

# INTERNAL CONTROLS

Colorado Office of the State Controller  
FY 2012 Open/Close Training  
April 17, 2012

# INTERNAL CONTROL ASSISTANCE

## ➤ Office of the State Controller – Internal Audit

### ➤ Short-term & Long-term plans:

- Update OSC website to include our draft Internal Control Guide and other tools Estimated date: June 2012
- Provide assistance to agencies – request basis
- Develop a statewide audit plan to conduct audits of high-risk agencies and programs

# PRESENTATION

- We would like to acknowledge the Vermont Department of Finance & Management for sharing their slideshow presentation on internal controls; several of those slides are contained in this slideshow.

# REQUIREMENTS – STATE LAW

**The Colorado State Department Financial Responsibility and Accountability Act (FRAC).** Requires that state agencies establish accounting and administrative **controls** to ensure public funds are used efficiently, effectively, and for approved purposes including:

- A plan of organization that specifies **segregation of duties**
- **Restricting access** to state assets only to authorized persons in the performance of their assigned duties
- **Authorization and record-keeping** procedures to provide effective accounting control over state assets, liabilities, revenues, and expenditures
- **Personnel of quality and integrity** commensurate with their assigned responsibilities
- An effective process of **internal review** and adjustment for changes in conditions

# REQUIREMENTS – STATE LAW

## CONTINUED

- Agencies are required to annually file a written statement that the agency's financial systems of internal accounting and control either do or do not fully comply with the requirements of the FRAC
- The statement is filed with the State Controller, State Auditor, and Governor
- Agencies need to understand their internal control systems and know whether they are working before filing their written statements

# REQUIREMENTS – FEDERAL LAW

- **A-102 Common Rule and the U.S. Office of Management and Budget (OMB) Circular A-110 (2 CFR part 215)** require that non-federal entities receiving federal awards (e.g., state agencies) establish and maintain **internal control** designed to reasonably ensure compliance with Federal laws, regulations, and program compliance requirements
- Good place to start when evaluating your controls over federal funds:
  - OMB Circular A-87 Cost Principles for State, Local and Indian Tribal Governments
  - OMB Circular A-133 Compliance Supplement (select the most recent version)  
[http://www.whitehouse.gov/omb/circulars\\_default/](http://www.whitehouse.gov/omb/circulars_default/)
    - Part 4 – Select the program applicable to your agency
    - Part 6 – Internal Control

# REQUIREMENTS – FEDERAL LAW CONTINUED

- General compliance areas:
  - Allowable/unallowable activities
  - Allowable costs
  - Cash management
  - Davis-Bacon Act
  - Eligibility
  - Equipment and real property management
  - Matching level of effort and earmarking
  - Period of availability of federal funds
  - Procurement, suspension, and debarment
  - Program income
  - Real property acquisition/relocation assistance
  - Reporting
  - Subrecipient monitoring

# STATE AUDIT FINDINGS

## FY 2011 Statewide Single Audit Findings

- 19 internal control weaknesses related to financial reporting other matters.
- 46 internal control issues related to federal programs.

# COSO'S\* DEFINITION OF INTERNAL CONTROL

Internal control is 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

\* Committee of Sponsoring Organizations of the Treadway Commission

# SIMPLE DEFINITION

- Internal control are the steps we take to ensure that the things we want to happen will happen...



- and the things we do not want to happen will not happen.

# PROGRAM VS. FINANCIAL

- Internal controls are important to both!



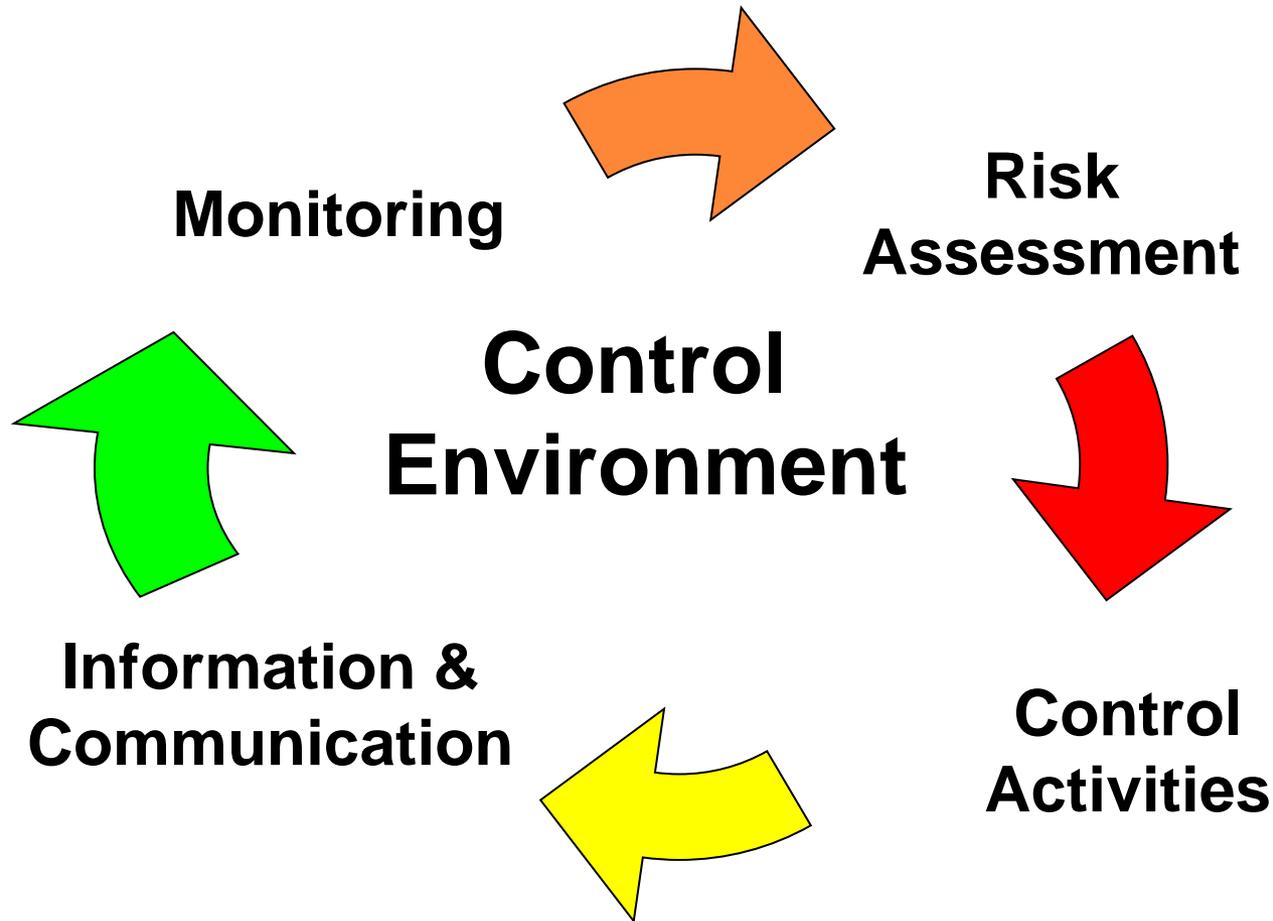
# WEAK INTERNAL CONTROLS INCREASE RISK THROUGH...



- **Business Interruption**
- **Erroneous Management Decisions**
- **Fraud, Embezzlement and Theft**
- **Statutory Sanctions**
- **Excessive Costs/Deficient Revenues**
- **Loss, Misuse or Destruction of Assets**

# COSO's INTERNAL CONTROL FRAMEWORK

## FIVE INTER-RELATED STANDARDS:



# 1. CONTROL ENVIRONMENT

- Foundation for all other standards of internal control
- Pervasive influence on all the decisions and activities of an organization
- Effective organizations set a positive “**tone at the top**”
- Factors include the integrity, ethical values and competence of employees, and, management’s philosophy & operating style

## 2. RISK ASSESSMENT

- Risks are internal & external events (economic conditions, staffing limitations, new systems, regulatory changes, natural disasters, etc.) that threaten the accomplishment of objectives.
- Risk assessment is the process of identifying, evaluating, and deciding how to manage these events. Good questions to ask yourself are:
  - What is the likelihood of the event occurring?
  - What would be the impact if it were to occur?
  - What can we do to prevent or reduce the risk?

# 3. CONTROL ACTIVITIES

- Tools - policies, procedures, processes designed and implemented to help ensure that management directives are carried out
- Help prevent or reduce the risks that can impede the accomplishment of objectives
- Occur throughout the organization, at all levels, and in all functions
- Include approvals, authorizations, verifications, reconciliations, security of assets, reviews of operating performance, and segregation of duties

# 4. COMMUNICATION & INFORMATION

- Pertinent information must be captured, identified and communicated on a timely basis
- Effective information and communication systems enable the organization's people to exchange the information needed to conduct, manage, and control its operations

# 5. MONITORING

- Internal control systems must be monitored to assess their effectiveness... *Are they operating as intended?*
- Ongoing monitoring is necessary to react dynamically to changing conditions... *Have controls become outdated, redundant, or obsolete?*
- Monitoring occurs in the course of everyday operations, it includes regular management & supervisory activities and other actions personnel take in performing their duties

# REVIEWS OSC HAS CONDUCTED

- Pilot Project
- Payment/Staffing Review
- Military and Veteran's Affairs Audit

# CHALLENGES

- Buy-in
- Terminology
- Culture
- Resources

# FIVE KEY INTERNAL CONTROL ACTIVITIES...



# 1. SEPARATION OF DUTIES

- Divide responsibilities between different employees so one individual doesn't control all aspects of a transaction
- Reduce the opportunity for an employee to commit and conceal errors (intentional or unintentional) or perpetrate fraud

## 2. DOCUMENTATION

### **Document & preserve evidence to substantiate:**

- Critical decisions and significant events...typically involving the use, commitment, or transfer of resources
- Transactions...enables a transaction to be traced from its inception to completion
- Policies & procedures...documents which set forth the fundamental principles and methods that employees rely on to do their jobs

# 3. AUTHORIZATION & APPROVALS

- Management documents and communicates which activities require approval, and by whom, based on the level of risk to the organization
- Ensure that transactions are approved and executed only by employees acting within the scope of their authority granted by management

# 4. SECURITY OF ASSETS

- Secure and restrict access to equipment, cash, inventory, confidential information, etc. to reduce the risk of loss or unauthorized use
- Perform periodic physical inventories to verify existence, quantities, location, condition, and utilization
- Base the level of security on the vulnerability of items being secured, the likelihood of loss, and the potential impact should a loss occur

# 5. RECONCILIATION & REVIEW

- Examine transactions, information, and events to verify accuracy, completeness, appropriateness, and compliance
- Base level of review on materiality, risk, and overall importance to organization's objectives
- Ensure frequency is adequate enough to detect and act upon questionable activities in a timely manner