



# Course 101

## Basics of Internal Control and Best Practices

### Description

This course is designed to introduce participants to the basics of Internal Control. The course will cover basic information on the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) *Framework for Internal Controls*. In addition the instructor will discuss internal control best practices for local governments in Louisiana. Participants will be able to use the information gained in class to begin or continue the implementation of Internal Control(s) in their governments.

### Objectives

After this class participants will be able to:


- Describe what internal control is,
- Relate what roles elected officials and staff play in establishing controls,
- Identify what controls are in place in their government,
- Identify what controls are needed, and
- Begin or continue the implementation of Internal Controls in their government.

### Who Will Benefit

- Elected Officials
- Appointed Officials
- Local Government Employees
- Local Government Auditors

### About the Instructor

Mike Battle has been with the LLA for 21 years. During the first part of his career, he conducted performance audits of state agencies. Mike now serves as a Manager in Advisory Services (AS) where he works to provide fiscal and programmatic advice to locally elected officials and their staffs. Advisory Services focuses on providing assistance to ensure compliance, enhance effectiveness and efficiency, and to move entities towards a more fiscally healthy position. Mike has also served as LLA's Fiscal Notes Coordinator during Legislative Sessions since 1999. Mike has a Master's in Public Administration from LSU and is a Certified Internal Auditor, Certified Government Auditing Professional, and is certified in Risk Management Assurance.



# Center for Local Government Excellence

## Basics of Internal Control and Best Practices

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September 27, 2017

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# Agenda

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## Learning Objectives

**This course is designed to:**

- \* Introduce participants to the overall concepts, components and processes of Internal Control
- \* Present Internal Control best practices to help local government officials/staff enhance fiscal and programmatic operations
- \* Then, you can go home and actually put in to play what you have learned here today!!!!!!

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## The Father of Internal Control: COSO



- \* In response to concerns in Congress regarding fraudulent financial reporting and improper payments by corporations (1970s and 1980s)
- \* Committee of Sponsoring Organizations of the Treadway Commission issued Internal Control: *Integrated Framework in 1992.*

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## Internal Control-what is it?



A process effected by those charged with governance, 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

**COSO:** Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control: Integrated Framework*

## Now, in plain English.....



Internal Controls help to **“make sure things happen the way you want them to happen and bad or unexpected things don’t happen.”**

Deane Hennett,  
Director of Internal Audit  
Old Dominion University

## Very Important Concepts



The **Board** exercises oversight for the development and performance of Internal Control.

**Management** is responsible for designing and implementing controls to prevent and detect fraud and to achieve objectives.

**(Cooperation, Coordination, Respect)**

## Very Important Concepts



### Internal Control is a Process!

- \* Several interrelated components that work together to accomplish the entity's **objectives**

## Very Important Concepts



### Internal Control is affected by people!

- \* Not just policy manuals and forms
- \* It's **people** performing assigned functions at **every level**
- \* Board Member to Agency Head to Accounting Clerk – **all have a role in successful operation** of Internal Controls

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## Very Important Concepts



### Internal Control provides reasonable assurance, not absolute assurance!

- \* No matter how well designed and operated, can't protect you from everything
- \* Errors in judgment, human error, **collusion** among employees, and **management override** of controls
- \* Absolute assurance would be really expensive

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## Very Important Concepts



### The Process of Internal Control is geared to the achievement of objectives!

- \* **Objectives** = things you want/need to happen (e.g., Provide utility services to paying customers)
- \* **Risks** = what could occur to keep objectives from happening (e.g., Customers don't pay, but receive services)
- \* **Controls** = actions to make sure objectives happen (e.g., review past-due accounts and apply cut-off policy)

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## Internal Controls-why are they important to Local Governments?



- \* **Safeguard** against fraud and the misuse of assets
- \* Serve as management tool to achieve objectives efficiently and effectively (**Operations**)
- \* Ensure accuracy and reliability of **financial reporting**/other information used for decision-making
- \* Ensure **compliance** with laws and regulations

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## What happens if controls are weak?



### Does it just happen in Government?

- \* Rock band *Cold Kingdom* has \$33,000 in equipment stolen
- \* New Jersey Doctor has 40,000 patient files stolen

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## What happens if controls are weak?



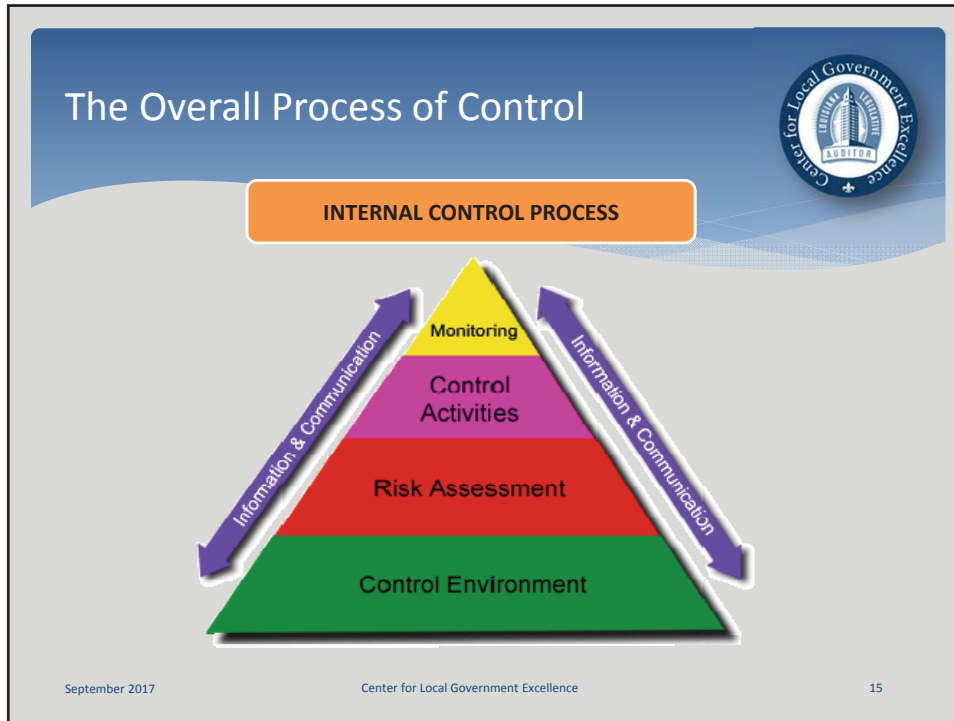
- \* Crazy Eddie's Electronics Business defrauds government and investors of millions
- \* Inflating inventory assets to increase reported profits
- \* Sam Antar said that nobody looked behind the boxes

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- ## Components of Internal Control
- ### Control environment
- \* Tone at the top – filters down to all in the organization
  - \* Bedrock on which all other elements based
  - \* Influences the risk assessment process; the control activities established; communication systems; and monitoring activities
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## Control Environment cont...



### The Board/Management Do the following:

- \* Communicate and enforce **integrity/ethical values** through codes of conduct
- \* Display **effective attitudes and actions** when objectives are being jeopardized (e.g. address policy violations immediately and consistently)
- \* Set the skills, knowledge, and experience needed by staff (e.g. job descriptions)
- \* Assign right number of staff with right skill sets for the job
- \* Consistently hire, train, evaluate, compensate, promote, and discipline based on solid policies and procedures


## Control Environment cont...



**When all in the organization know (and actually see) that the Board and Management take Internal Control Seriously, change will take place.**

**“Tone at the Top”**

## Components of Internal Control




### Risk assessment

- \* **What could go wrong?** Identifies/analyzes risks associated with achievement of objectives
- \* Estimates the impact on achievement of objectives
- \* Estimates the likelihood of occurrence
- \* Helps Board and Management decide what controls should be implemented to manage identified risks

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## Components of Internal Control




### Control activities: Strategies/activities that management designs to ensure that risks are addressed and objectives are achieved:

- \* Can be **Preventative** (avoid) or **Detective** (discover and correct)
- \* **Formal/Written Policies and Procedures** (your blueprint)

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Control Activities cont...




- \* **Segregation of Duties:** Segregation of Incompatible duties (separate approving, authorizing, recording, reconciling and custody of assets)

**No employee should be in a position to both commit an abuse/fraud and conceal it!**

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Control Activities cont...



- \* **Control over Transactions** (Approval, authorization, review, verification, and periodic reconciliation)
- \* **Physical Controls** (equipment, inventories, cash, etc. are locked up and access is restricted)
- \* **Reconciliation** of financial documents/records (sub-ledger to general ledger to bank statements)
- \* **Remember – look behind the boxes!!!!**

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## Components of Internal Control



### Information and Communication

- \* Supports the functioning of all components of internal control
- \* Information must be identified, captured, and communicated so that people can carry out their responsibilities
- \* Information can be operational, financial, and compliance related – makes it possible to run and control the organization
- \* Should be internal as well as external (e.g., info conveyed to/received from shareholders, customers, consultants)

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## Information & Communication cont...



### Information must be:

- \* **Accessible** – easy to obtain
- \* **Timely** – can access when needed
- \* **Correct** – accurate and complete (validation checks)
- \* **Current** – up-to-date data
- \* **Sufficient** – enough information to make informed decisions
- \* **Valid** – represents activities that actually occurred

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## Information & Communication cont...



### Forms of communication:

- \* Must have info available and be fully aware of your job responsibilities!
- \* Internal Financial reports available to Board, Management, and applicable Staff
- \* Strategic Plan (Mission, Goals, Objectives of the Entity)
- \* Policy and Procedure Manual(s)
- \* Job Specs and Performance Evaluations
- \* Discussions of Overall Performance at Board Meetings
- \* Channels for employees to report Fraud, Abuse, and/or Waste
- \* External Audits, customer feedback, transparency

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## Components of Internal Control



### Monitoring Activities

- \* **Self-assess:**
  - ✓ what is working
  - ✓ what is not
  - ✓ when we didn't meet objectives, why didn't we
  - ✓ which controls would move us towards achievement of objectives
- \* Internal Control System should be monitored continuously
- \* Deficiencies should be discussed and resolved

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# Internal Control Best Practices

<https://www.la.gov/local-government-entities/index.shtml>

**LOUISIANA LEGISLATIVE AUDITOR**  
*Daryl G. Perrier*

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Home > Local Government Entities & Quasi-Public Organizations > Overview

**Local Government Entities & Quasi-Public Organizations**

Provides resources and documentation for individuals involved with local government entities and quasi-Public organizations across the state including:

- Recommendations for governments to improve their controls that safeguard, manage, and account for assets and ensure compliance with applicable state laws;
- Training (Center for Local Government Excellence) to local government in implementing sound fiscal practices;
- Best practices guides and financial reporting forms for local governments;
- Accounting and auditing technical assistance to local governmental agencies and to independent certified public accountants that conduct government audits;
- Legal guidance on state laws to governmental agencies and to independent certified public accountants;
- The state audit law;
- The Louisiana State Bond Commission and Louisiana State Fiscal Review Committee;

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## Policies & Procedures

- \* No formal, written policies and procedures--**biggest problem that we see.**
- \* Necessary to provide a clear understanding of:
  - ✓ **What** should be done?
  - ✓ **How** it should be done?
  - ✓ **Who** should do it?
  - ✓ **When** it should be done?

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## Policies & Procedures



### Why are they important?

- \* It's your **blueprint** for current administration and those that follow
- \* Lessens the risk of violating state law and local ordinances
- \* Establishes controls that can deter theft and other losses

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## Policies & Procedures



- \* Ensures consistency and continuity of operations (all on the same page)
- \* A "go-to" during disputes
- \* Helps to cross-train staff
- \* Helps hold staff accountable

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## Policies & Procedures



### Policies and Procedures should address:

- \* Preparing, adopting, monitoring, and amending the **budget**
- \* **Financial Statement** preparation, reporting, and related council discussion of financial information
- \* **Procurement and purchasing** (Bid Law)
- \* Recording, tagging, and safeguarding of **assets** (conducting physical inventories)
- \* Use of **credit cards** and supporting documentation
- \* Dispensing **fuel** and reviewing usage

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## Ethics




- \* Emphasize the importance of the **Code of Ethics**  
**(R.S. 42:1101 et. seq.)**
- \* Require Board members, officials, and staff to sign **annual certification letters attesting to compliance** with the Code and other internal ethics policies
- \* Make sure all are receiving **yearly ethics training** per state law

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## Financial Management



**Board/Management should ensure that:**

- \* Budget is developed and adopted annually
- \* Budget is balanced
- \* Budget contains requirements as presented in law


**[R.S. 39:1305 (C)(2)(a)]**

- \* Budget is realistic and based on sound estimates
- \* Budget is used to drive decisions and plans

- \* **LMA/LLA Webinar: Using the Budget as a Financial Tool**

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## Financial Management



- \* Accurate and complete financial statements should be prepared each month
- \* Statements should include a comparison of actual results to budget amounts with variances
- \* Statements and other financial information should be provided to the Board and discussed in detail at regular Board meetings

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## Financial Management



### Suggested Financial Information to Present and Discuss at Board Meetings:

- \* Income Statement (should include a comparison of actual and projected revenues and expenditures compared to the budget)
- \* Balance Sheet
- \* Accounts payable and receivable aging schedules
- \* Analysis of budget variances and recommendations for corrective action
- \* Performance data

## Purchasing & Disbursements



- \* **Remember**, no single individual should control all facets of a financial function!
- \* Bid law is communicated to staff
- \* Process that flags requisitions/purchase orders when account is over budget
- \* Documented review of Purchase orders, receiving reports, and vendor invoices before payment is made

## Purchasing & Disbursements



- \* Supply of blank checks is secured
- \* Get rid of the check signing machine/stamp (or heavily restrict and log/monitor use)
- \* Develop an approved vendors list and review/update it periodically

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## Purchasing & Disbursements



**Make it clear to all that there will be regular,  
unannounced review of purchases/related  
documentation and fraud, abuse, and waste will be dealt  
with very seriously!**

**“Tone at the Top”**

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## Contracting for Services



- \* **Cost/benefit analysis** can show whether contracting is needed to carry out objectives
- \* Use **RFP** or traditional **bid thresholds/processes** to ensure fees for services are cost-effective
- \* Contract should include **specific services** to be performed
- \* **Legal counsel** should **review contracts** before signed
- \* Review/monitor to make sure **services received comply with contract**

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## Credit Cards




- \* **If you can get by without using them, don't use them**
- \* Limit the number if you must use them
- \* Define allowed purchases (don't circumvent approval)
- \* Always know how many cards you have and who has them at all times
- \* Itemized/detailed receipts should be required as support and business purpose should be documented for all charges (persons making and participating in expenditure should be identified)

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# Credit Cards




**Make it clear to all that there will be regular, unannounced review of credit card use/related documentation and fraud, abuse, and waste will be dealt with very seriously!**

**“Tone at the Top”**

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# Payroll & Attendance



**Payroll usually largest government expenditure**

- \* Document/List all employees and approved salary or rate of pay
- \* Someone independent of payroll and HR processes should review employee listing periodically for accuracy (Changes made? Authorized?)
- \* Physical observation of employees should periodically be conducted

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## Payroll & Attendance



- \* All should complete time reports documenting hours worked
- \* Require supervisory approval of time reports
- \* Document available leave and leave used

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## Accounts Receivable (AR)



- \* Reconcile detailed AR listing with general ledger on a monthly basis
- \* Reconcile detailed listing of meter deposits with general ledger and related cash in the bank
- \* Billing adjustments should be approved by position independent of billing process and reason for adjustment should be documented

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## Accounts Receivable (AR)



\* **Insufficient effort to collect delinquent AR could be considered a violation of the LA Constitution (Art. VII, Sec 14)**

- ✓ Cut-off policy is needed and should be enforced
- ✓ Policy should establish process for collecting delinquent AR
- ✓ Must actively try and collect money owed to you (e.g. payment plans; collection agency)

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## Collecting Money



\* **Remember Segregation of Duties**

- \* Make sure customer gets a receipt
- \* Conduct daily review of receipt book to deposit slips
- \* Position independent of collections should conduct regular, unannounced review of **receipt books** to **deposit slips** to **accounting records** to **bank statements**


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# Collecting Money



**Remember:**  
**When all in the organization are informed that review will occur and see it happening, this serves as a very strong control**  
**“Tone at the Top”**

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# Reconciling Bank Statements



**Reconciling the bank statements with the book balances is necessary to ensure that:**

- ✓ All receipts/disbursements are recorded (essential for complete and accurate monthly financial statements)
- ✓ Checks are clearing the bank in a reasonable time
- ✓ Unrecorded deposits and checks are appropriate

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## Reconciling Bank Statements



**R.S. 10:4-406(d)(2)** allows the entity **thirty days** to examine bank statements and canceled checks for unauthorized signatures or alterations.

**After thirty days**, the entity is precluded from asserting a claim against the bank for unauthorized signatures or alterations.

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## Capital Assets



- \* Develop a detailed listing of capital assets (e.g., cost; date of purchase; functions using the asset; disposition)
- \* Tag capital assets
- \* Conduct physical periodic inventories and resolve any discrepancies (**Remember**, when things don't look right, follow-up! There are no stupid questions!)

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## Traffic Tickets



- \* Safeguard blank traffic ticket books
- \* Account for and reconcile all issued books and returned citations (don't hand out new books until old ones are handed in)
- \* Make sure violations are heard in proper venue by proper officials and recorded in minutes of court

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## Traffic Tickets




- \* Prohibit officers from collecting money in the field
- \* Reconcile **issued citations** to **finances imposed/collected** to **fine schedules** to actual **deposits**
- \* **R.S. 32:398.3** requires **audit of traffic ticket process** by clerk

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## Disaster Recovery/Business Continuity



### Louisiana and It's Hurricanes!!!

- \* Develop a written disaster recovery/business continuity plan (continued operations/functions of the entity)
- \* Test the plan at least annually
- \* Need access to an offsite facility to provide for the timely restoration of operations in the event the entity's facility is unavailable for an extended period of time

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## Information Technology



### Must Guard Your Data!!!

- \* Physical Access (e.g., computer room locked; fire protection)
- \* Password Controls (only authorized users)
- \* Virus Protection (prevents viruses, worms, and Trojan horses from getting onto computer)
- \* Firewalls (prevent unauthorized network access)

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# Resources and Contacts



[www.coso.org](http://www.coso.org)

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