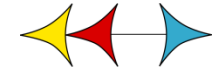


Kevin W. Harper CPA & Associates

Tales from the Trenches: Assessing Internal Controls

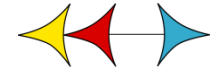
February 9, 2017



CONTROL vs KAOS



GET SMART



AGENDA

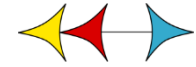
- Introduction
- Common Control Problems
- Self –Assessing Control Adequacy
- Managing City-wide Business Processes

WHAT IS INTERNAL CONTROL?

COSO defines internal control as “a process, effected by an entity’s board of directors, 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.

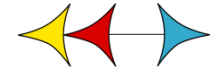




WHY ARE CONTROLS IMPORTANT?

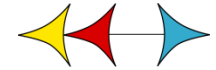
Controls help organizations:

- Achieve its mission/objectives
- Minimize surprises/problems
- Deal with changing environment
- Promote efficiency
- Reduce risk of asset loss
- Improve reliability of financial statements
- Improve compliance with laws and regulations



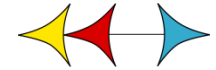
Common Control Problems

- 10 common control breakdowns
- Consequences
- Recommendations



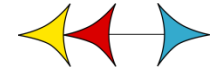
#1 Control over revenues

- Rogue billing/intercepted payments
- Ability to adequately analyze revenues
- Consequences
 - Embezzlement
 - Missed billings
- Would you know if someone were intercepting payment; or if some revenues were not being collected?



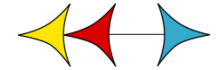
#2 Control over subsystems

- How are they integrated with GL
- Regularly reconciled? (e.g., a/r, deposits)
- Consequences
 - Embezzlement
 - Misstated financials
- How certain are you that your subsidiary systems (utility, class registration, building permits) are properly reported?



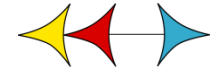
#3 Cash receipting

- Can employees collect cash and bypass reporting/deposit process?
- Is cash secure?
- Is the system tested (e.g., surprise audit, mystery shopper)?
- Would missing cash ever be discovered? (golf course, pool, tennis courts)



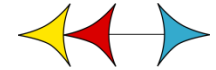
#4 Cash handling redundancies

- Cash is counted by employee, supervisor, sent to dept HQ, recounted and sent to finance, recounted with bank deposit and sent to bank who counts again.
- Do you have needless steps in the cash receipting and bank deposit process?



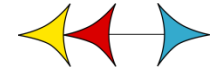
#5 Grant oversight

- Inability to produce full grant inventory
- Loss of funds due to insufficient spending or timely reimbursement requests
- Audit findings
- Repayment of grant funds
- Do you have central oversight, or at least coordination of all grants?



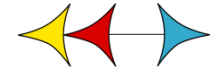
#6 Benefits reporting on W-2s

- Rules are increasingly complex
- Requires coordination between benefits administration and payroll
- Requires knowledge of what payments to employees are reportable
- Do you properly report cash payments, group life insurance, take-home vehicles, health club reimbursements?



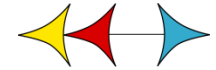
#7 Purchasing card review

- Importance of supervisor's review
 - knowledgeable of purchase rationale
 - not a rubber stamp
- Periodic audits required to maintain confidence in card controls
- Would you know if items purchased were not delivered to your agency?



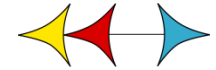
#8 Consultants / intermediaries

- Importance of reviewing work of those on whom agency relies for revenues compliance
 - Continuing disclosure
 - Third party administrators
 - County assessor
 - Rate consultants
- Is someone accountable for verification of the work of outside agents?



#9 Control over refunds

- Subject to abuse if basis for refund is not reviewed or properly documented
- Business license, code enforcement, developer deposits, class cancellations.
- Are there adequate controls over and verification of customer refunds?



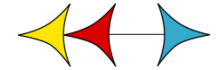
#10 Contract Authority

- Monitoring contract not-to-exceeds
- Payments not on purchase orders – brokers, attorneys, software support (particularly on older systems)
- Would you know if there were attempts to spend beyond authorized NTEs?

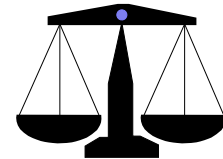
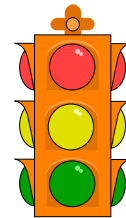
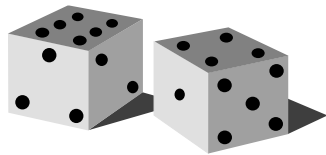
History of Controls in Local Government

- Governments are complex
- Controls were originally implemented long ago and revised by many people over many decades
- When a problem occurred, controls were added. Controls have seldom been taken away
- Most governments have not conducted a top-down assessment of the adequacy of internal controls





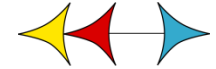
RISK(objective) – CONTROL = EXPOSURE



Self Assessing Internal Control Adequacy

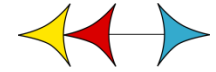
- Identify Objectives
- Brainstorm/Assess Risks
- List Existing Controls
- Assess Exposure
- Develop Improvement Plan





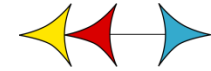
Identify Objectives

- Every business process has objectives.
- Each objective carries its own risks.
- Each objective should be specifically identified.

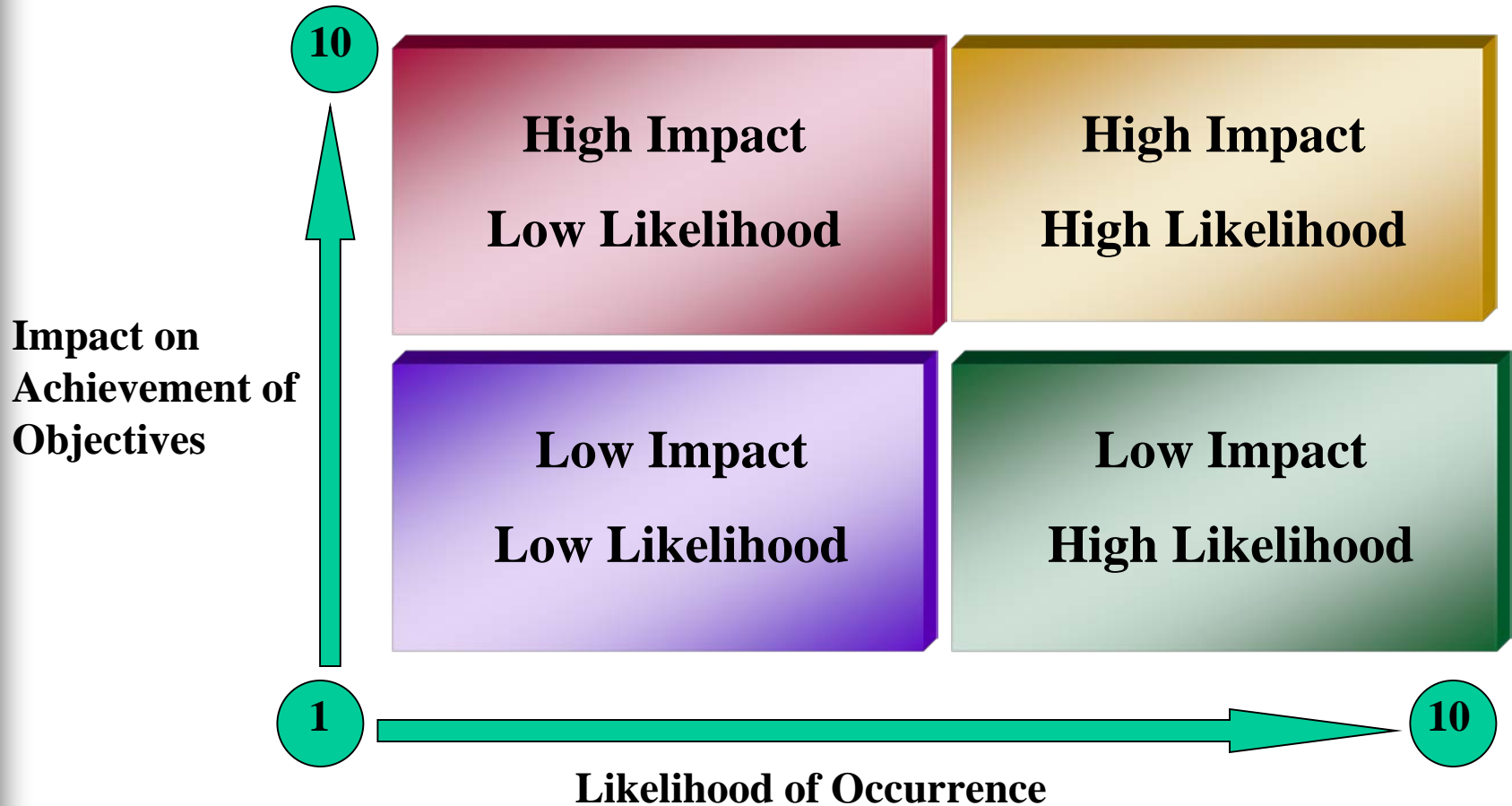


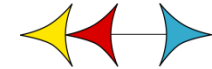
Brainstorm Risks

- The risks related to each of the government's major objectives should be identified
- Brainstorming sessions can be among the government's most knowledgeable employee experts



Assess Risk

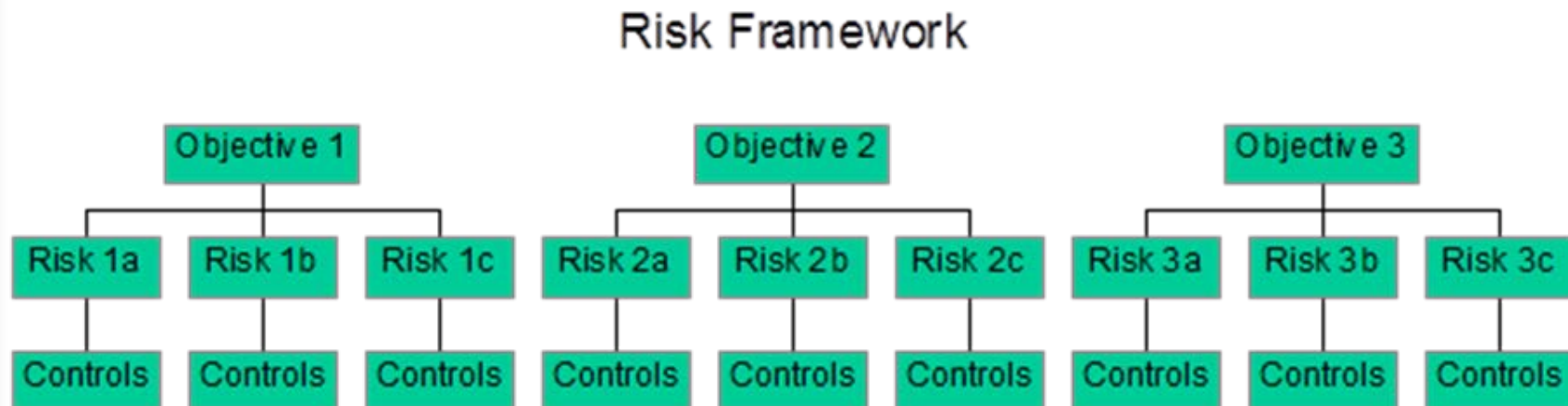


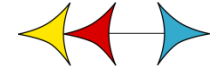


Identify Existing Controls

The government should identify the controls that are already in place to manage each major risk.

It should document its objectives, risk and controls in a logical framework, such as:

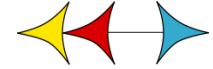




Assess Exposure

For exposure considered unacceptable, the government can:

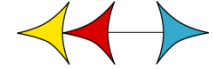
- **Avoid** – change its objective so that it is not exposed to this risk
- **Control** – enhance controls so that the resulting exposure is managed to an acceptable level
- **Transfer** – transfer the risk to another party through contract, ordinance or insurance
- **Accept** – revise its tolerance for risk and conclude that the resulting exposure is acceptable



Develop Improvement Plan

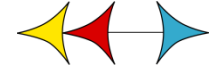
For exposures needing better control,
develop improvement plans that include:

- Needed improvements
- List of tasks needed to make each improvement
- Assign responsibility for each task
- Assign due date
- Monitor progress on all tasks in the improvement plans and conclude when each is complete



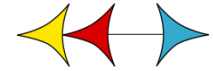
Managing City-wide Processes

- Most Finance tasks take place at the end of a City-wide process
- City-wide business processes are difficult to manage because many employees/departments involved
- Operating departments do not understand their role in the City-wide process



Managing City-wide Processes

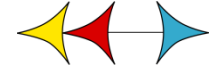
- Finance does not understand why operating departments do not “follow the rules”
- No one person understands the entire process from beginning in the operating departments to end in Finance
- No statistics monitored to know whether the processes are working well and whether operations are improving or deteriorating.



Organization-wide Workteams

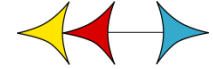
The benefits of City-wide workgroups are:

- Improved communication/cooperation between operating departments and Finance
- Improved City-wide understanding of risks and related controls
- Improved City-wide understanding of why procedures are needed
- A process owner who is focused on the efficient operations of each City-wide process across all departments
- Employees that feel empowered to improve the process.



Recommendations for Managing City-wide Processes

1. Appoint a workgroup and process owner
2. Maintain an error log
3. Develop and monitor other performance metrics
4. Conduct annual customer service survey
5. Develop action plans to improve business process



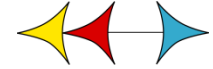
SAMPLE DISBURSEMENTS ERROR LOG

Payment Identification				Error Code	Comments
<u>Voucher #</u>	<u>Date</u>	<u>Payee</u>	<u>Amount</u>		

Resources for Developing/Assessing Internal Controls

- State Controller's Internal Control Guidelines for California Local Agencies
- http://sco.ca.gov/Files-AUD/2015_internal_control_guidelines.pdf
- GFOA – <http://www.gfoa.org>
- COSO - <http://www.coso.org/IC.htm>





Questions and Answers

Contacts

Kevin Harper – (510) 593-5037
kharper@kevinharpercpa.com

Mark Moses – (925) 980-6379
marklmoses@sbcglobal.net

