



Internal Controls FMC February 2017

Agenda

- ✓ **Introduction**
- ✓ **Internal Control Process Recap**
- ✓ **Risk Assessment**
- ✓ **Control Activities**
- ✓ **Looking to the future.....**

Internal Controls – what is it?

- A process that provides reasonable assurance that the objectives of the organization will be achieved
- Not one event, but a series of actions that occur throughout an organization's operations.
- An integral part of the operational processes and not a separate system.



Internal Control Responsibility



Everyone has a responsibility for internal controls

- Management – directly responsible for the design, implementation, and operating effectiveness
- Staff – help management and are responsible for reporting issues

Auditors are ***not*** considered part of an organization's internal control system.

Status Check

- **Statewide internal control framework:**
 - Guidance for all 5 Components
 - Control Environment – issued March 2016
 - Risk Assessment – issued August 2016
 - Control Activities – issued August 2016
 - Information and Communication – issued February 2017
 - Monitoring – issued February 2017
- Communications have been provided to organizations
- Support and training has been provided to organizations



Internal Control Process Recap



Overview of the Process

- Start by establishing objectives
 - Such as financial reporting
- Then identify risks getting in way of accomplishing those objectives (risk assessment component)
 - Includes inherent, likelihood and impact
 - Documented in the RA/CA template
- Consider how much risk are you willing to allow (risk tolerance)

The Process Continues....

- Consider “risk responses” already in place
 - Control activities component (common tasks)
 - Documented in the RA/CA template
- Do any of those control activities offset the risk
 - If residual risk remains, need to consider response (which could be doing nothing)
- Then continuously monitor the overall internal control system (monitoring component)



Risk Assessment

Important Things to Remember

- Consider what risks will get in the way of accomplishing the objective
 - Break down in to specific risks, as necessary
- Need to consider for service organizations (outside third parties) too! (ex: Teamworks infrastructure is outsourced but SAO is still responsible for risks and internal controls relating to that outsourced work)
- Consider fraud and Information System related risks throughout

Why does it matter if I consider risk ratings in the absence of management's response?

- Ultimately, the risk and change responses become internal controls (control activities) that management places in to operation

So.....

- Potentially may not list all of the control activities

Wording Discussion.....



Inherent Risk – Justification Example (original wording)

All Revenue posting is made by accounting staff and reviewed in detail monthly by the CFO

Does that wording seem like it is assessing risks before consideration of control activities

Wording Discussion.....



Inherent Risk – Justification Example (original wording) - continued

All Revenue posting is made by accounting staff and reviewed in detail monthly by the CFO

These items underlined are actually listing control activities.

Wording Discussion.....



Inherent Risk – Justification Example (original wording)

Expenses are generated via contract, purchase order or check request. Each requires department head, CFO & CEO/COO approval before being incurred.

Does that wording seem like it is assessing risks *before consideration of control activities*

Wording Discussion.....



Inherent Risk – Justification Example (original wording) - continued

Expenses are generated via contract, purchase order or check request. Each requires department head, CFO & CEO/COO approval before being incurred.

These items underlined are actually listing control activities.

Inherent Risk – Justification Example (suggested revisions)

- high susceptibility to fraud, has a lot of transactions and requires manual entry of deposit
- not inherently risky because accounting standards have not recently changed
- requires manual entry of billing - and there are numerous types of different billings done
- This is a complex process that involves numerous other Departments recording their data

This wording is assessing risks before consideration of control activities



Control Activities

Management designs risk responses to react to the identified risks. Responses could include:

- Acceptance - no action is taken
- Avoidance - action is taken to stop the operational process (for example, stop allowing cash to be collected offsite or stop collecting cash at all)
- Reduction - action is taken to reduce the likelihood or magnitude of the risk (for example, segregate duties, have more oversight, etc)

Control activities are generally in these common categories

- Segregation of duties
 - Assigning key duties and responsibilities to different personnel to reduce the risk of error, misuse, or fraud
 - Example: one person initiates, a different person records, a different person approves, etc.
- Accurate and timely recording of transactions
 - Example: accurate – proper State expense, approved to be entered, recorded at the correct amount, in the correct account, etc
 - Example: timely – within the established timeframe, bank reconciliations done within one week of month end, etc

Control activities are generally in these common categories (continued):

- Proper execution of transactions
 - Authorizing and executing transactions only by persons possessing proper authority
 - Example: does the approver verify it is a proper State purpose (such as expense), supported by documentation, received, etc
- Reconciliations
 - Example: comparing balances in the accounting records to source documents (such as cash balances recorded as compared to the bank statement), and following up on any differences timely (no “plug” amounts)

Control activities are generally in these common categories (continued):

- Controls over information processing
- Physical controls over vulnerable assets
- Access restrictions to and accountability for resources and records
- Appropriate documentation of transactions and internal controls

Control activities are generally in these common categories (continued):

- Establishment and review of performance measures and indicators
- Reviews by management at the functional or activity level
- Top-level reviews of actual performance
- Management of personnel

Actions management establishes through policies and procedures to achieve objectives and respond to risks (including fraud risks) in the internal control system

- Essentially, these are the tasks already being performed
- Remember this also includes information systems considerations

You want to make sure you have captured the entire process in detail, such as:

- Documenting all control activities/tasks that are performed with specifics such as:
 - Who does it
 - What is done
 - When is it done
 - How often is it done
 - Who reviews it
 - Etc

Why does it matter if I list the details of the control activities?

- Control activities document what tasks are actually occurring in response to risk ratings
- Control activities will be “monitored” going forward
 - Want to make sure you are monitoring the right things
- Control activities documented, support the residual risk rating

Expenditures that are not valid are included in the accounting records

Controls activities answer (original wording)

Have specific control activities in place such as verifying expenditures in the accounting records have followed the proper approval process

Versus.....

Controls activities answer (sample detailed wording)

- All invoices have a cover sheet with 3 levels of approval (individual who ordered the service/product; Department Director; and the CFO), the invoice, and if applicable a copy of the requisition) before they are entered in the financial system.
- The PO number, if applicable, is entered on the cover sheet.
- AP/AR Specialist enters the invoices in the financial system and prints a detailed invoice expense report. The report is reviewed by accounting management to verify all payables are recorded accurately.
- AP/AR Specialist posts to the AP subledger and accounting management posts to the general ledger.

Cash is not all included or not recorded at the correct amounts in the accounting records

Controls activities answer (original wording)

Have specific control activities in place to ensure all cash is included and is recorded at the correct amounts.

Versus.....

Controls activities answer (more detailed wording)

- Accountant maintaining accounting records has a bachelor's degree and five years of similar experience
- A different Accountant reconciles the bank statement to the general ledger for the 3 accounts on a monthly basis with discrepancies immediately followed up on (any outstanding checks more than two months are followed up on with payee and after six months they are written off)
- Accountant's supervisor verifies reconciliations are completed within one week of month end, and are accurate (compares balances used and mathematical accuracy, etc.). Supervisor has bachelor's degree and 10 years of experience.

Important Things to Remember



- Did you consider/include controls activities relating to payroll transactions?
 - Including gross payroll (not just net payroll)
- Did you consider/include controls activities relating to automated controls?
 - User Access
- Did you consider/include controls activities relating to automated transactions?
 - Payroll automatic calculations/postings
 - Travel automatic calculations/postings

Important Things to Remember



- Did you consider/include controls activities relating to segregation of duties?
 - Person recording does not receive goods
 - Person responsible for payroll does not have access to HR functions

- Did you consider/include controls activities relating to the entire process?
 - From purchase request, to recording, to receipt, to payment, etc.



Looking to the Future



Remaining Components



- **Information and Communication**
- **Monitoring**

Recently released – last week

- Pertinent information must be identified, captured, and communicated in a form and timeframe that enables people to carry out their responsibilities.
- All personnel must receive a clear message from top management that internal control responsibilities must be taken seriously.

- Everyone must understand their role in the internal control system, as well as how individual activities relates to the work of others.
- This component is intertwined with all aspects of the internal system, and therefore, there will not be a separate submission required

Monitoring

- Essential in helping internal controls to remain aligned with changing objectives, environment, laws, resources, and risks.
- Assesses the quality of performance over time and promptly resolves the findings of audits and other reviews.

Evaluation of Internal Control System

- Once system is in place, how is it working?
 - Management is responsible for monitoring (not Auditors)
- Determine if the controls were :
 - applied at relevant times
 - in a consistent manner
 - by whom they were applied

- A deficiency exists when a control does not operate as designed, or when the person performing the control does not possess the appropriate **authority or competence**.
- Corrective actions relating to the internal control system are a necessary complement to control activities in order to achieve objectives.

Using the more specific wording, you would assess to determine if the control activities are operating as designed

- All invoices have a cover sheet with 3 levels of approval (individual who ordered the service/product; Department Director; and the CFO), the invoice, and if applicable a copy of the requisition) before they are entered in the financial system.

Some possible monitoring activities could include:

- Testing some paid transactions (selected from the financial system), and verify they contain:
 - Cover sheet
 - 3 appropriate signatures on the cover sheet
 - Requisition, if applicable

Back to our Control Activities.....



Using the more specific wording, you would assess to determine if the control activities are operating as designed

- A different Accountant reconciles the bank statement to the general ledger for the 3 accounts on a monthly basis with discrepancies immediately followed up

Some possible monitoring activities could include:

- Verifying who prepared the reconciliation
- Verify the reconciliation was prepared properly:
 - Trace ending bank balance on the reconciliation to the bank statement
 - Trace ending book balance on the reconciliation to the accounting records
 - Trace deposits in transit on the reconciliation to the next bank statement
 - Did not contain any unsupported adjustments (“plug numbers”)

Future

- SAO will:
 - Provide detailed Agency specific feedback on all previous submissions
 - Request updated and/or new submissions
 - Offer additional trainings

To be continued.....



Where to Find Information



The Green Book is available on GAO's website at:

www.gao.gov/greenbook

SAO's website:

<http://sao.georgia.gov/internal-controls>

Information will be added when available

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