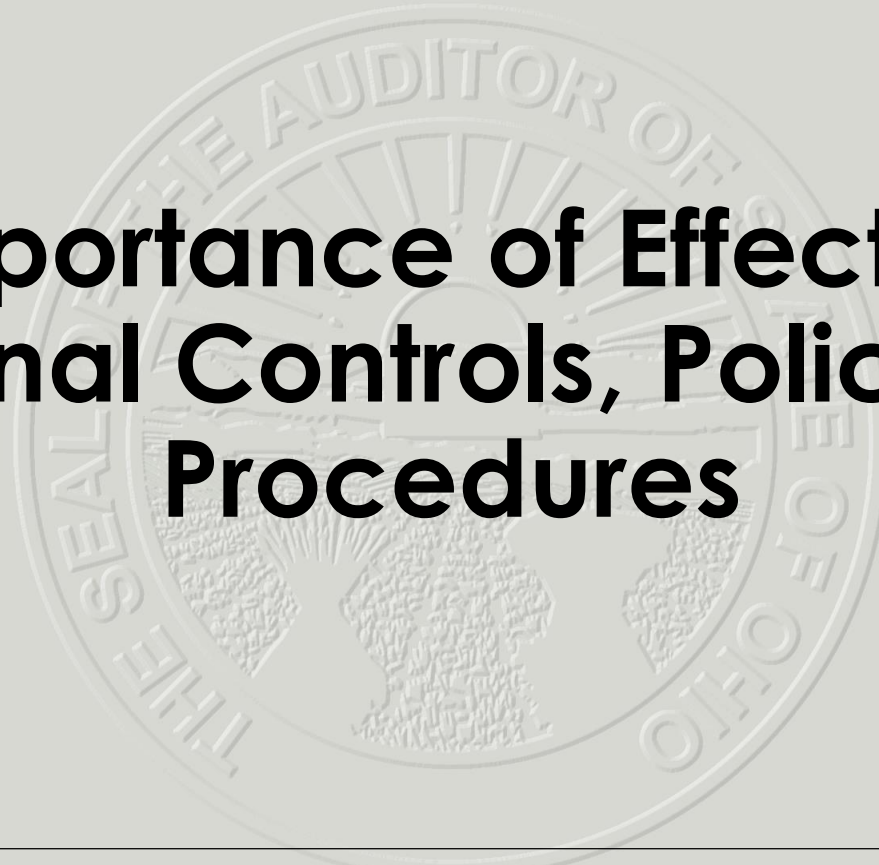


OHIO AUDITOR OF STATE  
**KEITH FABER**



# Importance of Effective Internal Controls, Policies & Procedures



Efficient • Effective • Transparent

# Overview of Topic

- Internal Controls - The Basics
- Components of Internal Controls
- Benefits of Internal Controls
- Management / Public officials responsibilities for Internal Controls
- Lack of Internal Controls - Lessons Learned

# Overview of Topic

- Segregation of Duties
- Common policies
- Credit Card Policies (Enacted HB 312 / ORC § 9.21)

# Internal Control –The Basics

## Definition

A process effected by those charged with governance & management designed to provide reasonable assurance about the achievement of the entity's objectives with regard to:

reliability of financial reporting;

effectiveness and efficiency of operations;

compliance with applicable laws & 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



# 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.

THESE ARE ALL DESIRABLE OUTCOMES

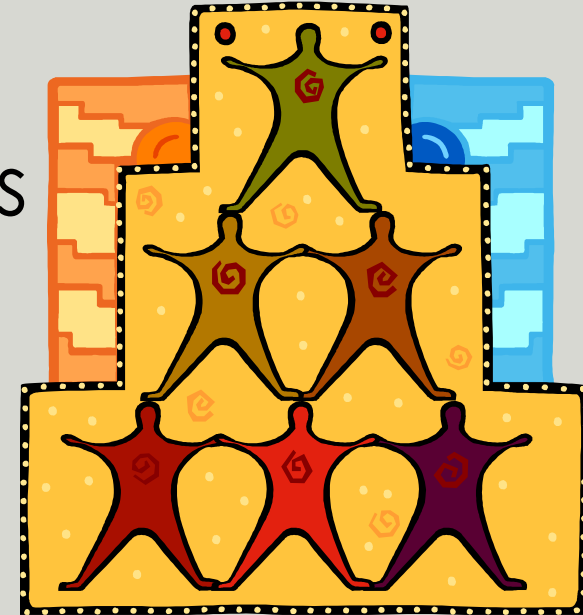
# Control Environment

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**. Reaching a conclusion about a financial institution's internal control environment involves a degree of subjectivity because of the intangible nature of measuring effectiveness.



# Control Environment: Starts at the Top!

- “Tone at the Top” for ethical behavior
- Committed to internal controls
- Code of conduct
- Hiring qualified job applicants



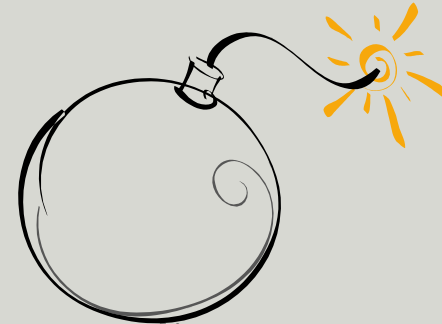
# Risk Assessment

- **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

**Think of the pension accounting changes**

# 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 can go wrong?
  - How can we avoid it?
- Particularly critical when things change:
  - Reorganization, new systems or computers, new transaction types, etc.

# 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.



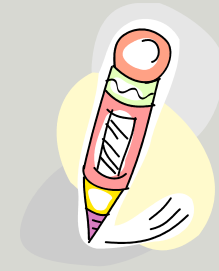
These all could be fraud indicators!!

# Monitoring

- Monitoring is a **process that assesses** the quality of the internal control performance over time
- Processes to ensure timely **modification of policies and procedures**, as needed



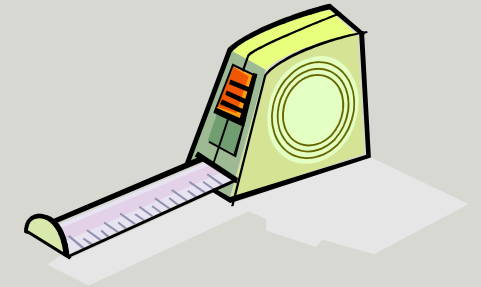
# Monitoring



A process that assesses the quality of internal control performance over time

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

# Monitoring

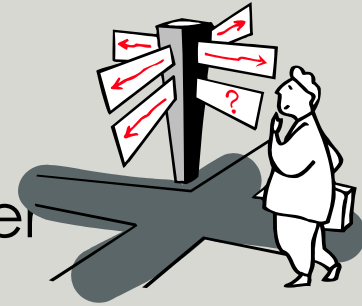


- Analytical Procedures:  
Compare what is reported with what was expected/reasonable
  - Collect / pay what was estimated?
  - Cash collected – is it reasonable in relation to the # of transactions processed?
  - Voided transactions: reasonable?
  - Any “unusual” transactions?
- **Use** budget and actual 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 the entities operations, financial reporting, and compliance areas.

# Types of Control Activities/Procedures



Control procedures include:

- Automated (Application) – Built in computer controls

i.e. Edit checks, automated computations  
(These controls are generally preventative in nature)

- Monitoring Controls - Typically performed by Management

i.e. Review month-end budget vs. actual reports occur after the transaction has been processed through the accounting system.  
(These controls are generally detective in nature)

# Partial List of Control Procedures

- Segregate incompatible duties
  - Single person [ideally] should not
    - Collect + Record + Reconcile + Deposit
- Periodic reconciliations & verifications
- Incorporate “edit” checks into computer systems



11/16 Monthly Service

Daily Balance

Date	Amount
10/20	\$ 738.97
10/21	526.82
10/22	590.53
10/23	524.21
10/24	362.24
10/27	306.42

# AU-C 315

- The Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework essentially defines internal control as a process, effected by an entity's board of directors, management and other personnel.

# COSO

- This process is 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.

# COSO

1. Internal control is a process. It is a **means to an end**, not an end in itself.
2. Internal control is not merely documented by policy manuals and forms. Rather, it is **put in by people** at every level of an organization.
3. Internal control can provide only reasonable assurance, **not absolute assurance**, to an entity's management and board.
4. Internal control is geared to the **achievement of objectives** in one or more separate but overlapping categories.



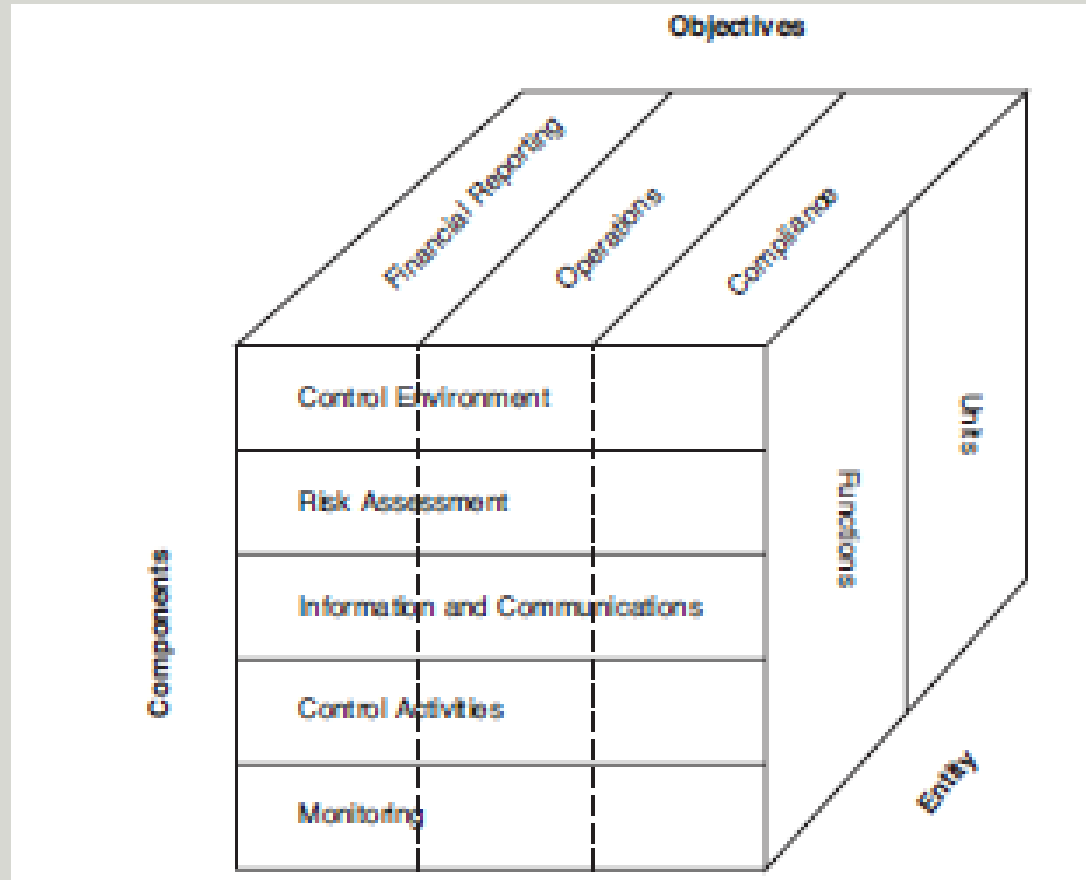
# Internal Control Structure

## 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. This relationship is depicted as follows:

# Components/Objectives/Entity



# Deficiency in Internal Control

- Results in errors which occur in 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.

# FYI – 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 Service Organization Control (SOC 1) report.



# FYI - Typical SO's

- Examples of typical SO's:
  - Payroll processing
  - Income tax processing
  - EMS billing services
  - Self-insurance claim processing
  - Investment purchases (transaction not 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 –  
Public money  
Public 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 complete, existed, occurred, are accurately recorded, properly cutoff and 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 used according to allowable purposes



# Responsibilities for Controls

- System of Internal Controls should be developed by “Management”
- It is Management’s primary responsibility to develop proper controls
- Internal controls assists the government in realizing their mission and objectives

# Responsibilities for Internal Controls

- Management must be committed to development and maintenance of controls.
- Management needs to clearly define expectations
- Segregation of duties has cost associated

# Responsibilities for Internal Controls

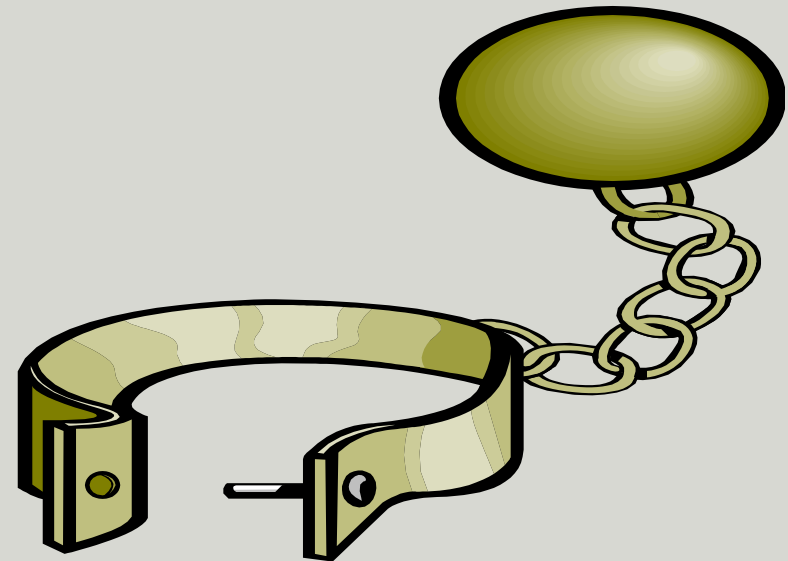
- Management must monitor controls
- Management must have understanding of information and be able to ask questions
- Management is front line to find a theft

# Who is Management?

- Smaller entities have elected officials such as Board of Trustees or Village Council but no layers of management.
- The elected officials would then function as management and have sole responsibility

# 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.



# 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**

# Various Standards

- 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
- 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 117-2-04(D)(4)
- And on and on and on.....



# Segregation of Duties in Standards/Guides

**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 117-2-04(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.

# Common Policies

Credit Cards

Cell Phones

Public Records

Cash Management

Equipment

Personnel

Travel Expenses

Budgets

Personal

Cybersecurity

# Credit Card Policies

## General Provisions - Enacted HB 312 / ORC § 9.21

- Effective date: November 2, 2018
- By February 2, 2019 each entity that holds a credit card account must adopt a written policy for the use of such
- If your entity currently does not use credit cards, you must adopt a policy prior to using or opening a credit card account
- Due to the increased risk and ability to conduct ATM transactions via debit card, HB 312 prohibits the use of a debit card except for law enforcement purposes and debit/gift cards which are tied to grant moneys.

# Credit Card Policies

## General Provisions - Enacted HB 312 / ORC § 9.21

### Policy Requirements:

1. Appointment of a compliance officer, where applicable
2. The officers or positions authorized to use a credit card account.
3. The types of expenses for which a credit card account may be used.
4. The procedures for acquisition, use, and management of a credit card account and presentation instruments related to the account including credit cards and checks.
5. The procedure for submitting itemized receipts to the fiscal officer or the fiscal officer's designee

# Credit Card Policy

## Policy Requirements (continued):

6. The procedure for credit card issuance, credit card reissuance, credit card cancellation, and the process for reporting lost or stolen credit cards.
7. The political subdivision's credit card account's maximum credit limit or limits.
8. The actions or omissions by an officer or employee that qualify as misuse of a credit card.



# Credit Card Policy

## Additional Resources:

AOS Bulletin 2018-003 – “House Bill 312 Amendments to Regulate the Usage of Credit and Debit Cards”

AOS Bulletin 2016-004 - “Credit Card Cash Withdrawals and Credit Card Controls in General”

AOS Best Practices December 2017 – “How to Minimize the Risk of Credit Card Abuse”

# Questions



# OHIO AUDITOR OF STATE KEITH FABER



**Columbus** – Doug Ferguson [DG Ferguson@ohioauditor.gov](mailto:DG Ferguson@ohioauditor.gov)

**Findlay** – Chris White [CMWhite@ohioauditor.gov](mailto:CMWhite@ohioauditor.gov) &

Ryan Seeholtz [RASeeholtz@ohioauditor.gov](mailto:RASeeholtz@ohioauditor.gov)

**Cincinnati** – Loren Crisp [LSCrisp@ohioauditor.gov](mailto:LSCrisp@ohioauditor.gov)

**Cleveland** – Katie Darno [KMDarno@ohioauditor.gov](mailto:KMDarno@ohioauditor.gov)

# OHIO AUDITOR OF STATE KEITH FABER



88 E. Broad St.

Columbus, Ohio 43215

Phone: (800) 282-0370 | Fax: (614) 466-4490

Email: [ContactUs@OhioAuditor.gov](mailto:ContactUs@OhioAuditor.gov)

[www.OhioAuditor.gov](http://www.OhioAuditor.gov)