewer usage. The Selectboard approves the fee schedule.

2. The Treasurer inputs the data into the Sewer Module using the updated usage and fees. Any changes in billing are documented electronically in Tax Administration(Sewer) and supported with:

    a. Thompson's Point Wastewater Operator's changes/errors in meter readings

3. Sewer usage billed out is reconciled with sewer usage fees collected by the Treasurer and available for review and approval by the independent auditor annually.

4. Calculations for recording deferred revenue are done by the Treasurer.

<u>Capital Assets</u>

Capital assets are monitored at the end of the year. In 2002, the Town of Charlotte Selectboard adopted a policy ("Capital Assets & Infrastructure – GASB 34 Policy").

After the fiscal year has closed, the Town Treasurer prints a Check Summary Report for payments greater than $4,999.99. The Town Administrator determines which of these payments are for capital assets. The capital assets identified in the Check Summary Report are compared with invoices to verify the nature of the purchases/expenses. A table is created which lists capital purchases/expenses by vendor on the vertical axis with the corresponding asset on the horizontal axis. Some assets could potentially have more than one vendor. For paving, a description of each road section paved is obtained from the Road Commissioner, including road names, the sections paved as identified by address number or landmark and mileage.

The capital assets/expenses are added to the fixed asset spreadsheet (use "save as" and re-name for the fiscal year just ended; create a tab for the fiscal year just ended). The following information is added: the asset (e.g. Library metal roof), the useful life (based on GAAP), and the value (for new assets, historic cost will match the total basis). For depreciable assets already listed on the sheet, a column is added for the year's depreciation (based on the useful life) and another column for the accumulated depreciation.

For capital projects that have been started but not completed, a separate tab is created, labeled "CIP FY _____ " (fiscal year). (CIP = "construction in progress). All values listed under Ending CIP (for the previous year) are moved to Beginning CIP (for the just completed year). All work/projects/purchases for the just completed year are added under "CY CIP Additions". For items that have been completed during the just ended fiscal year, the total value (i.e. Beginning + Additions) is indicated under "Deletions". The general ledger account number or grant description is written in for all items on the list.

Assets that have fully depreciated are "deleted" (using strikethrough).

Capital Assets (con't)

Journal entries to capitalize expenses are prepared and posted by the Town Treasurer and reviewed by the Town Administrator and Selectboard.

Key Controls:

1. A formal capitalization policy has been adopted by the Selectboard

2. A review of the general ledger (Check Summary Report) to identify items to be capitalized is performed by an official who is independent of the cash disbursement process.

3. A knowledgeable individual is preparing proper journal entries to record capital assets.

4. Segregation of duties is implemented by having independent individuals prepare/post and review journal entries related to capital assets.

Approved July 24, 2017
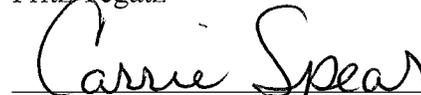
Charlotte Selectboard

Lane Morrison, Chair

Matt Krasnow, Vice Chair

Fritz Tegatz

Carrie Spear

Frank Tenney