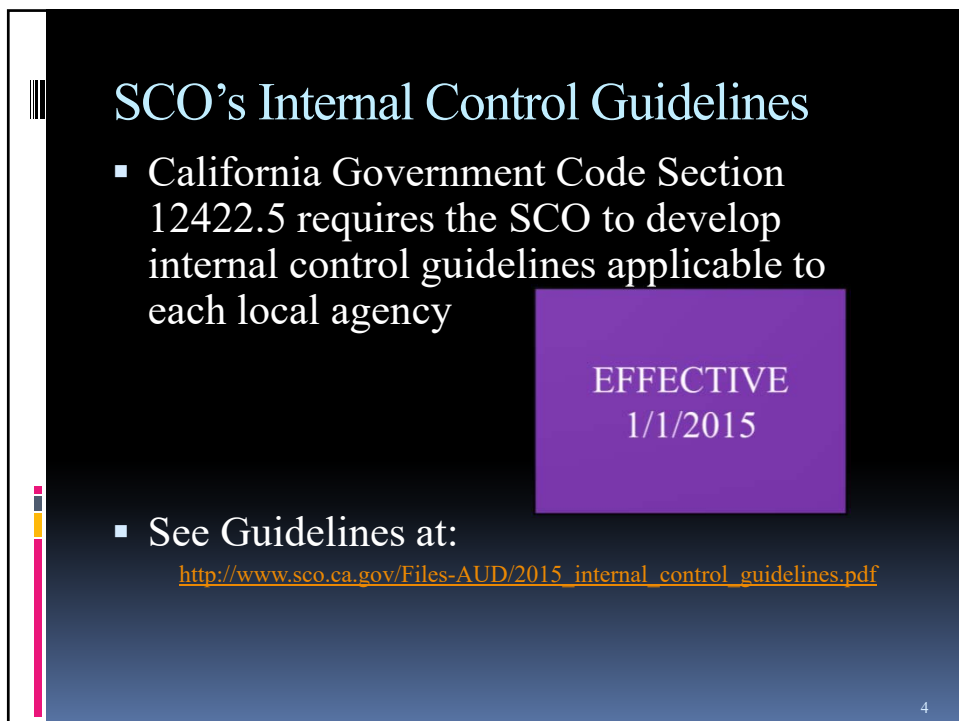


# STRENGTHENING INTERNAL CONTROLS

## What We Will Cover Today

1. Background
2. Integrated framework of internal control
3. Five elements of internal controls
4. Practical examples
5. Additional resources





## SCO's Internal Control Guidelines (Continued)

- Overview:
  - Based on current internal control standards and practical guidance published by various organizations (AICPA, GAO, OMB, COSO, IIA...etc.)
  - Contain suggested methods to address the components of internal control
  - However, these are just guidelines

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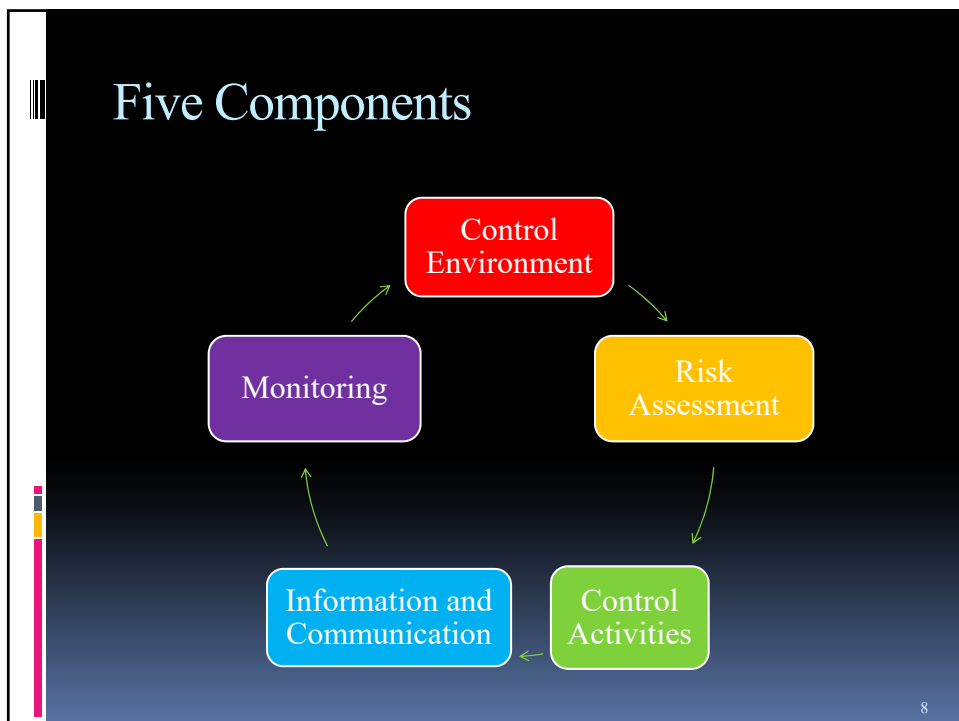
## SCO's Internal Control Guidelines

“.....to assist local agencies in establishing a system of internal control to safeguard assets and prevent and detect financial errors and fraud.”

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# Integrated Framework of Internal Control

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Integrated Framework of Internal Control  
Must Provide for:

- **Favorable** *control environment*
- **Periodic** *risk assessment*
- **Effective** *control activities* (design, implementation and maintenance)
- **Effective** *information and communication*
- **Ongoing** *monitoring*

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Control Environment

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## Control Environment -- Definition

- Covers both Management and Governing Board



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## Control Environment – Overview

- Should include some or all of the following elements:
  1. Organization's integrity and ethical values
  2. Governing board's oversight responsibilities
  3. Assignment of authority and responsibility
  4. Process for attracting, developing, and retaining employees
  5. Measures, incentives and rewards to drive accountability for performance

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## Control Environment – How to Apply?

1. Organization's integrity and ethical values
2. Governing board's oversight responsibilities
3. Assignment of authority and responsibility
4. Process for attracting, developing, and retaining employees
5. Measures, incentives and rewards to drive accountability for performance

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# Risk Assessment

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## Risk Assessment -- Definition

- Identification, analysis, and management of risks relevant to the preparation and fair presentation of financial statements



```
graph LR; Identify[Identify] --> Analyze[Analyze]; Analyze --> Manage[Manage]
```

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## Risk Assessment -- Definition

- On an **on-going** basis, management should attempt to **identify** and **assess** potential risks that could prevent management from fully meeting its responsibilities



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Rationalization

FRAUD

Opportunity

Pressure

## Risk Assessment – Fraud Triangle

- Pressure
  - Sever business pressure, for example:
    - Unrealistic budgetary goals
    - Cash flow pressures
    - Economic decline
    - Maturing debt or restrictive bond covenants

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## Risk Assessment – Fraud Triangle

- Pressure (continued)
  - Immediate financial needs, for example:
    - Substance abuse
    - Involvement in an expensive relationship
    - Excessive debt
    - Medical/financial emergencies of family members

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## Risk Assessment – Fraud Triangle

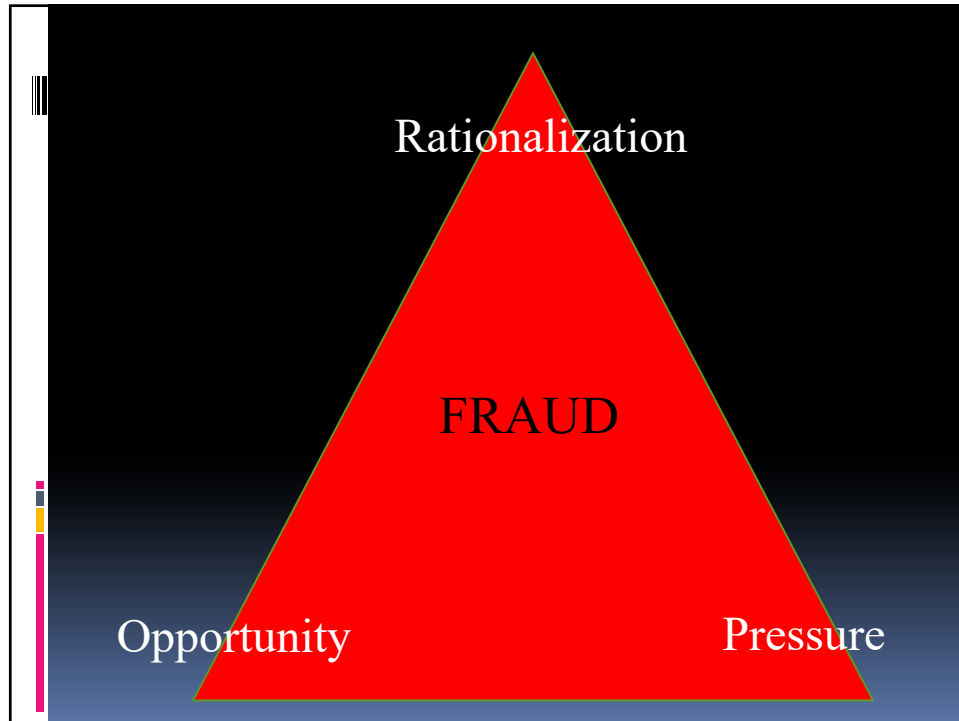
- Opportunity
  - Examples:
    - Weak design of internal controls
    - Lack of monitoring or periodic review of internal control system
    - Employee turnover/lay off

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## Risk Assessment – Fraud Triangle

- Rationalization
  - Examples:
    - “It is for the good of the organization.”
    - “I am just borrowing the money.”
    - “I am getting what I deserve.”
    - An attempt to depersonalize his/her actions.

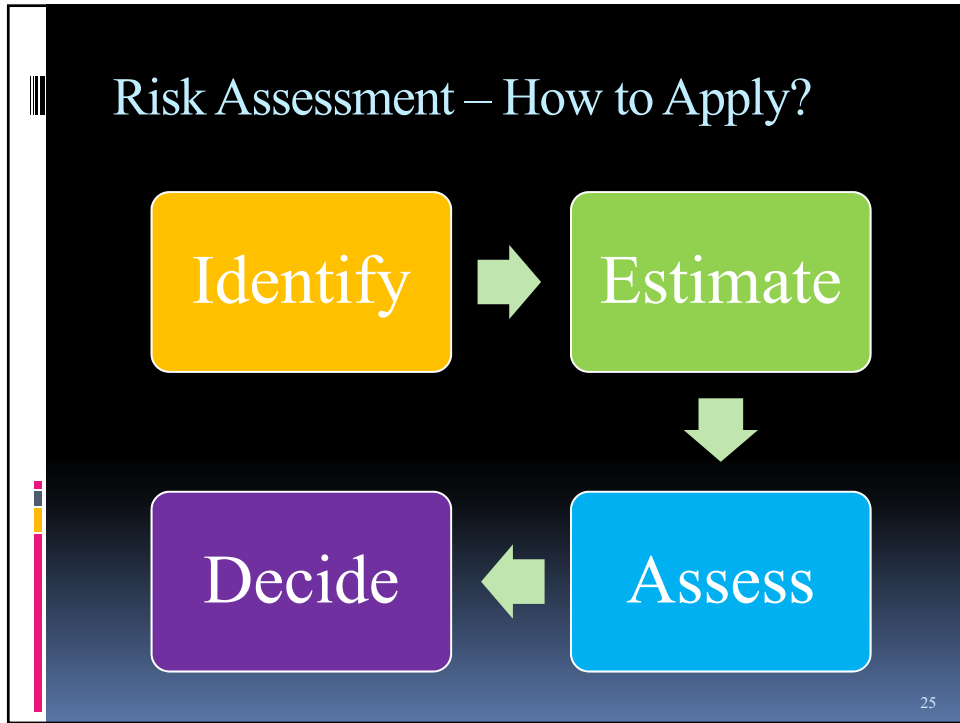
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## Risk Assessment – Overview

Process includes:

1. Identifying risks (including fraud risk)
2. Estimating the significance of each risk
3. Assessing the likelihood of the occurrence
4. Deciding upon actions to respond to and manage the occurrence and the results thereof



### Control Activities

The number 26 is visible in the bottom right corner of the slide.

## Control Activities -- Definition

Policies and procedures that help ensure that management directives are carried out.

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## Control Activities -- Overview

- Establish through policies and procedures to:
  - Achieve management directives
  - Respond to identified risks in the internal control system

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**cia** CareersInAudit.com



No, a tweet made up entirely of emojis is not sufficient documentary evidence!

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## Control Activities -- Overview

- Benefits vs. Cost
  - Benefits > Cost of control activities
  - For smaller governments, an **appropriate** second person may be a member of the governing body

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## Control Activities -- Types

1. Authorization
  - Activities should be authorized in accordance with local government's policies and procedures
2. Performance reviews
  - Local should perform analyses of financial data
3. Information processing
  - Application controls
  - General IT controls

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## Control Activities – Types

4. Physical controls
  - Tangible + Intangible
5. Segregation of duties
  - Should segregate:
    - Authorization
    - Recording or reconciling
    - Custody of assets

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## Control Activities – How to Apply?

1. Authorization
2. Performance reviews
3. Information processing
  - Application controls
  - General IT controls
4. Physical controls
5. Segregation of duties

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## Information and Communication



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## Information and Communication -- Definition

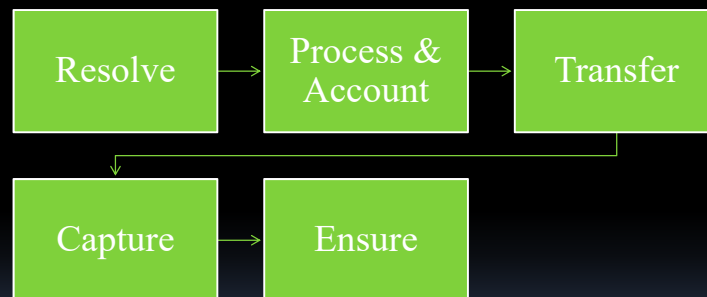
### Information System

- Enables the organization to obtain, generate, use and communicate transactions and information in order to **maintain accountability** and **measure and review the organization's performance or progress** toward the achievement of objectives
- Involves people, processes, data and/or technology (not just the IT system)

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## Information and Communication -- Definition

### Information System includes:



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## Information and Communication -- Definition

### Communication System

- Consists of methods and records established to **identify, capture, and exchange useful information**
- Ensures information is **timely** (i.e. useful), **sufficiently detailed**, and **appropriate** to the user

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## Information and Communication -- Overview

- Effective flow of information and good communication is the key
- Communication should be multidirectional and lateral
- There should also be a way for external parties to provide feedback to the local government

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## Information and Communication – Elements

Reliable

Relevant

Timely

Information and communication

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## Information and Communication – How to Apply?

- Job descriptions for all personnel
  - Documented?
- Policies and procedures
  - Detail expectations and actions?
  - Articulate distinct responsibility and accountability of each involved?
  - Communicated to the appropriate personnel periodically?

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## Information and Communication – How to Apply?

- Monthly or quarterly reports
  - Available for review by management and governing body?
- Board agenda items and decisions
  - Reviewed regularly by staff to make sure that they are carried out?
- Staff meetings
  - Feedback welcome?
- Reporting channels for wrongdoing

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# Monitoring

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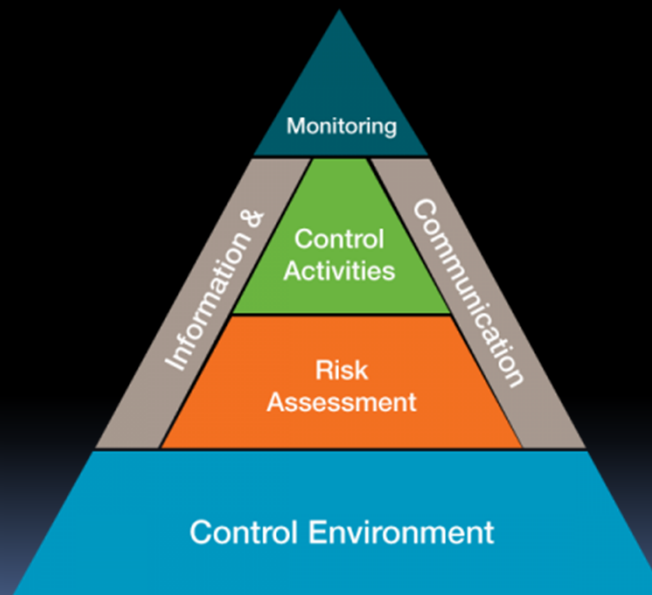


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## Monitoring -- Definition

- A process that is used by management to **assess** the effective operation of internal controls over time
- Should be done on an **on-going basis** and taking **remedial actions** when necessary

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## Monitoring – How to Apply?

- Policies and Procedures
  - Have they been updated to adequately address new challenges?
- Control Activities
  - Are they functioning properly?
- Audit findings
  - Have they been resolved?

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ADDITIONAL RESOURCES

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## Additional Resources

- Governmental Accounting Auditing, and Financial Reporting (2012) (i.e. the Blue Book), Chapters 42 & 43
- GAO's Internal Control Standards, Internal Control Management and Evaluation Tool (<http://www.gao.gov/products/GAO-01-1008G>).
- COSO's Internal Control – Integrated Framework 2013. Executive Summary can be downloaded from COSO's website (<http://www.coso.org/IC.htm>).

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QUESTIONS??

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