



Internal Controls and Audit Findings

FMC Conference September 2018

Agenda

- ✓ **Internal Control System Overview**
- ✓ **Accurate Financial Reports and YOU.....**
- ✓ **Control Activities and Audit Findings**
- ✓ **Internal Control System Ongoing Considerations**

Effective Internal Control System



- The five components (of Green Book) must be properly designed, implemented, and then operate together, for an internal control system to be effective.
- The 17 principles support the associated components and represent additional requirements for an effective internal controls system.
- The various attributes provide further explanation and documentation requirements, or include examples of procedures that may be appropriate for an organization.

Internal Control System Design

- **Management needs to implement and design an internal control system that effectively and efficiently addresses the identified risks, and allows the organization to achieve their objectives.**
- **No two organizations will have an identical internal control system because of differences in factors such as mission, regulatory environment, size, and management's judgment.**

Internal Control System Design

- **Accuracy** - Transactions are recorded at the correct amount in the right account (and on a timely basis) at each stage of processing.
- Does it matter which way you establish and analyze control activities???? For example, looking for capital asset balances recorded in the accounting records at the correct amounts, would it matter if you:

- Start at accounting records

vs.

- Start at an outside source

Internal Control System Design

- Completeness - Transactions that occur are recorded and not understated.
- So, does it matter which way you establish and monitor control activities???? For example, looking for capital assets not recorded in accounting records, would it matter if you:

■ ~~Start at accounting records~~

vs.

■ Start at an outside source

Internal Control System Design

- Validity - Recorded transactions represent economic events that actually occurred and were executed according to prescribed procedures.
- Does it matter which way you establish and analyze control activities???? For example, looking for capital assets recorded in the accounting records that do not exist, would it matter if you:

■ Start at accounting records

vs.

■ ~~Start at the source~~

Internal Control System Design

Therefore, when designing control activities for these two specific risks, should they be the same?

NO

Capital assets are not all included in the accounting records.

Capital assets that are not valid are recorded in the accounting records (such as including capital assets that do not physically exist).

Where would you start designing control activities looking this specific risk?..... Outside sources

Specific Risk	Potential Control Activities
Capital assets <u>are not all included</u> in the accounting records.	<ul style="list-style-type: none">• Perform physical verifications (comparing <u>physical existence to actual assets</u> recorded) and reconcile any differences• Review purchases over the capitalization threshold and verify asset was added to records, if appropriate

Where would you start designing control activities looking this specific risk?..... Accounting records

Specific Risk	Potential Control Activities
<p>Capital assets <u>that are not valid</u> are recorded in the accounting records (such as including capital assets that do not physically exist).</p>	<ul style="list-style-type: none">• Perform routine physical verifications (comparing <u>assets recorded to physical existence</u>) and reconcile any differences• Performing routine reconciliations between the control account in the accounting records to the detail accounts/asset records.

- Once the internal control system has been properly designed, management then determines if the organization has placed the system into operation as designed.
- Management determines if the controls were applied at relevant times, in a consistent manner, and by whom they were applied.

Putting it all Together

- **Your internal control system should be what is recorded on the submissions to SAO**
 - Document controls actually in place, don't just document the "right answer"
- **Also, this is not just an exercise to fill out something to be submitted to SAO, instead your internal control system should be monitored on an ongoing basis.**





Accurate Financial Reports and YOU.....



So How Does This Impact Me??

The State has an objective for “accurate financial reports”, so there should be internal control systems designed and operating effectively to provide accurate data.....

Where does the data creating the State’s Statewide financial reports (such as CAFR and Single Audit) come from?

YOU

CAFR Information....



Statement of Funds Available and Expenditures Co

Governor, Office of

Year-End Fo

Governor's Emergen
State Appropriation
State General Fu

Governor's Office

State Appropriation
State General Fu
Federal Funds
Federal Funds N
Other Funds

Total Governor's Of

The information on this page
State level year-end report

2013
GA

20

Entire Year-
End Package

Compre
Implem
Gu

General
Information

-
-
-
-
-



Organization's
accounting records you
maintain in State's
Financial Software
(Teamworks)

Data you submit to SAO on
Year-end forms, trial
balance shells, and
miscellaneous requests

Single Audit Information...



Entity	CFDA	Federal
8684	84.010	Title I Grants to I
8684	84.027	Special Educatio

Federal awards data you submit to SAO via the SEFA webportal



State of Georgia

Single Audit Report

For the Year Ended June 30, 2017



Entity	Non Monetary Amount	Previous Year Amt
8.5E	\$ 0	\$
9.8E	\$ 0	\$
08.43	\$0.00	

Status of Prior Year Findings and Current Year Corrective Action Plans you submit to SAO



Control Activities and Audit Findings

“Why” should we all care about your internal control system:

- Effective internal controls provides reasonable assurance that objectives of the organization will be achieved:
 - Accurate accounting records and financial reports
 - Maintain fiscal health of the State

Your internal control system relating to accurate accounting records and financial reports should be documented on SAO’s templates.

So, if the control activities reported in SAO submissions seem pretty good, then why are there still audit findings (which identify internal control system weaknesses)?



The control activities reported in the submission must not be actually occurring the same way as documented..... So either they are not designed properly OR not operating as designed.

Therefore.....

- **Organizations should already identifying these internal control system deficiencies in your submissions, mainly as:**
 - High residual risk ratings
- **Remember, organizations then need to “fix “ that high residual risk which could include:**
 - Redesigning the internal control system
 - Monitoring more closely to ensure the internal control system is operating as designed

Single Audit Finding Trends



Now, let us look at the “Top 4” topics in recent audit findings:

Number of Financial Statement Findings by Topic						
Finding Topic	2013	2014	2015	2016	2017	Grand Total
financial reporting		3	5	7	7	22
capital assets	2	3	3	4	3	15
IT controls			1	5	7	13
bank recs	2	2	1	2	2	9

Financial Reporting Findings



- **Audit Findings were received at both the organization level and Statewide level (relating to both CAFR and SEFA schedule)**
- **Statewide finding has been received last four years**

Financial Reporting Findings



- **Some “highlights” from these audit findings:**
 - “Our examination of all the forms included in the year-end financial reporting package revealed some errors and omissions....”
 - “...basic financial statements revealed several material errors”
 - “Identified discrepancies in the reporting of federal award expenditure information related to transactions between State organizations”
 - The Organizations were not able to reconcile the difference of \$10,702,279.
 - The Organizations were not able to reconcile the remaining \$6,007,518 difference.
 - The Organizations did not report the pass-through activity under the same CFDA number.

Findings vs. Internal Control System



Finding	Control Activities Submitted by Organization	Residual Risk
“Our examination of all the forms included in the year-end financial reporting package revealed some errors and omissions...”	<ul style="list-style-type: none">• The Accounting Manager verifies amounts are properly reported on the General Ledger.• Queries and reports are examined to ensure all applicable information is properly reported.• The Accounting Manager prepares the form and gives all documentation to the CFO to verify the amounts and information is reported correctly.• If the CFO agrees, the Accounting Manager submits report to SAO.	Low – All risks compensated for

Does that internal control system seem appropriately designed? If so, then how can there be a finding? And should the auditor or management be the first to be aware of the finding?

Findings vs. Internal Control System

Finding	Control Activities Submitted by Organization	Residual Risk
The Organizations were not able to reconcile the difference of Federal related amounts.	<ul style="list-style-type: none">• Information is reconciled at the transaction level to totals from accounting systems and modules.• A reconciliation is part of the SEFA process to ensure accuracy, completeness and appropriate accounting basis.• Once the SEFA report is completed it is forwarded to the Finance Director for final review and approval.	Low

Do those internal control systems seem appropriately designed? If so, then how can there be a finding? And should the auditor or management be the first to be aware of the finding?

Findings vs. Internal Control System



Finding	Control Activities Submitted by Organization	Residual Risk
The Organizations did not report the pass-through activity under the same CFDA number.	<ul style="list-style-type: none">• Preparer uses guidance from Federal Uniform Grant Guidelines concerning federal awards and sub-recipients• Report is reviewed and approved by competent person before submission to SAO;• Preparer uses documentation identifying sub-recipients by CFDA number.	Low - Residual risk is very minimal if all the control steps are completed.

Does this internal control system seem appropriately designed? If so, then how can there be a finding? And should the auditor or management be the first to be aware of the finding?

FY18 Deficiencies Already Seen.....



- SAO has already returned FY18 year-end forms, PCAs, and SEFA data for not being fully and accurately completed by organizations
- Remember your data is used to prepare the Statewide financial reports, therefore, it is important to record correct information, on the year-end forms, PCAs, and in the SEFA webportal.
- Inaccurate information should not be turned in just to meet a deadline.

- Those organizations should take a look at their internal control system now and update the design or find a way to make sure it is operating as designed, in order for system to be effective.
- Remember, there are still various year-end forms to be submitted, and effective internal control systems should be in place to ensure only accurate data is submitted.
- And if applicable, determine how to mitigate residual risk to low.

FY18 Deficiencies vs. Internal Control System



FY18 Deficiency	Control Activities Submitted by Organization	Residual Risk
"Post-Closing Adjustments Form: fund, amounts and account codes, etc. reported are not accurate and do not agree with accounting records and/or supporting documentation"	<ul style="list-style-type: none">• Accountant completes a trial balance reconciliation and analysis to ensure PCA will have the desired impact.• Management reviews the completed form, reconciliation and supporting documentation.	Medium

Does that internal control system seem appropriately designed? If so, then how can there be PCAs that need to be returned?

Capital Asset Findings

- **Some “highlights” from these audit findings:**
 - Assets could not be located
 - Assets missing from inventory records
 - Errors in inventory records (wrong location, wrong serial number, not complete, etc.)
 - Amounts not properly recorded and reported

Findings vs. Internal Control System

Finding	Control Activities Submitted by Organization	Residual Risk
<ul style="list-style-type: none">• Assets could not be located• Errors in inventory records and assets not listed	<ul style="list-style-type: none">• Inventory rows of RA/CA submission were marked N/A• Ensure that all capital assets recorded in the accounting records are valid by utilizing layers of control activities• Personnel perform reconciliations with management reviews, and management monitors and reviews account balances, variances, and reports.	Low - Manual and system controls reduce the risk to a low level.

Does that internal control system seem appropriately designed (is there enough detail to determine that)? In this case, would need to capture more specifics to determine if it is not designed properly or not operating as designed.

Findings vs. Internal Control System

Finding	Control Activities Submitted by Organization	Residual Risk
<ul style="list-style-type: none">Amounts not properly recorded and reported	<ul style="list-style-type: none">Accountant follows guidance from SAO specifically <u>the "Cash, Cash Equivalents and Investments"</u> and <u>business process policies in the Cash Management</u> section.Accountant's manager reviews a sample of general ledger cash postings and traces back to source documents to ensure correct chartfields were used.	Low - All Risks are compensated for in this analysis.

Does that internal control system seem appropriately designed? In this case, would need to capture more specific control activities relevant to capital assets to determine if it is not designed properly or not operating as designed.

IT Findings

- **Some “highlights” from these Information Technology (IT) audit findings:**
 - Lack of segregation of duties for user access
 - Lack of adequate procedures to monitor internal controls at service organization
 - User access not match current job role
 - Lack of segregation of duties for system changes

Findings vs. Internal Control System

Finding	Control Activities Submitted by Organization
Lack of segregation of duties for user access	<ul style="list-style-type: none">• Separation of duties not allowing the same position to record and reconcile cash activity.• There is a segregation of duties between the individuals recording cash transactions (AR & AP) and the individuals performing the cash reconciliations (GL).

Finding	Control Activities Submitted by Organization
Lack of adequate procedures to monitor internal controls at service organization	Reconciliations to external Systems are prepared at least monthly.

Findings vs. Internal Control System

Finding	Control Activities Submitted by Organization
User access not match current job role	<ul style="list-style-type: none">• Restricted account setup to Sr. Accounting Mgr/Director of Accounting/Sr. Director of Finance

Finding	Control Activities Submitted by Organization
Lack of segregation of duties for system changes	None

- Most organizations included little to no IT controls in their submissions.
- Should IT controls be documented???

IT Control Activities

- **Yes.....**
- **Even though there are not specific questions or risk examples solely devoted to IT, the statewide guidance for the control activities component has this requirement:**
 - “If the organization relies on information technology in its operations, then management designs control activities so that the information technology continues to operate properly”
- **Most every organization relies to some extent on information technology, so therefore those control activities should be documented in your submission.**

IT Control Activities

Remember most of the IT Findings could be mitigated by fairly simple control activities.....

Specific Risk	Potential Control Activities
<ul style="list-style-type: none">• Lack of segregation of duties for user access• User access not match current job role	<ul style="list-style-type: none">• Supervisor or Manager routinely reviews user access for segregation of duties (for example, someone with payroll access should not have HR access).• CIO routinely compares financial user access to job roles.• Supervisor completes form signed by Manager (and others) updating or removing user access for job changes.

Bank Reconciliation Findings



- **Some “highlights” from these audit findings:**
 - Not properly identifying and resolving reconciling items timely
 - Unreconciled differences between accounting records vs. bank balances

Findings vs. Internal Control System



Finding	Control Activities Submitted by Organization	Residual Risk
Not properly identifying and resolving reconciling items timely	<ul style="list-style-type: none">• Bank reconciliation performed and signed by employee comparing G/L activity with the Bank Statement.• Supervisor performs verification and attestation by authorizing signature on monthly Bank Reconciliation.• Reconciling items are reviewed and corrected in a timely manner.	Low - Multiple touch points of verification mitigated by supervisory review for accuracy.

Does this internal control system seem appropriately designed? If so, then how can there be a finding? And should the auditor or management be the first to be aware of the finding?

Findings vs. Internal Control System

Finding	Control Activities Submitted by Organization	Residual Risk
Unreconciled differences between accounting records vs. bank balances	<ul style="list-style-type: none"><li data-bbox="529 446 1277 544">• N/A - Minimal cash received by the Department	N/A

Does that internal control system seem appropriately designed (is there enough detail to determine that)? In this case, would need to capture more specifics to determine if it is not designed properly or not operating as designed?

Bank Reconciliations

Remember bank reconciliations are a very important control activity that will most likely be documented in other specific risk rows in the template, such as:

- Fund balance is not all included or not recorded at the correct amounts in the accounting records
- Revenues are not all included or not recorded at the correct amounts in the accounting records
- Expenditures are not all included or not recorded at the correct amounts in the accounting records

So, even though this organization did not record control activities in the cash rows in the initial template, bank reconciliation controls should have been documented in other risk areas as well.



Internal Control System Ongoing Considerations

Overall Impact

- Remember your internal control system impacts all aspects of your organization and daily functions
- Don't wait for an audit finding before reviewing the internal control system design and operation
- Also, don't just think of it as completing the submission but more an overall culture change, training, discussion, etc.



Future

- **SAO will request updated and/or new submissions**
 - Control Environments will be re-submitted in November
- **Some new and exciting ways to submit internal control templates**
- **SAO will offer additional trainings**



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>

My Contact Information:

Compliance@sao.ga.gov

Rachael.Krizanek@sao.ga.gov