

# Ohio Association of Public Treasurers Finance Officer Training

## Internal Controls

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# Agenda

## Internal Controls

- Internal Controls - The Basics
- Components of Internal Controls
- Benefits of Internal Controls
- Management / Public officials responsibilities for Internal Controls
- Common policies

## Segregation of Duties

- Standards/Guidance

# Internal Control –The Basics

AU-C 315.12 defines system of internal control as:

The system designed, implemented, and maintained by those charged with governance, management, and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to:

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

# Internal Control –The Basics



How do you prevent errors?

If an error occurs, will you detect it timely?

Preventing errors is a shared concern of both management & auditors.

# What do Internal Controls look like?

- **Plans, methods, policies, and procedures** used to fulfill the mission, strategic plan, goals, and objectives of the entity
- **Continuous built-in component of operations** that provides *reasonable assurance, not absolute assurance*, that an entity's objectives will be achieved
- **Not one event, but a series of actions** that occur throughout an entity's operations

# Internal Controls: Five Components

*More than just control procedures*

Control environment

Information &  
communication

Risk assessment

Monitoring

Control activities/procedures

# Internal Controls Objectives

Safe and sound operations.

The integrity of records and financial statements.

Compliance with laws and regulations.

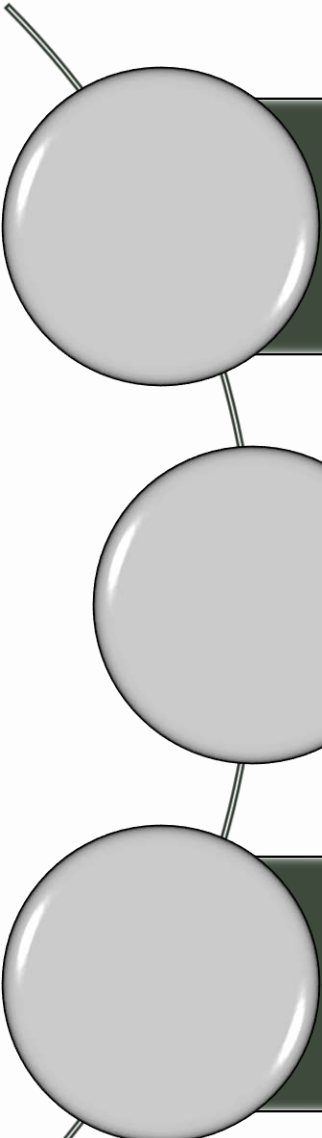
A decreased risk of unexpected losses.

A decreased risk of damage to the government's reputation.

Adherence to internal policies and procedures.

Efficient operations.

# Control Environment



The effectiveness of internal controls rests with the people of the organization who create, administer, and monitor them.

Integrity and ethical values are essential elements of a sound foundation for all other components of internal control.

The commitment for effective control environment rests at the top.



# Control Environment: Starts at the Top!



# Risk Assessment

Management should identify risks relevant to financial reporting including external and internal events

- Operating environment changes
- New personnel
- New technology
- Accounting pronouncements
- New or revamped information systems

# Risk Assessment

- Ask yourself: How do I avoid reading the following headline while drinking my morning cup of coffee?



*“\$50,000  
embezzlement  
Found at (insert  
name of **your**  
entity here)”*

# Risk Assessment

**Answer: Ask more questions!**

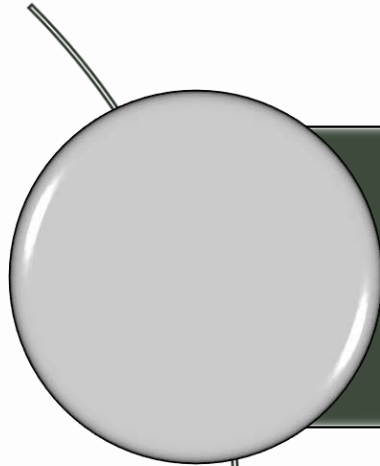
What  
could go  
wrong?

Could the  
same thing  
happen to  
us as xxx  
entity?

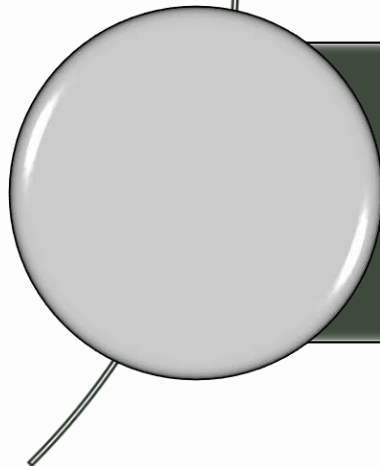
How can  
we avoid  
it?

**Particularly critical when things change!**

# Information and Communication Systems



Internally generated data, along with external events, activities, and conditions are necessary for a business to make informed decisions.



Information system should provide sufficient detail to properly classify the transaction for financial reporting, and measure the value of the transactions.

# Information & Communication



Management's monitoring activities may include using information from communications from external parties such as customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.

Entity should have those issues reviewed by someone other than the individual responsible for that accounting function.

Entities should have procedures in place regarding how these items are followed up.

# Information & Communication Examples

Customer calls regarding late fees assessed however customer has documentation they were not late.

Customer calls regarding payments made by check not cashed timely.

Call regarding customers not given a receipt.



# Monitoring

Monitoring is a process that assesses the quality of the internal control performance over time

- Management / supervisory reviews
  - Critical when it is impractical to segregate duties
- Analytical review (see next slide)

Processes to ensure timely modification of policies and procedures, as needed



# Monitoring



## Analytical Procedures:

- Compare what is reported with what was expected/reasonable
  - Collect / pay what was estimated?
  - Cash collected – is it reasonable in relation to the # of transactions processed?
  - Voided transactions: reasonable?
  - Any “unusual” transactions?

Use budget and actual reports!!!

# Control Activities/Procedures

Control activities are the policies and procedures that help ensure management carries out its directives.

Control activities should assure accountability in:

- Operations
- Financial Reporting
- Compliance areas

# Types of Control Activities/Procedures

## Automated (Application)

- Built in computer controls
- Are generally preventative in nature
- i.e. Edit checks, automated computations

## Monitoring Controls

- Typically performed by Management
- Occur after the transaction has been processed through the accounting system.
- Are generally detective in nature
- i.e. Review month-end budget vs. actual reports

# Example Control Procedures

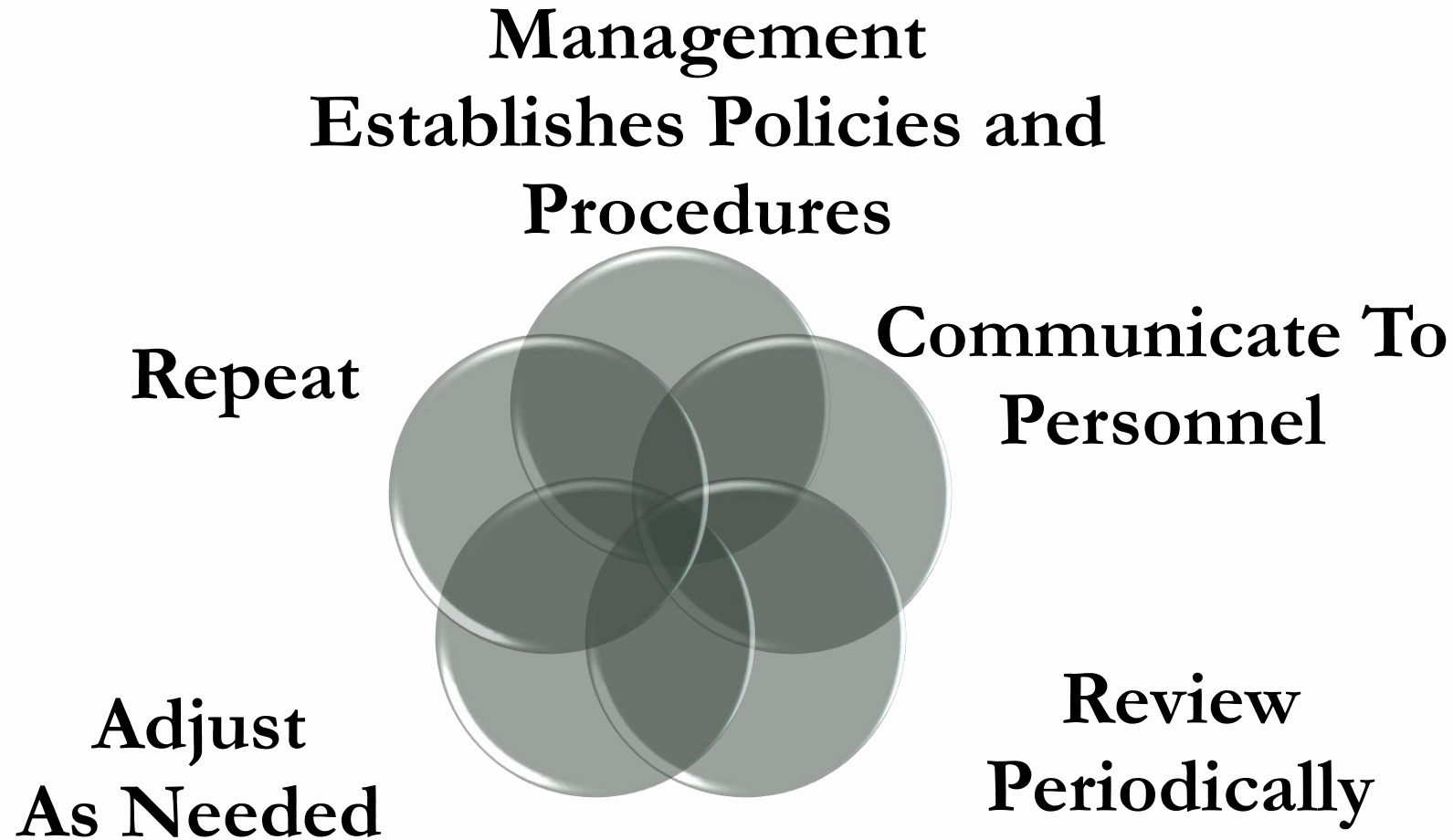
## Segregate Incompatible Duties

- Single person [*ideally*] should not:
  - Collect + Record + Reconcile + Deposit
- Will cover further in the next section

## Periodic Reconciliations & Verifications

## Incorporate “Edit” Checks Into Computer Systems

# How do we implement internal controls?



# Control Examples

## Larger Entity

- **Control:**
  - Invoices are reviewed prior to payment to determine that the goods or services were received and the payment is for the proper amount/proper public purpose
- **Control Evidence:**
  - Invoice is marked “ok to pay” by the department employee who has knowledge of the expense

## Smaller Entity

- **Control:**
  - Bills are presented to the Board of Trustees for review prior to payment to determine that the goods or services were received and the payment is for the proper amount/proper public purpose
- **Control Evidence:**
  - Review and approval of the bills is documented in the Board Minutes

# Control Examples

## Larger Entity

- **Control:**
  - Bank Reconciliation is reviewed and approved by the Finance Director after being prepared by the Accounting Clerk
- **Control Evidence:**
  - The Bank Reconciliation is initialed by the Finance Director

## Smaller Entity

- **Control:**
  - Bank Reconciliation is reviewed and approved by Township Trustees after being prepared by the Fiscal Officer
- **Control Evidence:**
  - Review and approval of the Bank Reconciliation is documented in the Board Minutes

# 3 Sources for Internal Control Guidance

**#1**

**COSO**

**#2**

**GAO's Green Book**

**#3**

**AICPA AU-C 315**





COMMITTEE OF SPONSORING  
ORGANIZATIONS OF THE TREADWAY COMMISSION

**COSO framework essentially defines internal control as a process, effected by an entity's:**

- Board
- Management
- Other Personnel

**This process is designed to provide reasonable assurance regarding:**

- Achievement of objectives in effectiveness and efficiency of operations,
- Reliability of financial reporting,
- Compliance with applicable laws and regulations.

**COSO is not a required internal control structure – just an option/source.**

# COSO – Internal Control



Internal control is a process. It is a means to an end, not an end in itself.

Internal control is not merely documented by policy manuals, systems, and forms. Rather, it is put in by people at every level of an organization.

Internal control can provide only reasonable assurance, not absolute assurance, to an entity's senior management and board.

Internal control is geared to the achievement of objectives in one or more separate but overlapping categories.



- GAO's Green Book is a required internal control structure for federal agencies.
- May also be adopted by state & local gov's.



# AU-C 315

A direct relationship exists between an entity's objectives and the controls it implements to provide reasonable assurance about their achievement.

The entity's objectives and, therefore, controls relate to financial reporting, operations, and compliance; however, not all of these objectives and controls are relevant to the auditor's risk assessment.

## **AU-C Section 315**

### ***Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement***

(Supersedes SAS No. 122section 315)

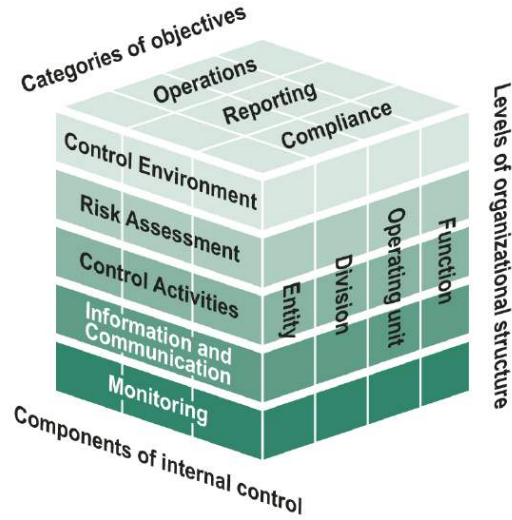
Source: SAS No. 145.

### **[SAS No. 145: Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement](#)**

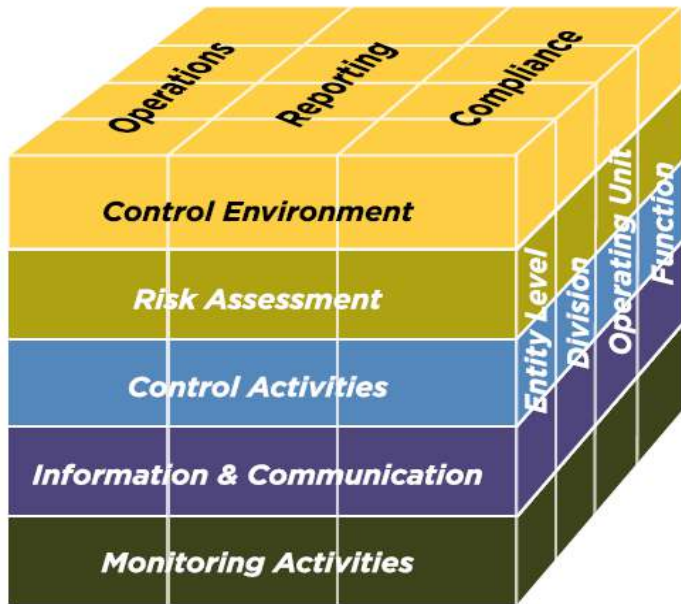
**Effective for audits of financial statements for periods ending on or after December 15, 2023.**

# Components/Objectives/Entity

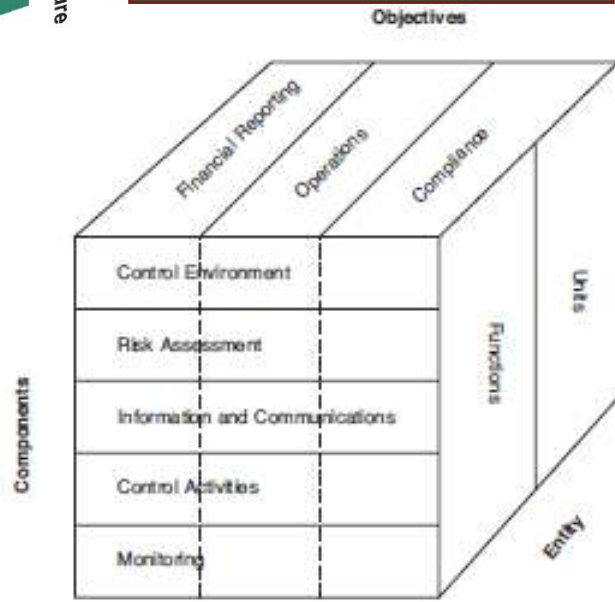
**GAO  
Green Book**



**COSO**



**AU-C 315**



# Deficiency in Internal Control

I/C deficiencies result in errors which occur in the normal course of operations and are not detected or corrected timely. These are due to:

- Deficiency in Design - Existing control is either nonexistent or control in place does not address the specific control objective.
- Deficiency in Operation - Control not being performed by an individual being bypassed during daily operations.





# Service Organizations (SO's)

- Even if you outsource or delegate some processing, you are not absolved from your duties to have controls over that activity.
- The best way to accomplish this is to ensure your service organization has a Service Organization Control (SOC 1) report.
- A SOC 1 report provides your auditors the necessary understanding of your SO's systems and the operating effectiveness of their controls



# Typical SO's

## Examples of typical SO's:

- Payroll processing
- Income tax processing
- Self-insurance claim processing
- EMS billings
- Investment purchases (transaction not pre-approved)

## Examples that are not SO's:

- Bank checking account
- Investment purchases (entity approves each trans.)
- Purchased insurance policy
- Purchase of utility services for your office building



# Benefits of Internal Controls



Safeguard and Protect public assets – money & property

Make responsible financial decisions via budgeting

Properly manage government resources to achieve goals of government via internal controls



# Internal Controls

Internal controls can **help** assure that balances and transactions are:

- Accurately recorded
- Complete
- Properly cutoff
- Existed
- Occurred
- Properly classified

# Internal Controls

## Develop internal controls to:

- Protect assets from loss
- Ensure transactions are authorized
- Ensure all funds are collected for services provided by the local government
- Ensure restricted funds are used only for allowable purposes

# Internal Control: An Evolving Process

## Monitor Internal Controls for the need for change

- Changes to policies and procedures
- Changes to laws, regulations, grant requirements, etc.
- Communicate changes to employees

## Not enough to implement internal controls

- If the controls aren't working – change the internal controls

## Controls must be followed

- **EVERY** time not just **SOME** of the time
- Not following the control process one time is too many-
  - That might be when fraud/misuse, errors, or misstatements occur

# Internal Controls in the Remote and Hybrid Work Environment

## Reviews

- Electronically transmitted, and reviewed remotely
- Saved emails and instant messages possibly serve as control evidence
- Accounting System may allow for approvals to be evidenced electronically



## Human Element

- Don't forget about the people behind the processes
- Consider checking in daily/weekly with your team
- Video more often than telephone or email

## Monitoring

- Continuously discussing processes
- Demonstrates that someone is always assessing the situation
- May serve as a fraud deterrent

## Segregation of Duty Issues

- Only certain employees are going into the office
- May need to reassign duties temporarily

## Security

- Secure portals to transmit documents

## Document

- Document any changes made to internal control procedures
- Auditors will likely review the changes

# Responsibility for Controls

**MANAGEMENT!**

**MANAGEMENT!**

**MANAGEMENT!**

# Responsibility for Controls

## Who Is Considered Management?

The person(s) with executive responsibility for the conduct of the entity's operations.

For some entities, management includes some or all of those charged with governance; for example, executive members of a governance board or an owner-manager.

# Responsibility for Controls

System of internal controls should be developed by management

It is management's primary responsibility to develop proper controls

Management must be committed to development and maintenance of controls

Management needs to clearly define expectations

Management must understand that segregation of duties has associated costs

Management must monitor controls

Management must have understanding of information and be able to ask questions

Management is front line to find a theft



# Management's Responsibility for Fraud

Management should assess risks and review fraud risk indicators to develop policies or controls to minimize the risk of a fraud occurring.



# Common Policies

Credit Cards

Cell Phones

Public  
Records

Cash Mgmt.

Equipment

Personnel

Travel  
Expenses

Budgets

Cybersecurity

# Focus of Internal Control



## Integrity of Information

- How accurate is the information used to process the information?
- Who approves the information or changes to the information before and after input into the system?
- Examples: Employee and Vendor Information

## Authorization

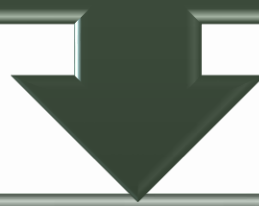
- Who has access to the information?
- Who has authorization to change or alter the information?
- Are changes to information approved?
- Examples: Access to the vendor and payroll master file is limited and changes to the vendor and payroll master files require approval

# Segregation of Duties



# Segregation of Duties Definition

Process where management divides or segregates key duties and responsibilities among different people to reduce the risk of error, misuse, or fraud.



So that no one individual controls all key aspects of a transaction or event, this includes separating the responsibilities for:

**Authorizing  
Transactions**

**Processing &  
Recording  
Transactions**

**Reviewing the  
Transactions**

**Handling Any  
Assets Related to  
the Transactions**

# Focus of Internal Control



## Segregation of Duties

- Who has responsibility for authorization, recording, and safekeeping?
- Examples:
  - No single person should: Prepare bills, Receive money, Record receipts, Deposit money, Reconcile bank accounts
  - No single person should: Authorize payments, Disburse funds, Reconcile bank accounts

## Review and responsibility

- Work should be regularly checked
- Examples:
  - Payroll: Personnel records, Employee pay rates, leave entitlements, Verify payroll reports agree to the bank statements
  - Vendor : Vendor Master File, Vendor Payments
  - Bank Reconciliations: Review all information on the bank reconciliation, including the underlying information

# Segregation of Duties in Standards/Guides

Council of  
Sponsoring  
Organizations  
(COSO)

Green Book  
(GB)

AU-C's  
(US Auditing  
Standards)

Ohio  
Administrative  
Code (OAC)

# Assignment of Responsibility & Delegation of Authority

Mgmt. determines what level of authority each key role needs to fulfill a responsibility.



Mgmt. delegates authority only to the extent required to achieve the entity's objectives.



As part of delegating authority, management evaluates the delegation for proper segregation of duties.



# Segregation of Duties

AU-C  
240

- Inadequate segregation of duties or independent checks increases the susceptibility of misappropriation

AU-C  
265

- Absent or inadequate S.o.D may be deficiencies, significant deficiencies, or material weaknesses

# Segregation of Duties

## AU-C 315

- Should reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or fraud

## OAC 117-2-01(D)(4)

- When designing the public office's system of internal control and the specific control activities, mgmt. should plan for adequate segregation of duties or compensating controls.

# Document Internal Controls

## Maintain Documentation of Internal Controls being performed

- Assists in the internal review process
- Provides evidence to auditors



# Lessons Learned

## City

- Payroll Clerk
- Stole nearly \$68,000
- Writing additional payroll checks to herself

## County

- Utility Clerk
- Stole nearly \$15,000
- Adjusting and voiding customer accounts and pocketing cash payments

## County

- Clerk of Courts
- Stole over \$17,000
- Used various schemes, including reversing deposits, altering deposit slips, and pocketing cash payments paid to the Court

## School

- Account Clerk
- Stole over \$500,000
- Used various schemes, including issuing checks to himself, using the District's credit card to make personal purchases, and pocketing cash from athletic events and student fees

# Take-Aways

## Importance of Internal Controls

- Reliable financial reporting
- Effective and efficient operations
- Compliance with laws and regulations
- Assets safeguarded against unauthorized acquisition, use, or disposition

# Take-Aways

## What should you do now?

- Determine policies necessary for your entity
- Determine if your entity has any service organizations
- Determine if your entity has adequate segregation of duties or compensating controls
- Ensure procedures are in place so controls identified in your policies are operating effectively

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