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# **INTERNAL CONTROLS**

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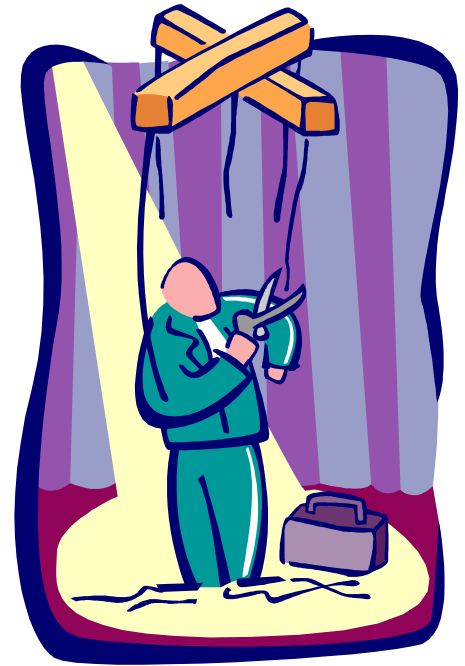
# INTERNAL CONTROL

- A government's internal control structure safeguards its assets and provides management with reasonable assurance that transactions are being processed accurately and completely.



# OBJECTIVES OF INTERNAL CONTROL

- Reliability of financial reporting.
- Effectiveness and efficiency of operations.
- Compliance with applicable laws and regulations (state and federal) and policies.
- Safeguarding of assets
- To prevent or detect material misstatements timely



# 5 COMPONENTS OF INTERNAL CONTROL

- Control Environment
- Risk Assessment
- Control Activities
- Information and Communication
- Monitoring



# CONTROL ENVIRONMENT

*Sets the tone of the organization and influences the control consciousness of its People. This is the foundation for all other Components.*

-Integrity and Ethical Values

-Organizational Structure

-Commitment to Competence

-Assignment of Authority and Responsibility

-Legislative Authority

-Policies and Procedures

-Management's Philosophy and Operating Style

# RISK ASSESSMENT

*The identification and analysis of internal and external risks relevant to the achievement of objectives and then determining how to manage those risks.*

-Entity-wide Objectives

-Risk Identification and Analysis

-Process-level Objectives

-Managing Change

# CONTROL ACTIVITIES

**Policies and procedures occurring throughout the organization, at all levels and in all functions, that help ensure management directives are carried out.**

-Policies and Procedures

-Application Change Management

-Security (Application and Network)

-Continuity/Backups

-Outsourcing/Service Organizations

# INFORMATION AND COMMUNICATION

*Identifying, capturing and communicating pertinent information in a form and timeframe that enable people to carry out their responsibilities.*

-Quality of Information

-Effectiveness of Communication



# MONITORING

*A process that assesses the quality of the internal control system's performance over time.*

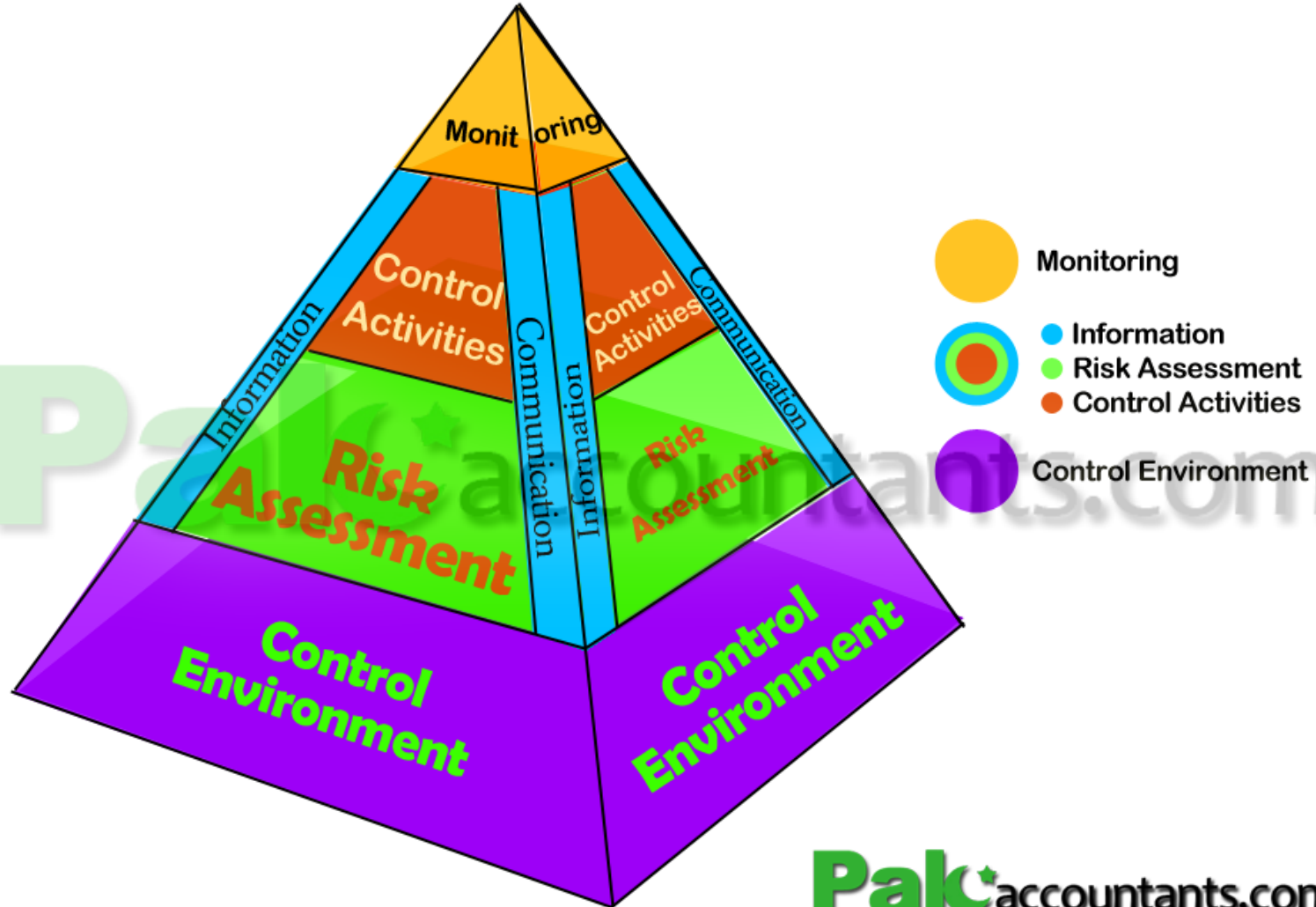
-Ongoing Monitoring

-Reporting Deficiencies

-Separate Evaluations

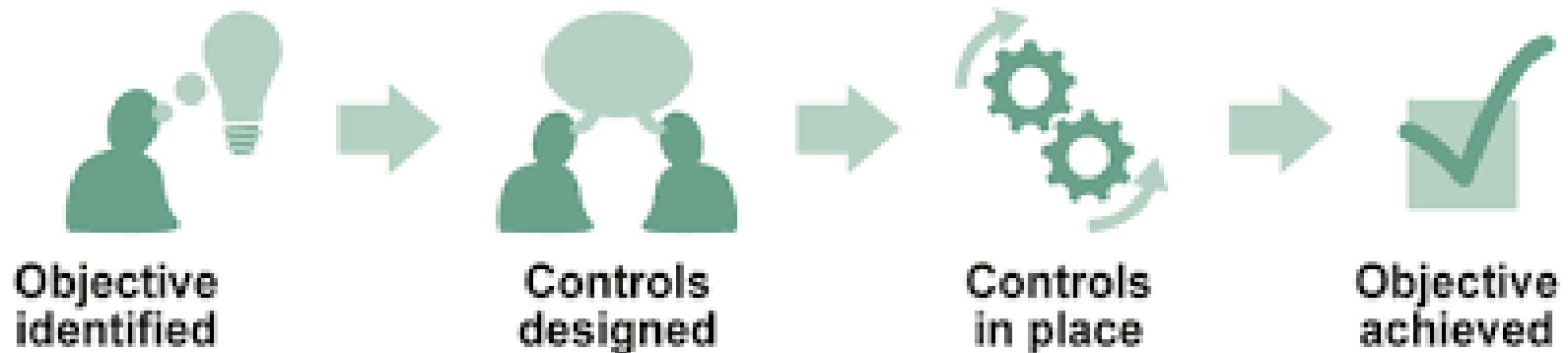
# Components of Internal Control System

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# COMPONENTS OF AN INTERNAL CONTROL PROCEDURE

- Who performs the procedure?
- What is the procedure?
- How often is it performed?
- How is it evidenced?



# TWO CATEGORIES OF INTERNAL CONTROL PROCEDURES

- Application Control
  - preventative in nature
- Monitoring Controls
  - detective in nature



# CASH RECEIPTS

- Prenumbered receipt documents should be utilized and controlled
- Receipts should be promptly recorded and deposited in a timely manner
- Receipt documents approved by an appropriate level of management
- All employees with access to cash must be bonded and should be required to take vacations.
- Cash on-hand must be appropriately safeguarded with restricted access

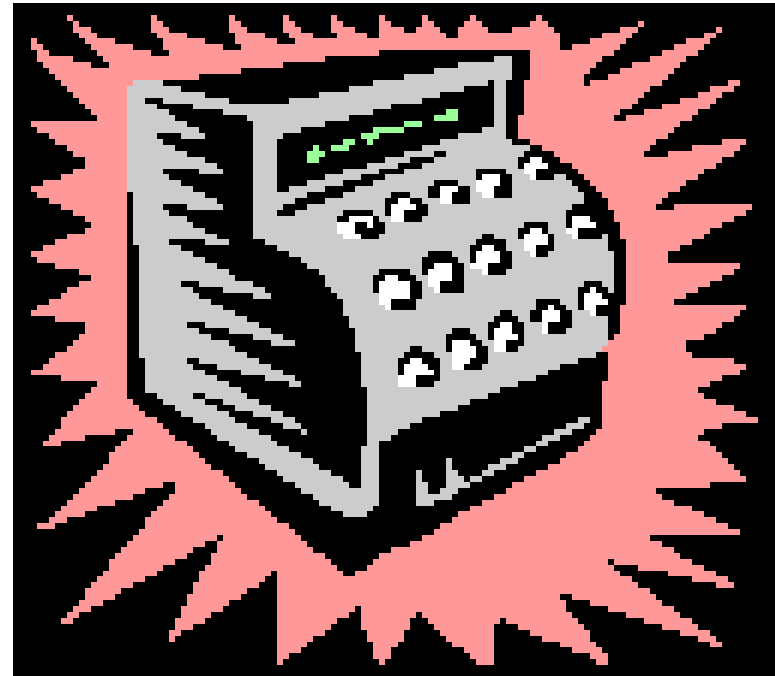
# CASH RECEIPTS

Segregation of Duties between receiving, recording, and custody of cash:

- Individuals who open mail **should** not prepare deposits, deposit cash receipts, reconcile bank accounts, investigate discrepancies, or record journal entries;
- Individuals who deposit cash receipts **should** not reconcile bank accounts or record journal entries; and
- Individuals who reconcile the bank accounts **should** not investigate discrepancies or maintain access to cash.

# CASH RECEIPTS

- Cash registers should be utilized when appropriate.
- Cash register tapes should be reconciled daily.
- Cashier funds should be counted and reconciled at the end of each shift.
- Daily cash receipts should be compared to postings to customer accounts.



# CASH DISBURSEMENTS

- Requisitions to purchase should be reviewed and approved by an appropriate level of management.
- Purchase orders should be reviewed and certified by an authorized individual.
- Purchase order, receiving report, and invoice should be matched prior to payment.
- Prenumbered purchase orders/  
System Generated





# CASH DISBURSEMENTS

- Should pay from original invoices only (no statements or proposals).
- Paid invoices should be approved for payment by appropriate department/individual and not individual cutting the check
- Pre-numbered checks – any voids/nonissues accounted for and appropriately marked void
- Vendor check should be compared with the approved vendor invoice before it is mailed.
- Blank checks should be appropriately safeguarded with restricted access.

# CASH DISBURSEMENTS

- Passwords are established and used for individuals authorized to make wire transfers and/or ACH. 2<sup>nd</sup> approval where able.
- Segregation of Duties – Individuals who review, authorize, or sign checks ***should*** not prepare checks, mail checks, have access to edit the vendor master file, investigate discrepancies involving cash disbursements, or reconcile the bank accounts.

# PETTY CASH

- A petty cash fund should be used for relatively small amounts only.
- Approval must be obtained to establish a petty cash account.
- Petty cash custodian must be appointed.
- Policy should be developed to govern allowable payments from petty cash.

# PETTY CASH

- Petty cash on-hand must be appropriately safeguarded with restricted access.
- Each petty cash expenditure must be adequately documented to support replenishment.
- Replenishment should be requested once a pre-determined minimum level has been reached.

# PAYROLL DISBURSEMENTS

- Leave forms should be approved (pre-approved whenever possible).
- Time records should be approved.
- Payroll journals, Hours registers, etc. should be reviewed prior to final processing.



# PAYROLL DISBURSEMENTS

If using Paper Checks for Payroll:

- Prenumbered checks should be used.
- Blank checks should be appropriately safeguarded with restricted access.
- Payroll checks released only to employee and employee should be required to sign.

Direct Deposit:

Bank file needs to be compared to the final payroll journal and payment should have separate approval

# PAYROLL DISBURSEMENTS

- Quarterly payroll filings should be reviewed and approved to ensure accuracy.
- Personnel files should be reviewed on a periodic basis to ensure completeness.
- HR function and payroll processing function should be separate where possible

# QUIZ

True or False?

- Applications controls are detective in nature.
- Documentation evidencing the performance of an internal control should be discarded immediately.
- Approving an invoice for payment is an example of an application control.
- All employees should have access to the safe in the event of an emergency.



# MONITORING CONTROLS

- Monthly financial reports should be reviewed by the governing body.
- Budget vs. Actual comparisons should be reviewed on a periodic basis.
- Monthly bank reconciliations should be performed.

# BANK RECONCILIATION

- Should be performed at least monthly.
- Should be performed by an employee who has no other responsibilities pertaining to cash and reviewed by supervisor
- Necessary to identify time lags and detect errors.



# BANK RECONCILIATION

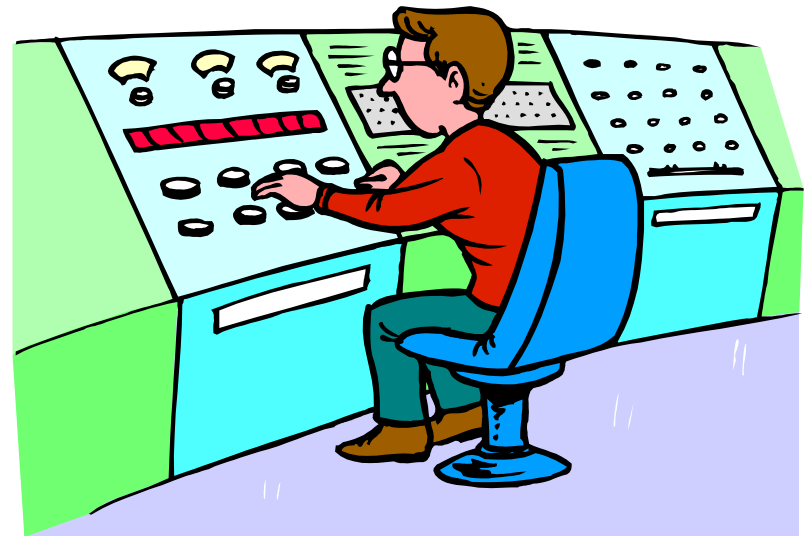


## Common Reconciliation Items:

- Deposits-in-transit
- Outstanding checks
- Miscellaneous bank debits and credits

# ACCESS CONTROLS

- Computer terminals should be password protected.
- Computer applications should be restricted to only those with a need for such access.
- Computer facilities should be restricted to authorized personnel only.



# Computer Controls

- Accountability, authorization, and approval
  - Who has access?
  - Why do they have access?
  - What information systems and data are authorized for use?
  - What is their role and what do they do?
  - Where does sensitive, private information reside?



# Computer Controls

- Limit system and data access to appropriate users
- Determine approval hierarchies and limit access
- Appoint a departmental security administrator
- Implement security measures to protect access
- Train employees in computer access, security, software, and appropriate use of information

# DISASTER RECOVERY

Procedures to minimize the disruption of Government Operations if computers or other advanced technologies are disabled following a disaster.

# DISASTER RECOVERY

At a minimum, a Government's policies and procedures should:

- Formally assign a disaster recovery team
- Require creation and preservation of back-up data
- Make provision for the alternative processing of data following a disaster
- Establish guidelines for the immediate aftermath of a disaster



# DISASTER RECOVERY

- Copy of policies and procedures should be kept off-site to ensure availability in the event of a disaster
- Every Government should test its plan and take immediate action to remedy deficiencies identified
- Disaster recovery for outsourced services must also be considered

# SERVICE ORGANIZATIONS

- Outsourced services
- SOC 1, Type 2 (Old SAS 70) audit.
- User control considerations.

# TYPICAL SO's

- Payroll processing (ADP)
- Income tax processing (RITA)
- EMS billing services
- Self-insurance claims processing
- Investment purchases (where each transaction is NOT pre-approved).

# NOT SO'S

- Bank checking account
- Investment purchases (where your entity approves each transaction).
- Purchased insurance policy

# WHO'S RESPONSIBLE?

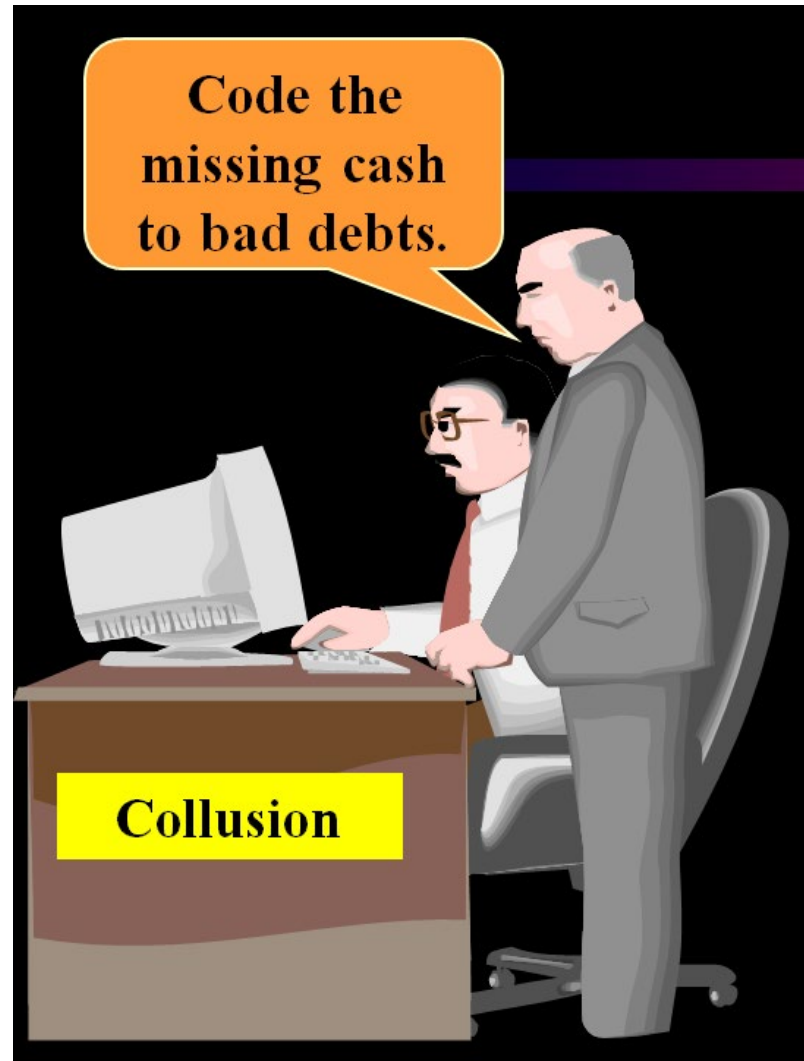
- No shift in responsibility for the underlying activity, the activity remains your entity's activity
- Your entity shares responsibility for processing transactions
- The ultimate responsibility regarding proper processing is yours
- Your entity has a responsibility to monitor its SO's.

# INTERNAL CONTROL MONITORING

- Performance of internal control procedures should be monitored by management periodically.
- Monitoring should be the responsibility of an internal audit team.
- Deviations should be reported to management for corrective action.

# INTERNAL CONTROL LIMITATIONS

- Cost-Benefit Rule
- Human Element
- Employee Collusion



# QUIZ

True or False?

- Reviewing budget vs. actual reports on a periodic basis is an example of a monitoring control.
- It is management's responsibility to implement user control considerations identified in a SOC I Type 2 report.
- A purchased insurance policy is an example of the use of a service organization.
- Internal control procedures will eliminate all accounting errors/omissions.



# QUESTIONS?

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