

**Date**

October 20, 2021

Time

12:45 pm – 2:20 pm

Instructor

Michael G. Battle, CIA, CGAP,
CRMA, MPA
Advisory Services Manager

Location

Virtual

Method of Delivery

Webinar

Learning Level

Basic

CPE Hours

1.5 Hours

CPA Subject Matter

Accounting and Auditing

Yellow Book Subject Matter

Accounting and Auditing

Prerequisite

None

Internal Controls and Best Practices

Description

This course is designed to introduce participants to the basics of Internal Control. The course will cover important concepts related to Internal Controls. In addition, the instructor will discuss internal control best practices for local governments in Louisiana. Participants will be able to use the information gained in class to begin or continue the implementation of Internal Control(s) in their governments.

Objectives

After this class participants will be able to:


- Describe what internal control is,
- Relate what roles elected officials and staff play in establishing controls,
- Identify what controls are in place in their government,
- Identify what controls are needed, and
- Begin or continue the implementation of Internal Controls in their government.

Who Will Benefit

- Elected Officials/Appointed Officials
- Local Government Employees/Local Government Auditors

About the Instructor**MICHAEL G. BATTLE, CIA, CGAP, CRMA, MPA
ADVISORY SERVICES MANAGER**

Mike Battle has been with the LLA for more than 25 years. During the first part of his career, he conducted performance audits of state agencies. Mike now serves as a Manager in Advisory Services (AS) where he works to provide fiscal and programmatic advice to locally elected officials and their staffs. Advisory Services focuses on providing assistance to ensure compliance, enhance effectiveness and efficiency, and to move entities towards a more fiscally healthy position. Mike has also served as LLA's Fiscal Notes Coordinator during Legislative Sessions since 1999. Mike has a Master's in Public Administration from LSU and is a Certified Internal Auditor, Certified Government Auditing Professional, and is certified in Risk Management Assurance.



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Basics of Internal Control and Best Practices

Michael J. "Mike" Waguespack, CPA
Louisiana Legislative Auditor

October 2021

Presented by:
Michael G. Battle, CIA, CGAP, CRMA, MPA

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Agenda

- * Learning Objectives
- * Father of Internal Controls: COSO
- * What is Internal Control?
- * Very Important Concepts
- * Importance of Internal Controls
- * Overall Process of Internal Control
- * Components of Internal Control
- * Internal Control Best Practices
- * **Questions:** if we run out of time due to the amount of information that I am presenting, please don't hesitate to call and/or email me with your questions.

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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 actually put into play what you have learned here today!!!!!!
- * Towards the end of this presentation, we will discuss adapting internal controls to our remote work environment and workforce.

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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
- * Employee steals \$500,000 from Doctor's office (According to police, doctors were aware of financial issues, but thought they were related to the pandemic)

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What happens if controls are weak?

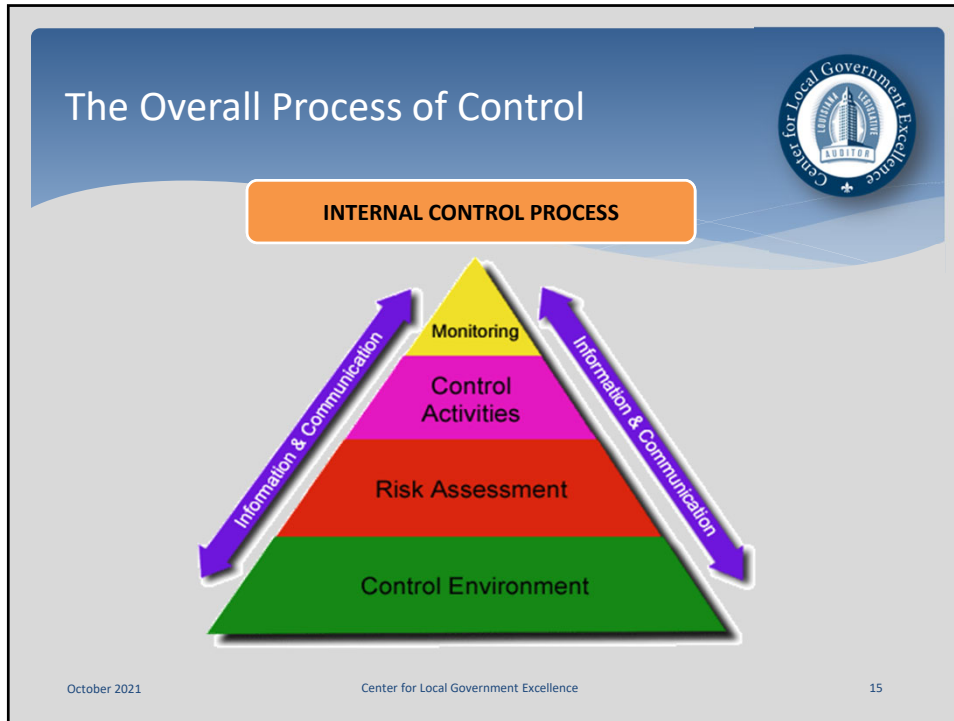


- * Crazy Eddie's Electronics Business defrauds government and investors of millions
- * Inflating inventory assets to increase reported profits
- * Sam Antar said that nobody looked behind the boxes

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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
 - * Association of Certified Fraud Examiners reported that poor tone at the top was one of the top five control weaknesses contributing to fraud (study of over 2,500 fraud cases)
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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 continued...



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)
- * ACFE reported that **lack of internal controls** was primary weakness contributing to fraud in 32% of cases studied

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Control Activities continued...



- * **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 continued...




- * **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!!!!** (ACFE reported that lack of management review is major control weakness contributing to fraud)

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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 continued...



Information must be:

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

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Information & Communication continued...



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

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

Internal Control Best Practices

<https://www.lla.la.gov/local-government-entities/index.shtml>

The screenshot shows the Louisiana Legislative Auditor website. The main heading is "Local Government Entities & Quasi-Public Organizations". Below this, there is a list of resources including "Approved CPAs Listing", "Assessors & Millages", "Best Practices", "Center for Local Government Excellence Extension Request Form & Instructions", "Legal Assistance", "Louisiana Governmental Audit Guide", "Louisiana Compliance Questionnaire & Louisiana Attestation Questionnaire", "Peer Reviews", "Practitioner Tools", and "Sworn Financial Statements". A bulleted list of services is provided, such as recommendations for improving controls, training, best practices guides, and technical assistance.


ps://www.la.la.gov
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Policies & Procedures

- * No formal, written policies and procedures— **Very common 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** (e.g., Bid Law; purchase initiation; vendor listing maintenance; **compliance with federal law**)
- * Use of **credit cards** (e.g. allowable purchases and supporting documentation requirements)
- * Dispensing **fuel** and reviewing usage
- * Recording, tagging, and safeguarding of **assets** (conducting physical inventories)

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Policies & Procedures



Policies & Procedures should also address areas such as:

- * Receipts and Collections
- * Payroll and Personnel
- * Contracting
- * Travel and Expense
- * Debt Service Requirements (**fund debt reserve accounts and don't miss debt payments – Fiscal Admin.**)
- * IT Disaster Recovery and Business Continuity
- * Ethics (e.g., prohibitions, responses to violations, monitoring system for potential violations)
- * Sexual Harassment Prevention (**La. R.S. 42:341 – 345 requires education/training, certain records, and reporting**)

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Policies & Procedures



- * **Policies & Procedures should provide guidance to staff regarding the reporting of fraud and abuse:**

- ✓ Per La. R.S. 24:523, agency head who has actual knowledge of or reasonable cause to believe that there has been misappropriation of public funds or assets shall immediately notify the LLA and DA in writing
- ✓ Require LLA hotline notice to be posted on premises and website (Fraud Hotline: 1-844-503-7283)

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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

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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 (at least monthly)

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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
- * Formal plans to eliminate deficits!

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Purchasing & Disbursements



- * **Remember**, no single individual should control all facets of a financial function! **Segregation of Duties:**
 - ✓ Two employees involved in initiating, approving, and making purchase
 - ✓ Two employees involved in processing and approving vendor payments
 - ✓ Employee processing payments does not add/modify vendor files (unless independent employee reviews changes to master list)
 - ✓ Person processing payments does not mail the checks
- * Bid law is communicated to staff
- * Process that flags requisitions/purchase orders when account is over budget

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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
- * **Grant money is pouring into our state. Make sure you adequately account for these funds; follow all grant reporting and spending requirements; and manage spending in a fiscally responsible manner.**

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Purchasing & Disbursements



- * Perform documented review of purchase orders, receiving reports, vendor invoices, and quality of **product/services** (if possible before payment; if not, catch irregular items and resolve)
- * **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” - ACFE reports that lack of management review is major weakness contributing to fraud!!!**
- * See slides on our website for “Course 205 – Expenditures: Best Practices”.

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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
- * Make sure the proper authority is approving/signing contract
- * Review/monitor to make sure **services received comply with contract and amendments comply with contract terms**

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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 and **control usage**
- * 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); **ask the question, "how is this expenditure benefitting the public/the people we are serving?"**

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Credit Cards



- * Monthly statement with supporting documentation is reviewed and approval is documented – review and approval should be done by someone other than the card holder. Follow up on irregular purchases.

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”

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?)
- * Review to make sure that salaries are being paid at authorized rates
- * Physical observation of employees should periodically be conducted

Payroll & Attendance



- * All should complete time reports documenting hours worked
- * Require documented supervisory approval of time reports and leave
- * Document accrued leave, leave taken, and available leave

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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)
- ✓ Must collect money for water usage and use to maintain the water system – **We are seeing major problems related to neglect of water systems!**

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Collecting Money



* **Remember Segregation of Duties**

- ✓ Separate cash drawers for each employee collecting cash
- ✓ Employee collecting cash is not making deposits, entries to the general ledger, and performing reconciliations;
- ✓ If incompatible duties cannot be segregated properly (e.g., small office), use mitigating controls (e.g., bring in alderman to review the entire process from collection to bank statement reconciliations).
- ✓ See slides on our website for “Course 202 – Collections: Best Practices”.

* Make sure customer gets a receipt (audit trail and sends **strong message**).

* All employees who have access to cash are covered by theft bond/insurance

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Collecting Money



- * Conduct daily review of receipt book to deposit slips (receipts should be sequentially numbered)
- * Deposits are made in a timely manner (within 1 business day or 1 week if depository is 10 miles away and collections are secured until deposit)
- * Position independent of collections should conduct regular, unannounced review of receipt books to deposit slips to accounting records to bank statements

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”

Reconciling Bank Statements



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

- ✓ All receipts/disbursements are recorded (essential for complete and accurate monthly financial statements)
- ✓ Checks are clearing the bank in a reasonable time
- ✓ Collections are being deposited and inappropriate disbursements are not occurring (follow up on discrepancies/irregularities)

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
- ✓ It's a good idea to have bank reconciliations reviewed by a member of management (who doesn't handle cash, post entries, or issue checks)

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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 (and other emergencies)!!!

- * 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
- * Do we have the tools and connectivity to work from home or other locations? **Covid!**

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Information Technology



Must Guard Your Data!!!

- * **Physical Access** (e.g., computer room locked; fire protection; secured remote working locations)
- * **Password Controls** (only authorized users; especially now that we are working at home more)
- * **Control Access to Information** – everyone does **NOT** need access to everything

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Information Technology 

Must Guard Your Data!!!

- * **Back up Your Data** – Rule of three: have at least three copies of your data on at least two different media types (keeping at least one copy offsite); weekly back up for critical data; test backed up data to verify they can be restored (every 3 months)
- * **Virus Protection** (prevents viruses, worms, and Trojan horses from getting onto computer)
- * **Firewalls** (prevent unauthorized network access)
- * Make sure protection software is **up-to-date**

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Information Technology 

October is Cybersecurity Month!!!

- * A large majority of **ransomware attacks** start with **phishing** or "bad" email where the user opens an attachment or clicks a link that then attacks their PC (ransomware insurance?)
- * Although spam filters, firewalls, and anti-virus programs are all very helpful tools, a **major internal control that will help protect us against such attacks is the implementation of an awareness and training program for staff**

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Information Technology




Awesome Security Resources

- www.cisa.gov/cybersecurity-awareness-month
- www.staysafeonline.org/cybersecurity-awareness-month
- www.idtheftcenter.org/annual-reports
- www.youtube.com/user/GOHSEP/videos
- Teletwork Reference Materials for the At-Home Worker:
www.cisa.gov/teletwork-reference-materials-home-worker

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Managing the Remote Workforce



Best Practices to Promote Productivity and Success:

- * Establish rules and expectations that will guide the remote workforce and make sure all understand these guidelines
- * Give employees the tools to stay connected and productive (e.g., chat/messaging; video conferencing; network connectivity; laptop with camera)
- * Encourage dedicated workspaces so that distractions are reduced
- * Communicate with employees (e.g., set regularly scheduled video/audio meetings; create virtual office hours; check in with employees regularly; encourage staff to check in with co-workers) – **deliberate communication helps establish and maintain “Tone at the Top!!!” Remember, staff is not watching you set an example when they are at home working.**
- * Set clear objectives and tasks to be completed and focus on results; track progress and productivity

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Managing the Remote Workforce

Ask these questions to re-assess Risk and strengthen controls:

- * **Segregation of Duties:** With the remote workforce, are duties still divided among employees to reduce the risk of error, abuse, and fraud? Or, has one person become responsible for multiple duties out of convenience?
- * **Authorization & Approval:** Are transactions still authorized and approved by someone other than the individual responsible for daily financial reporting?
- * **Reconciliation & Review:** Do staff still cross-check transactions and records to ensure accuracy and resolve questionable items?
- * **Physical Security:** How are checks, cash, and other assets protected?
- * **Accounting System Access Controls:** Are proper IT and cybersecurity measures in place now that users may be accessing systems from networks outside the organization?

Source: Upholding Internal Controls in a Remote Work Environment; Hawkins Ash CPAs; Leslie Smith.

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Managing the Remote Workforce

Making a Plan:

- * Once you have reassessed risk in your remote work environments, make a plan to address those areas
- * Clearly define and document adjusted processes and internal controls
- * Clearly identify changes to the roles of your employees
- * Communicate these changes to applicable staff
- * As our work environments and the world around us change, we should continue to evaluate risk and plan to control our daily operations
- * **Remember, just because we are working at home (or out of the office), internal controls are still essential in helping us accomplish our objectives.**

Source: Upholding Internal Controls in a Remote Work Environment; Hawkins Ash CPAs; Leslie Smith.

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Resources and Contacts



- * Association of Certified Fraud Examiners at <https://Acfе.com>
- * Institute of Internal Auditors at <https://na.theiia.org>
- * Government Finance Officers Association at <https://www.gfoa.org/best-practices--resources>

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Resources and Contacts



www.coso.org

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