Internal Controls for Local Government

A Training Presentation for City of Tampa's Leaders

Training Objectives

What you should know after this class:

- **Types of risk**
- **Who commits fraud and why**
- **Internal controls - who needs them**
- **5 internal control components**
- **What *you* can do!**

What are Internal Controls?

To put it simply, internal controls are an exercise of common sense. You are practicing good internal controls when you?

- Balance your checkbook

- Keep your ATM/debit card pin number separate from your card

- Keep copies of your tax return

- Compare your monthly credit card statement to the credit card receipts

- Lock your car doors

- Other examples….???

What are Internal Controls?

Internal controls are an integral part of any organization's financial and business policies and procedures. Internal controls consist of all the measures taken by the organization for the purpose of:

- Protecting its resources against waste, fraud and inefficiency

- Ensuring accuracy and reliability of accounting and operating data

- Ensuring compliance with the policies of the organization

- Evaluating the level of performance in all organizational units of the organization

What are Internal Controls?

Important concepts concerning internal controls include:

- Internal control is a process. It is a means to an end, not an end itself.

- Internal control is effected by *people.* It's not merely policy manuals and forms, but *people* functioning at every level of the institution.

- Internal control is geared to the achievement of objectives in several overlapping categories.

- Internal control only provides *reasonable* assurance to an institution's leaders regarding achievement of operational, financial reporting and compliance objectives.
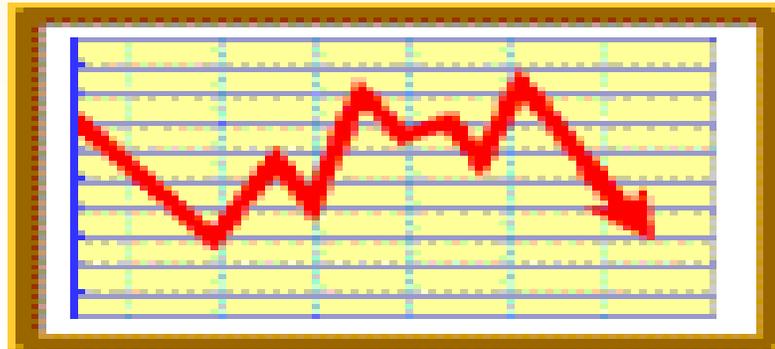
What are Internal Controls?

What Internal Controls Do...

- Promote orderly, economical, efficient and effective operations.

- Safeguard resources against loss due to waste, abuse, mismanagement, errors and fraud.

- Promote adherence to laws, regulations, contracts and management directives.

- Develop and maintain reliable financial and management data, and accurately present that data in timely reports.

What are Internal Controls?

Who is Responsible for Internal Controls?

- Everyone has a part in the internal control system.
- The roles vary depending upon what level of responsibility and the nature of involvement by the individual.
- Managers and supervisors are responsible for ensuring that internal controls are established and functioning to achieve the mission and objectives of their unit.
- Each employee within an area should be made aware of proper internal control procedures associated with their specific job function.

What is Risk?

- Anything that could negatively impact the City's ability to meet it's operational objectives.

What are Internal Controls?

Assessing Risk...

Management must be able to identify, analyze and manage any risk that prevents them from achieving their objectives. Basically you should ask yourself what could go wrong and what assets do we need to protect.

- **Please *Note* Risk….**

will increase during a time of change (i.e. personnel turnover and adding a new service).

5 Types of Risk

- **Strategic** - risk that would prevent a department from accomplishing it's objectives.
- **Financial** - risk that could result in a negative financial impact to the City.
- **Regulatory (Compliance)** - Risk that could expose the City to fines and penalties from a regulatory agency due to non-compliance with laws and regulations.
- **Reputational** - risk that could expose the City to negative publicity.
- **Operational** - risk that could prevent a department from operating in the most effective and efficient manner.

What are Elements of Internal Control?

- **Control Activities….**

  These are the policies and procedures that help to ensure that actions necessary to achieve the department's objectives are effectively carried out.

- **Policies and Procedures….**

  These should be formalized and communicated to employees.

- **Employee Roles….**

  Help the employees to understand where the organization is going and their role in it.

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Examples of Internal Controls

- ➢ Separation of duties,

- ➢ Authorization and approval,

- ➢ Verification,

- ➢ Review of operating performance,

- ➢ Physical control,

- ➢ Reconciliation,

- ➢ Training and guidance and monitoring.

What control ? ? ? ? ?

Internal Controls – Appropriate Balance

What is the cost of Internal Control?

- Remember that when determining whether a particular control should be implemented, the risk of failure and the potential effect must be considered along with the cost of establishing the control.

- Excessive control is costly and counterproductive. Too little control presents undue risk. There should be a conscious effort to arrive at an appropriate balance.

EXCESSIVE CONTROL IS COSTLY

INTERNAL CONTROLS

Monitoring Internal Controls?

Monitoring is key….

The controls put in place must be periodically reviewed and assessed to ensure that they are effective and adequate.

- This is done through ongoing monitoring and separate evaluations of internal controls.

- When were your policies and procedures last updated?

- Do you schedule in *advance* an annual review of them and assign responsibility to a reviewer?
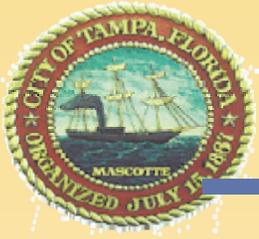

YIP.... I'M MONITORING YOU! ! !

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What are Internal Controls?

Inherent *Limitations* of Controls….

- Cost/benefit considerations should be weighted

  - See cost-effective alternatives

- Examine the potential for "management override"

- Cannot always eliminate the risk of collusion

Policies & Procedures

Policies and Procedures should help to ensure:

- Authorizations are required

- Records are properly designed

- Security of assets and records is maintained

- Segregation of incompatible duties is achieved
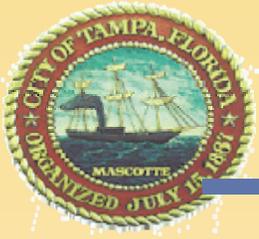
- Consistent behavior across the organization

Examples of Policy & Procedures

Policies and Procedures should include:

- Periodic reconciliations
  - Cash/Bank reconciliations monthly
  - Miscellaneous A/R on a monthly basis
  - Other

- Periodic verifications
  - Fixed assets

- Analytical reviews

Examples of Authorization

- Require advance approval

- Require written documentation of approval

- Proper authorization levels

- Compliance with entities' approved policies

- Compliance with other legal restrictions

Documentation

Proper Documentation should be maintained….

- Invoice, P/O, receiving documents matched

- Sequential numbering of internal documents should be maintained with no unexplained gaps

- Automatic duplicates - cash receipts

- Payroll support documentation

- Bid documentation

Security of Assets & Records

- Control access to both
  - Access on an as-needed basis only
  - Inventory counts should not be done by custodians
- Separate confidential or sensitive material
- Assign responsibility for both
- Backup and disaster recovery plans
  - Should be periodically tested
- Data Center controls maintained

What are Internal Controls?

Segregation of Duties….

- An individual should **not** be able to commit and conceal an irregularity

- Separate **incompatible** functions
  - Authorization
  - Record keeping
  - Custody

- Level of segregation/alternatives

You're under arrest ! ! ! ! !
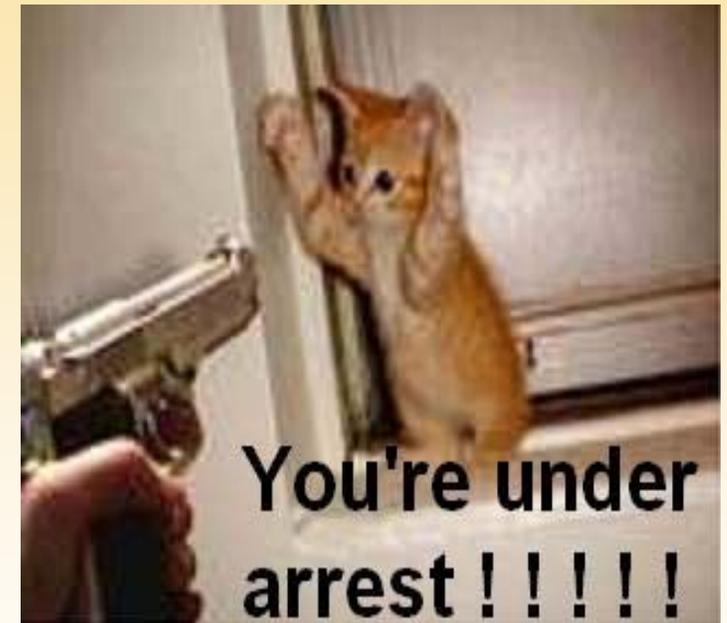
Quiz...

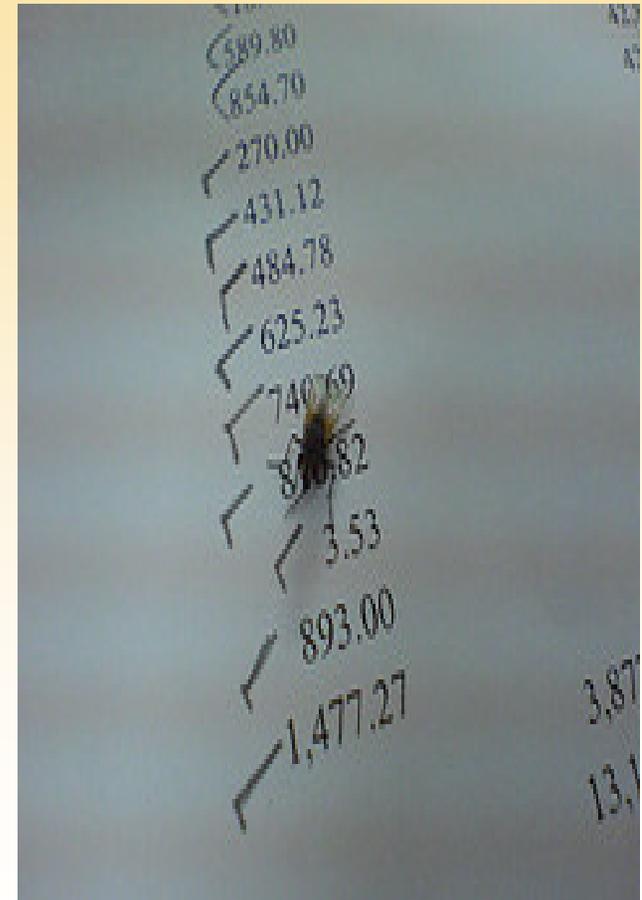**Should one person be able to….**

- ➢ Initiate transaction,

- ➢ Approve transaction,

- ➢ Record transaction,

- ➢ Reconcile balances,

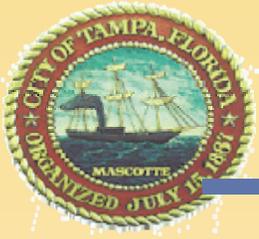- ➢ Handle assets,

- ➢ Review reports,

Reconciliations

Periodic Reconciliations include….

- ➤ Work orders to billings,

- ➤ Bank statements and General Ledger (Books),

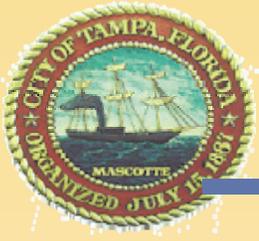- ➤ General ledger and subsidiary ledgers.

Examples of Reconciliations

Periodic Verifications….

➢ Physical inventory of assets,

➢ Inventory petty cash and credit cards,

➢ Receivables confirmations,

➢ Payables confirmations.

See! I did find an error!

Reviews are Internal Controls

Analytical Reviews….

- Financial data

    – Compared to other financial data

    – Compared to non-financial data

- Only practical assurance regarding completeness

Types of Internal Controls

Control Techniques….

Preventative techniques

are designed to provide reasonable assurance that only valid transactions are recognized, approved and submitted for processing. Many of the preventive techniques are applied *BEFORE* the processing activity occurs.

- Segregation of duties
- Business systems integrity and continuity controls
- Physical safeguard and access restriction controls
- Effective planning budgeting process
- Effective "whistle blowing" processes

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Types of Internal Controls?

Control Types….

***De**tective techniques*

are designed to provide reasonable assurance that errors and irregularities are discovered and corrected on a timely basis. Detection techniques normally are performed ***AFTER*** processing has been completed.

- Reconciliation of batch balance reports to control logs
- Reconciliation of cycle inventory counts with perpetual records
- Comparison of reported results with plans and budgets
- Review of on-line access and transaction logs
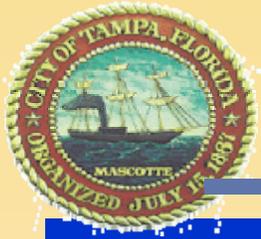
Internal Control Myths and Facts

MYTHS:

Internal control starts with a strong set of policies and procedures.

Internal control: That's why we have internal auditors!

Internal control is a finance thing.

Internal controls are essentially negative, like a list of "thou-shalt-nots!"

Internal controls take time away from our core activities of making products, selling, and serving customers.

FACTS:

Internal control starts with a strong control environment.

While internal auditors play a key role in the system of control, management is the primary owner of internal control.

Internal control is integral to every aspect of business.

Internal control makes the right things happen the first time.

Internal controls should be built "into," not "onto" business processes.

Internal Audit

Internal Audit's Role….

The Internal Audit department is responsible for assessing the operation of the internal control system and making recommendations to improve it.

Examples of duties include:

- Raising level of awareness
- Delivering internal control training

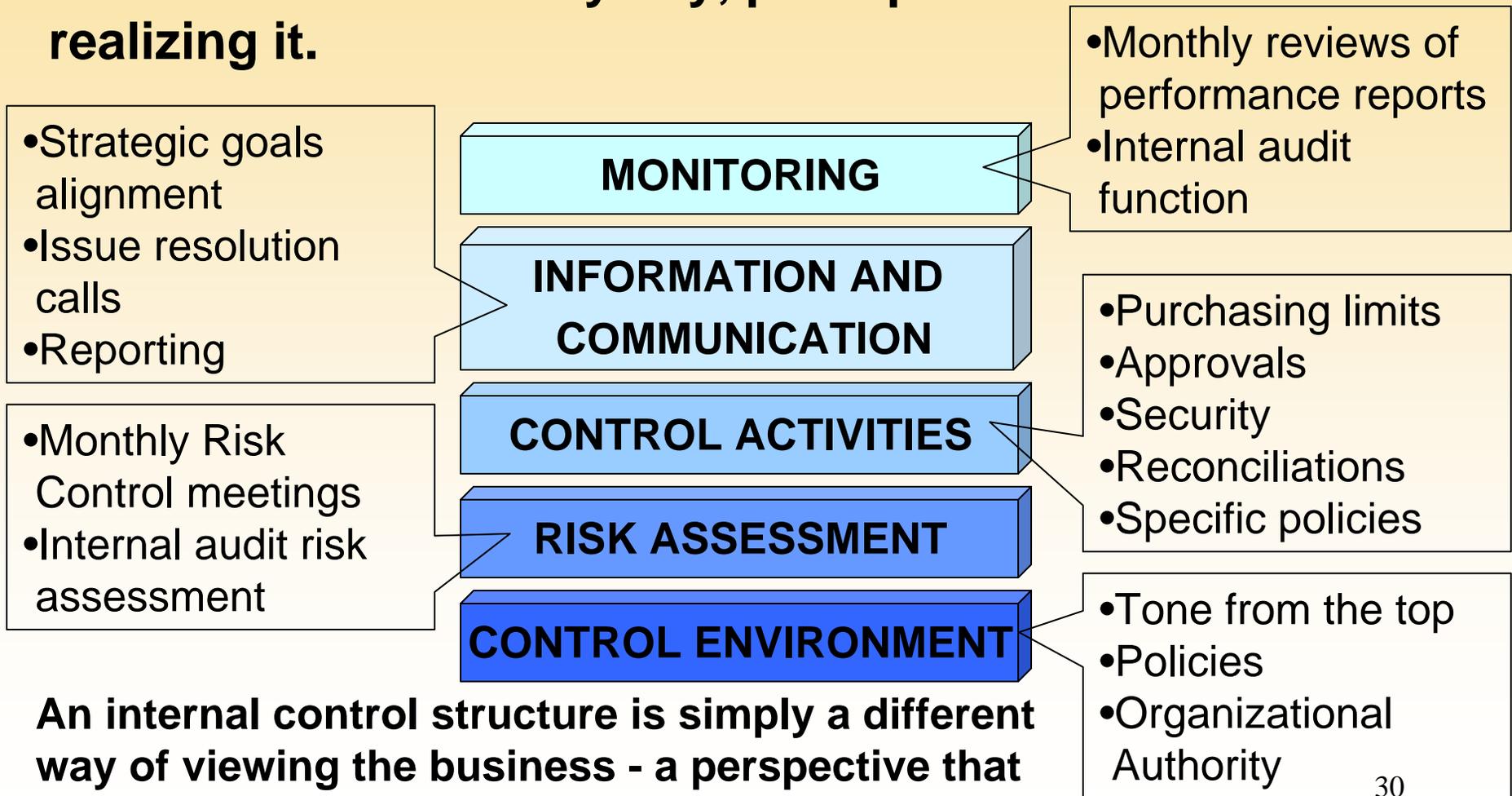Examples of duties NOT to be performed by Internal Audit:

- Not design controls
- Not involved in day-to-day running of the system

Internal Control Structure

In many cases, you perform controls and interact with the control structure every day, perhaps without even realizing it.

- Monthly reviews of performance reports
- Internal audit function

- Strategic goals alignment
- Issue resolution calls
- Reporting

MONITORING

INFORMATION AND COMMUNICATION

- Purchasing limits
- Approvals
- Security
- Reconciliations
- Specific policies

- Monthly Risk Control meetings
- Internal audit risk assessment

CONTROL ACTIVITIES

RISK ASSESSMENT

CONTROL ENVIRONMENT

- Tone from the top
- Policies
- Organizational Authority

An internal control structure is simply a different way of viewing the business - a perspective that focuses on doing the right things in the right way.

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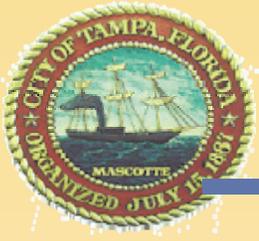
Why Controls Don't Always Work

- Inadequate knowledge of policies or governing regulations. *"I didn't know that!"*

- Inadequate segregation of duties. *"We trust 'A' who does all of those things."*

- Inappropriate access to assets. *Passwords shared, cash not secured…..*

- Form over substance. *"You mean I'm supposed to do something besides initial/sign it?"*

- Control override. *"I know that's the policy, but we do it this way." "Just get it done, I don't care how!"*
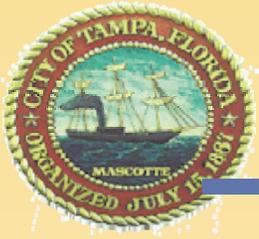
Purchasing Guidelines

Preventing Procurement Problems

- Never make oral commitments to bidders or suppliers

- If you don't know, please ask, don't guess!

- Document all Supplier problems

WIDGET SUPPLIER

Purchasing Guidelines

Preventing Procurement Problems

- All Agreements requiring signatures (regardless of dollar amount):

  📄 Require Legal Review and Approval

  📄 Must be Approved via City Council Resolution

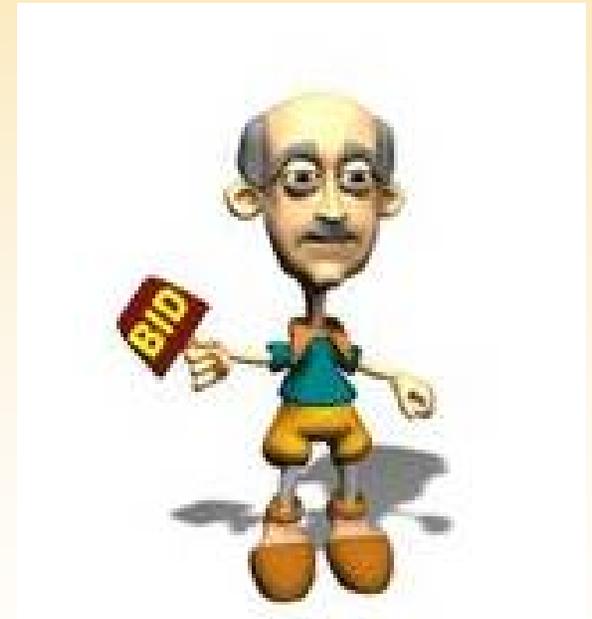 📄 Must be Executed by the Mayor

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Purchasing Guidelines

Basis of Award for Bids

- Lowest Responsive and Responsible Bidder

  - Responsive

    - ✓ Bid was received at the time and place specified

    - ✓ Late bids cannot be accepted by the city and are deemed non-responsive.

Purchasing Guidelines

Emergency Purchases

- Purchases which are necessary due to unforeseen events which present a threat to life, health, property or an occurrence which requires immediate attention which would reflect poorly on the City if not immediately acted upon.

Purthasing Guidelines

Emergency Purchases

- If **less** than $100,000.00

  - Requires Emergency Certificate signed by the Requesting Department's Director

- If **more** than $100,000.00

  - Requires Emergency Affidavit with Notarized Signature of Requesting Department's Director

Purchasing Guidelines

Use of the Procurement Card

- Limited to items Less than $2,000 per Single Transaction
- *Non-capital* items are allowed
- *Capital* items are *NOT* allowed
  - Capital Items are any single item costing $1000 or more, requires a black tag or 6000 sub-code
- $15,000 monthly limit on procurement card use

Purchasing Guidelines

Insurance

- Specific Requirements on the INET

- Always Required when Suppliers Perform Services on City Property

I just saved a bunch of money on my car insurance by threatening my agent with a golf club.
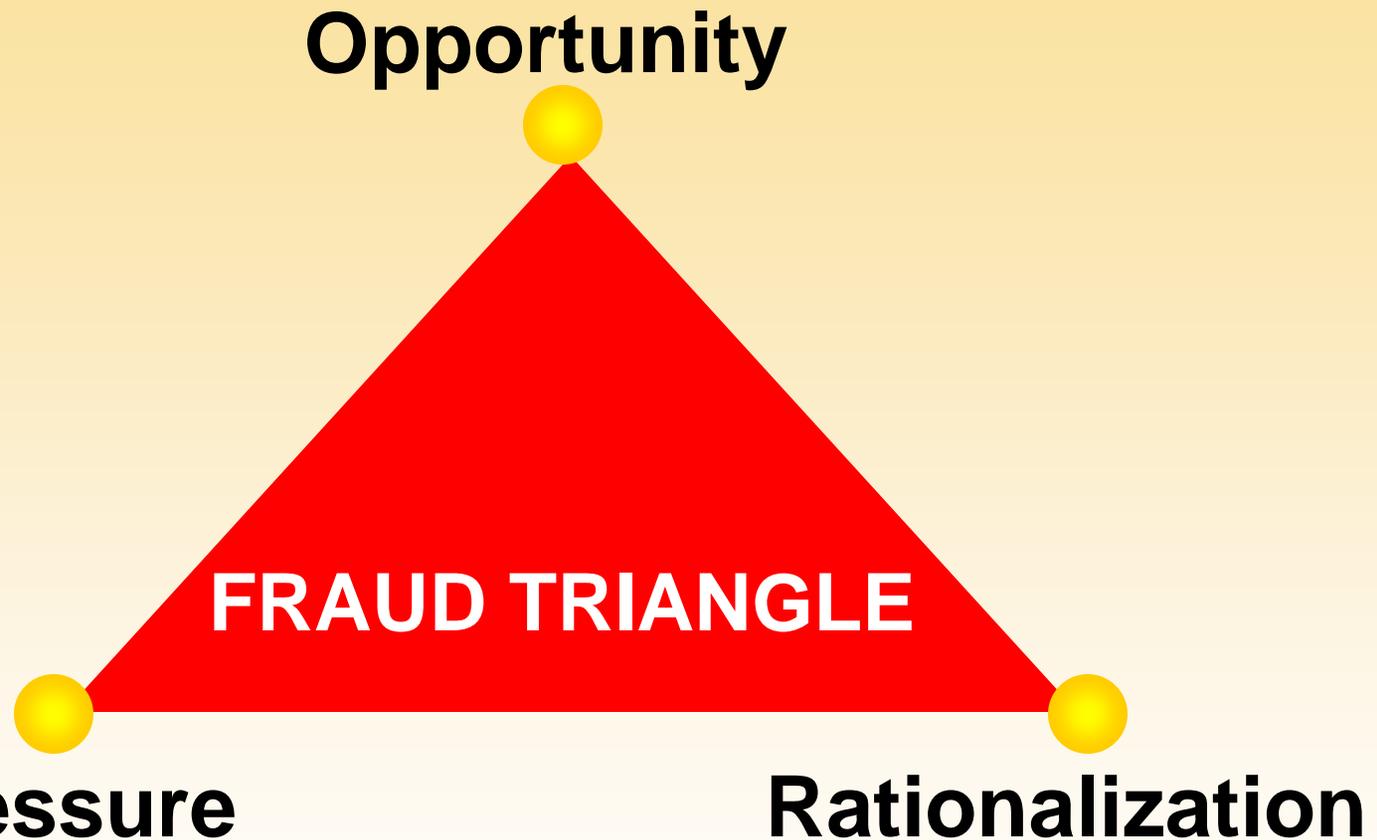
Red Flags of Fraud

Fraud Danger Signals… (Red Flags)

- Borrowing money from co-workers
- Creditors or collectors appearing at the workplace
- Gambling beyond the ability to stand the loss
- Excessive drinking or other personal habits
- Easily annoyed at reasonable questioning
- Providing unreasonable responses to questions
- Refusing vacations or promotions for fear of detection
- Bragging about significant new purchases
- Carrying unusually large sums of money
- Rewriting records under the guise of neatness in presentation

Causes of Fraud

Opportunity

FRAUD TRIANGLE

Pressure

Rationalization

Poor internal control creates the *opportunity* for fraud.

Red Flags of Fraud

Other Fraud Danger Signals...

- High personnel turnover
- Low employee morale
- No supporting documentation for adjusting entries
- Incomplete or untimely bank reconciliations
- Increased customer complaints
- Write-off's of inventory shortages with no attempt to determine the cause
- Unrealistic performance expectations
- Rumors of conflicts of interest
- Using duplicate invoices to pay vendors
- Frequent use of sole-source procurement contracts

How Does Fraud Occur?

- Poor internal controls
  - Lack of proper authorization
  - No separation of authorization, custody, record keeping
  - No independent checks on performance
  - Lack of clear lines of authority
  - Inadequate documentation
- Management override of internal controls
- Collusion between employees and 3rd parties
- Collusion between employees and management
- Poor or non-existent ethics policy
- Limited, unclear or no policies and procedures to direct department/division processes

Accounting Do's & Don'ts

Handling of Payments to the City

- Payments should not be forwarded to the individual who maintains the invoice or property records

- Checks should be restrictively endorsed as soon as possible

- Checks and payments should be physically secured and custody tracked and documented

Accounting Do's & Don'ts

Accounting Entries & Adjustments

- Journal Entries should be carefully reviewed and approved

- Approvals should be independent of the originator and at an authority level consistent with the dollar amounts of the transaction

- Journal Entries that create negative balances should be carefully evaluated
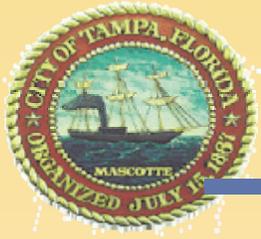
Ethics Highlights

Conflicts of Interest

- Non-City Employment Restrictions

- Contractual Restrictions

- Financial Interest Restrictions

- Voting Conflict Restrictions

- Other Conflict Restrictions

Ethics Highlights

Non-City Employment Restrictions

- Impairs, or could be expected to impair, independence in judgment or performance of City duties.

- Mandatory disclosure each July 1 and within 30 days.

Ethics Highlights

Non-City Employment Disclosure

Non-City Employment/Private Business Entity Disclosure and Approval

The CITY OF TAMPA ETHICS CODE requires the mandatory disclosure by officials and employees of non-city employment or private business entity (see Sec. 2-511). Approval of such non-city employment/active participation in a private business entity by the department director (or the Mayor for department directors) is required (Sec. 2-512). Employees are considered to be "engaged in non-city employment" if they have or hold an employment relationship with any entity other than the City of Tampa. Employees are considered to be "engaged in a private business entity" if they own or operate a business entity defined as a corporation, partnership, limited partnership, limited liability corporation, limited liability partnership, proprietorship, firm, enterprise, franchise, association, self-employed individual or trust, whether fictitiously named or not. See the reverse side of this form for additional instructions and information for completion of the form.

Employee Name:	Department/Division:
Employee Identification Number:	City Job Title/Position Name:

Check one box in this section and follow the instructions for the box you selected.

☐ I am not engaged in any non-city employment or active participation in a private business entity.
If you checked this box, complete the final section of this form (employee/official signature area only).

☐ I am requesting approval of non-city employment or active participation in a private business entity.
If you checked this box, you must complete the information below.

Name and Address of non-city employment/private business entity:

Name: _____

Address: _____

_____ Telephone #: _____

Brief description of the purpose and activities of the non-city employer/private business entity:

_____

I DISCLOSE

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Ethics Highlights

Use of Public Property

- Cannot request, use, or permit the use of any publicly owned or publicly supplied

  – Property

  – Vehicle

  – Equipment

  – Material

  – Labor or Service

  for personal convenience or private advantage to the employee or any other person.

Ethics Highlights

Misuse of Position

- Cannot intentionally use position to secure, by coercion or threat or otherwise, a special privilege or exemption for yourself or others.

- Or to secure confidential information for any purpose other than official responsibilities.

Ethics Highlights

Public Endorsements

- No officer or employee of the City of Tampa shall publicly endorse or recommend any product, person, service, or entity, unless they have received written approval from the Mayor.

Ethics Highlights

Gifts from Lobbyists

- Under no circumstances can a gift be accepted by an employee, either directly or indirectly, from a lobbyist, if the gift is valued over $100.00.

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What You Can Do!

- Make sure you have up-to-date policies and procedures;

- Ensure authorization limits are communicated within your department;

- Ensure all assets (especially cash) are safeguarded at all times;

- Establish document control (especially for spreadsheets);

- Ensure approval signatures are visible (legible) on all required documentation;

What You Can Do!

- Make sure data is *only* accessible by authorized personnel;

- Understand your department/function's risks;

- Ensure adherence to City policies and City code

- Establish objectives and measures for your department/ function and for major programs; and

- Track performance to evaluate your success!

Summary and Comments

QUESTIONS…...

- Other Topics you would like to see covered?

- Topics that would benefit from more examples?

- Subjects with too much emphasis?

Thank you for participating today!