



Center for Local Government Excellence

Basics of Internal Control and Best Practices

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Learning Objectives



This course is designed to:

- * Introduce participants to the overall concepts, components and processes of Internal Control
- * Present Internal Control best practices to help local government officials/staff enhance fiscal and programmatic operations
- * Then, you can go home and actually put in to play what you have learned here today!!!!!!

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The Father of Internal Control: COSO



- * In response to concerns in Congress regarding fraudulent financial reporting and improper payments by corporations (1970s and 1980s)
- * Committee of Sponsoring Organizations of the Treadway Commission issued Internal Control: *Integrated Framework in 1992.*

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Internal Control-what is it?



A process effected by those charged with governance, management, and other personnel, 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

COSO: Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control: Integrated Framework*

Now, in plain English.....



Internal Controls help to **“make sure things happen the way you want them to happen and bad or unexpected things don’t happen.”**

Deane Hennett,
Director of Internal Audit
Old Dominion University

Very Important Concepts



The **Board** exercises oversight for the development and performance of Internal Control.

Management is responsible for designing and implementing controls to prevent and detect fraud and to achieve objectives.

(Cooperation, Coordination, Respect)

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Very Important Concepts



Internal Control is a Process!

- * Several interrelated components that work together to accomplish the entity's **objectives**

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Very Important Concepts



Internal Control is affected by people!

- * Not just policy manuals and forms
- * It's **people** performing assigned functions at **every level**
- * Board Member to Agency Head to Accounting Clerk – **all have a role in successful operation** of Internal Controls

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Very Important Concepts



Internal Control provides reasonable assurance, not absolute assurance!

- * No matter how well designed and operated, can't protect you from everything
- * Errors in judgment, human error, **collusion** among employees, and **management override** of controls
- * Absolute assurance would be really expensive

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Very Important Concepts



The Process of Internal Control is geared to the achievement of objectives!

- * **Objectives** = things you want/need to happen (e.g., Provide utility services to paying customers)
- * **Risks** = what could occur to keep objectives from happening (e.g., Customers don't pay, but receive services)
- * **Controls** = actions to make sure objectives happen (e.g., review past-due accounts and apply cut-off policy)

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Internal Controls-why are they important to Local Governments?



- * **Safeguard** against fraud and the misuse of assets
- * Serve as management tool to achieve objectives efficiently and effectively (**Operations**)
- * Ensure accuracy and reliability of **financial reporting**/other information used for decision-making
- * Ensure **compliance** with laws and regulations

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What happens if controls are weak?



Does it just happen in Government?

- * Rock band *Cold Kingdom* has \$33,000 in equipment stolen
- * New Jersey Doctor has 40,000 patient files stolen

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What happens if controls are weak?



- * Crazy Eddie's Electronics Business defrauds government and investors of millions
- * Inflating inventory assets to increase reported profits
- * Sam Antar said that nobody looked behind the boxes

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- ## Components of Internal Control
- ### Control environment
- * Tone at the top – filters down to all in the organization
 - * Bedrock on which all other elements based
 - * Influences the risk assessment process; the control activities established; communication systems; and monitoring activities
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Control Environment cont...



The Board/Management Do the following:

- * Communicate and enforce **integrity/ethical values** through codes of conduct
- * Display **effective attitudes and actions** when objectives are being jeopardized (e.g. address policy violations immediately and consistently)
- * Set the skills, knowledge, and experience needed by staff (e.g. job descriptions)
- * Assign right number of staff with right skill sets for the job
- * Consistently hire, train, evaluate, compensate, promote, and discipline based on solid policies and procedures

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Control Environment cont...



When all in the organization know (and actually see) that the Board and Management take Internal Control Seriously, change will take place.

“Tone at the Top”

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Components of Internal Control



Risk assessment

- * **What could go wrong?** Identifies/analyzes risks associated with achievement of objectives
- * Estimates the impact on achievement of objectives
- * Estimates the likelihood of occurrence
- * Helps Board and Management decide what controls should be implemented to manage identified risks

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Components of Internal Control



Control activities: Strategies/activities that management designs to ensure that risks are addressed and objectives are achieved:

- * Can be **Preventative** (avoid) or **Detective** (discover and correct)
- * **Formal/Written Policies and Procedures** (your blueprint)

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Control Activities cont...



- * **Segregation of Duties:** Segregation of Incompatible duties (separate approving, authorizing, recording, reconciling and custody of assets)

No employee should be in a position to both commit an abuse/fraud and conceal it!

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Control Activities cont...



- * **Control over Transactions** (Approval, authorization, review, verification, and periodic reconciliation)
- * **Physical Controls** (equipment, inventories, cash, etc. are locked up and access is restricted)
- * **Reconciliation** of financial documents/records (sub-ledger to general ledger to bank statements)
- * **Remember – look behind the boxes!!!!**

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Components of Internal Control



Information and Communication

- * Supports the functioning of all components of internal control
- * Information must be identified, captured, and communicated so that people can carry out their responsibilities
- * Information can be operational, financial, and compliance related – makes it possible to run and control the organization
- * Should be internal as well as external (e.g., info conveyed to/received from shareholders, customers, consultants)

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Information & Communication cont...



Information must be:

- * **Accessible** – easy to obtain
- * **Timely** – can access when needed
- * **Correct** – accurate and complete (validation checks)
- * **Current** – up-to-date data
- * **Sufficient** – enough information to make informed decisions
- * **Valid** – represents activities that actually occurred

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Information & Communication cont...



Forms of communication:

- * Must have info available and be fully aware of your job responsibilities!
- * Internal Financial reports available to Board, Management, and applicable Staff
- * Strategic Plan (Mission, Goals, Objectives of the Entity)
- * Policy and Procedure Manual(s)
- * Job Specs and Performance Evaluations
- * Discussions of Overall Performance at Board Meetings
- * Channels for employees to report Fraud, Abuse, and/or Waste
- * External Audits, customer feedback, transparency

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Components of Internal Control



Monitoring Activities

- * **Self-assess:**
 - ✓ what is working
 - ✓ what is not
 - ✓ when we didn't meet objectives, why didn't we
 - ✓ which controls would move us towards achievement of objectives
- * Internal Control System should be monitored continuously
- * Deficiencies should be discussed and resolved

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Internal Control Best Practices

Best Practices Checklist

<http://www.la.gov/auditresources/bestpractices>



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Policies & Procedures



- * No formal, written policies and procedures--**biggest problem that we see.**
- * Necessary to provide a clear understanding of:
 - ✓ **What** should be done?
 - ✓ **How** it should be done?
 - ✓ **Who** should do it?
 - ✓ **When** it should be done?

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Policies & Procedures



Why are they important?

- * It's your **blueprint** for current administration and those that follow
- * Lessens the risk of violating state law and local ordinances
- * Establishes controls that can deter theft and other losses

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Policies & Procedures



- * Ensures consistency and continuity of operations (all on the same page)
- * A “go-to” during disputes
- * Helps to cross-train staff
- * Helps hold staff accountable

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Policies & Procedures



Policies and Procedures should address:

- * Preparing, adopting, monitoring, and amending the **budget**
- * **Financial Statement** preparation, reporting, and related council discussion of financial information
- * **Procurement and purchasing** (Bid Law)
- * Recording, tagging, and safeguarding of **assets** (conducting physical inventories)
- * Use of **credit cards** and supporting documentation
- * Dispensing **fuel** and reviewing usage

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Ethics



- * Emphasize the importance of the **Code of Ethics**
(R.S. 42:1101 et. seq.)
- * Require Board members, officials, and staff to sign **annual certification letters attesting to compliance** with the Code and other internal ethics policies
- * Make sure all are receiving **yearly ethics training** per state law

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Financial Management



Board/Management should ensure that:

- * Budget is developed and adopted annually
- * Budget is balanced
- * Budget contains requirements as presented in law

[R.S. 39:1305 (C)(2)(a)]

- * Budget is realistic and based on sound estimates
- * Budget is used to drive decisions and plans

- * **LMA/LLA Webinar:** Using the Budget as a Financial Tool

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Financial Management



- * Accurate and complete financial statements should be prepared each month
- * Statements should include a comparison of actual results to budget amounts with variances
- * Statements and other financial information should be provided to the Board and discussed in detail at regular Board meetings

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Financial Management



Suggested Financial Information to Present and Discuss at Board Meetings:

- * Income Statement (should include a comparison of actual and projected revenues and expenditures compared to the budget)
- * Balance Sheet
- * Accounts payable and receivable aging schedules
- * Analysis of budget variances and recommendations for corrective action
- * Performance data

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Purchasing & Disbursements



- * **Remember**, no single individual should control all facets of a financial function!
- * Bid law is communicated to staff
- * Process that flags requisitions/purchase orders when account is over budget
- * Documented review of Purchase orders, receiving reports, and vendor invoices before payment is made

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Purchasing & Disbursements



- * Supply of blank checks is secured
- * Get rid of the check signing machine/stamp (or heavily restrict and log/monitor use)
- * Develop an approved vendors list and review/update it periodically

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Purchasing & Disbursements



Make it clear to all that there will be regular, unannounced review of purchases/related documentation and fraud, abuse, and waste will be dealt with very seriously!

“Tone at the Top”

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Contracting for Services



- * **Cost/benefit analysis** can show whether contracting is needed to carry out objectives
- * Use **RFP** or traditional **bid thresholds/processes** to ensure fees for services are cost-effective
- * Contract should include **specific services** to be performed
- * **Legal counsel** should **review contracts** before signed
- * Review/monitor to make sure **services received comply with contract**

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Credit Cards



- * **If you can get by without using them, don't use them**
- * Limit the number if you must use them
- * Define allowed purchases (don't circumvent approval)
- * Always know how many cards you have and who has them at all times
- * Itemized/detailed receipts should be required as support and business purpose should be documented for all charges (persons making and participating in expenditure should be identified)

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Credit Cards



Make it clear to all that there will be regular, unannounced review of credit card use/related documentation and fraud, abuse, and waste will be dealt with very seriously!

“Tone at the Top”

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Payroll & Attendance



Payroll usually largest government expenditure

- * Document/List all employees and approved salary or rate of pay
- * Someone independent of payroll and HR processes should review employee listing periodically for accuracy (Changes made? Authorized?)
- * Physical observation of employees should periodically be conducted

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Payroll & Attendance



- * All should complete time reports documenting hours worked
- * Require supervisory approval of time reports
- * Document available leave and leave used

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Accounts Receivable (AR)



- * Reconcile detailed AR listing with general ledger on a monthly basis
- * Reconcile detailed listing of meter deposits with general ledger and related cash in the bank
- * Billing adjustments should be approved by position independent of billing process and reason for adjustment should be documented

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Accounts Receivable (AR)



* **Insufficient effort to collect delinquent AR could be considered a violation of the LA Constitution (Art. VII, Sec 14)**

- ✓ Cut-off policy is needed and should be enforced
- ✓ Policy should establish process for collecting delinquent AR
- ✓ Must actively try and collect money owed to you (e.g. payment plans; collection agency)

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Collecting Money



* **Remember Segregation of Duties**

- * Make sure customer gets a receipt
- * Conduct daily review of receipt book to deposit slips
- * Position independent of collections should conduct regular, unannounced review of **receipt books** to **deposit slips** to **accounting records** to **bank statements**

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Collecting Money



Remember:
When all in the organization are informed that review will occur and see it happening, this serves as a very strong control
“Tone at the Top”

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Reconciling Bank Statements



Reconciling the bank statements with the book balances is necessary to ensure that:

- ✓ All receipts/disbursements are recorded (essential for complete and accurate monthly financial statements)
- ✓ Checks are clearing the bank in a reasonable time
- ✓ Unrecorded deposits and checks are appropriate

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Reconciling Bank Statements



R.S. 10:4-406(d)(2) allows the entity **thirty days** to examine bank statements and canceled checks for unauthorized signatures or alterations.

After thirty days, the entity is precluded from asserting a claim against the bank for unauthorized signatures or alterations.

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Capital Assets



- * Develop a detailed listing of capital assets (e.g., cost; date of purchase; functions using the asset; disposition)
- * Tag capital assets
- * Conduct physical periodic inventories and resolve any discrepancies (**Remember**, when things don't look right, follow-up! There are no stupid questions!)

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Traffic Tickets



- * Safeguard blank traffic ticket books
- * Account for and reconcile all issued books and returned citations (don't hand out new books until old ones are handed in)
- * Make sure violations are heard in proper venue by proper officials and recorded in minutes of court

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Traffic Tickets



- * Prohibit officers from collecting money in the field
- * Reconcile **issued citations** to **finances imposed/collected** to **fine schedules** to actual **deposits**
- * **R.S. 32:398.3** requires **audit of traffic ticket process** by clerk

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Disaster Recovery/Business Continuity



Louisiana and It's Hurricanes!!!

- * Develop a written disaster recovery/business continuity plan (continued operations/functions of the entity)
- * Test the plan at least annually
- * Need access to an offsite facility to provide for the timely restoration of operations in the event the entity's facility is unavailable for an extended period of time

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Information Technology



Must Guard Your Data!!!

- * Physical Access (e.g., computer room locked; fire protection)
- * Password Controls (only authorized users)
- * Virus Protection (prevents viruses, worms, and Trojan horses from getting onto computer)
- * Firewalls (prevent unauthorized network access)

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Resources and Contacts



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