

The logo for FORVIS, featuring the word "FORVIS" in a bold, white, sans-serif font with a registered trademark symbol (®) to the upper right of the letter "S".

FORVIS[®]

The title of the presentation, "Internal Controls for Small Cities", written in a bold, white, sans-serif font. A large, semi-transparent orange diagonal bar is positioned behind the text, extending from the top right towards the bottom left.

Internal Controls for Small Cities

GFOAT Spring Conference —
April 2024

Meet Your Presenters



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Partner & Market Industry Leader



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Accounting Services*

Overview of Today's Presentation

- 30,000 Foot View
 - Internal Control
 - The COSO Cube-Basic Concepts
 - Advantages of Applying COSO
 - Challenges of applying internal controls to a small organization
 - Exploding some myths about internal controls
 - Types of controls

Overview of Today's Presentation (Continued)

- Discussing details and examples on specific controls related to the following transaction cycles and areas within a government:
 - Cash Receipts
 - Cash Disbursements
 - Payroll
 - Purchasing Cards
 - Information Technology

30,000 Foot View

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Demystifying Internal Controls

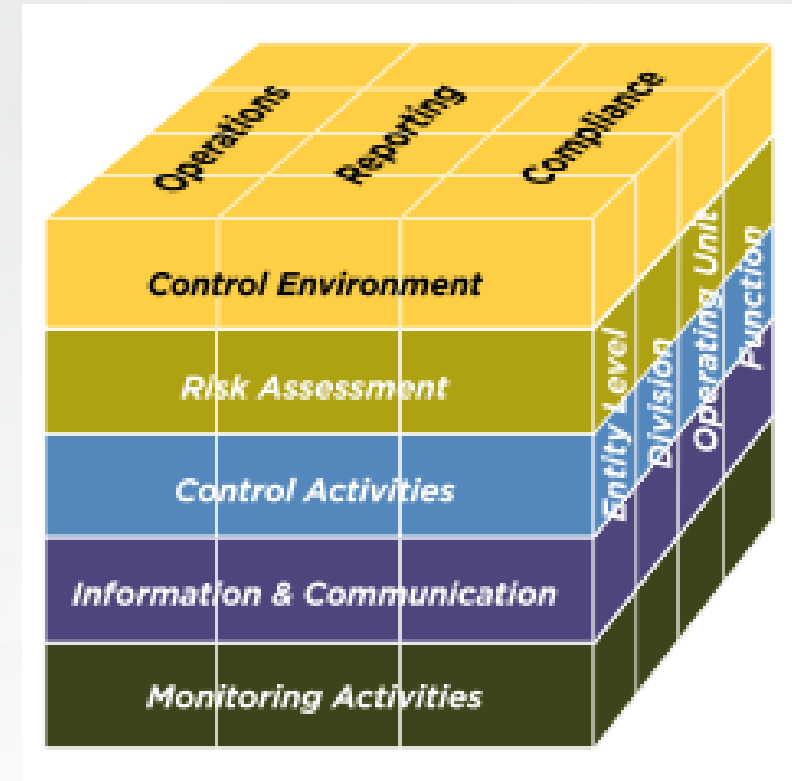
- For years good internal controls were undefined and you were just suppose to “Know it when you see it”
- Enter COSO-Committee of Sponsoring Organizations a joint venture of AICPA, FEI, IIA, AAA and IMA
- Internal Control – Integrated Framework (Framework)

Defining Internal Control

Internal control is a process, effected by an entity's board of directors, city council, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance.

The COSO Cube

- Objectives – what we strive to achieve
- Components – what is required to achieve the Objectives
- Principles – fundamental concepts associated with each component



COSO Principles



Advantages of COSO

- It is comprehensive covering far more than finance and accounting
- It is simple
- It is scalable-just as applicable to a 5 employee small government as it is to a Fortune 500 company
- Its elements and principles cut across industries and sectors
- It is the recognized world-wide standard for internal control

Disadvantages of COSO

It is a high level map not GPS

- It is not tailored to government
- It will point you in the right direction but does not provide step by step detail on how to get there or when you've arrived
- It does not specifically address the challenges of small entities

It requires training and use of professional judgement

Control Challenges of Small Governments

Resource Constraints

- Limited personnel
- Training
- Software

Familiarity

- Everyone knows each other
- Often many are related to each other

Trust is Natural

- Internal control can be interpreted as a lack of trust making it both unnecessary and offensive

Multiple Roles for a Single Position

- Finance and HR Director

Exploding the Myths - Trust

- Trusting your employees should be a given but blind trust has burned many an organization.
 - The Association of Certified Fraud Examiners routinely report that the higher the position of the embezzler, the more trusted the embezzler and the longer they have been with the organization, the greater the loss.
- Consider Dixon, Illinois a town of 16,000 in the rural heartland
 - Rita Crundwell grew up in Dixon and had worked for the city since High School becoming controller in 1983 after 13 years of city service
 - She was beloved, trusted and a symbol of pride for her success in breeding Quarter Horses and winning Quarter Horse Championships.
 - In total she embezzled \$54 million from the city over 22 years
 - In 2008 when the city had a stated budget of \$8-9 million she embezzled \$5.4 million

Exploding the Myths - Fraud

- While every organization should have a goal of protecting assets, internal controls is about accomplishing ALL of an organization's goals
 - Risks of mistakes, lack of training, lack of timely information, inaccurate information, compliance violations and poor management occur more often than fraud and can have just as devastating an impact on the organization.
 - Good internal controls should be viewed as both a tool and a protection to employees
 - A tool to help them accomplish the organizations objectives
 - A protection in that it both prevents bad things but it also keeps innocent employees from being implicated

Categories of Controls

Preventive vs.
Detective

Traditional/Preferred
vs. Mitigating

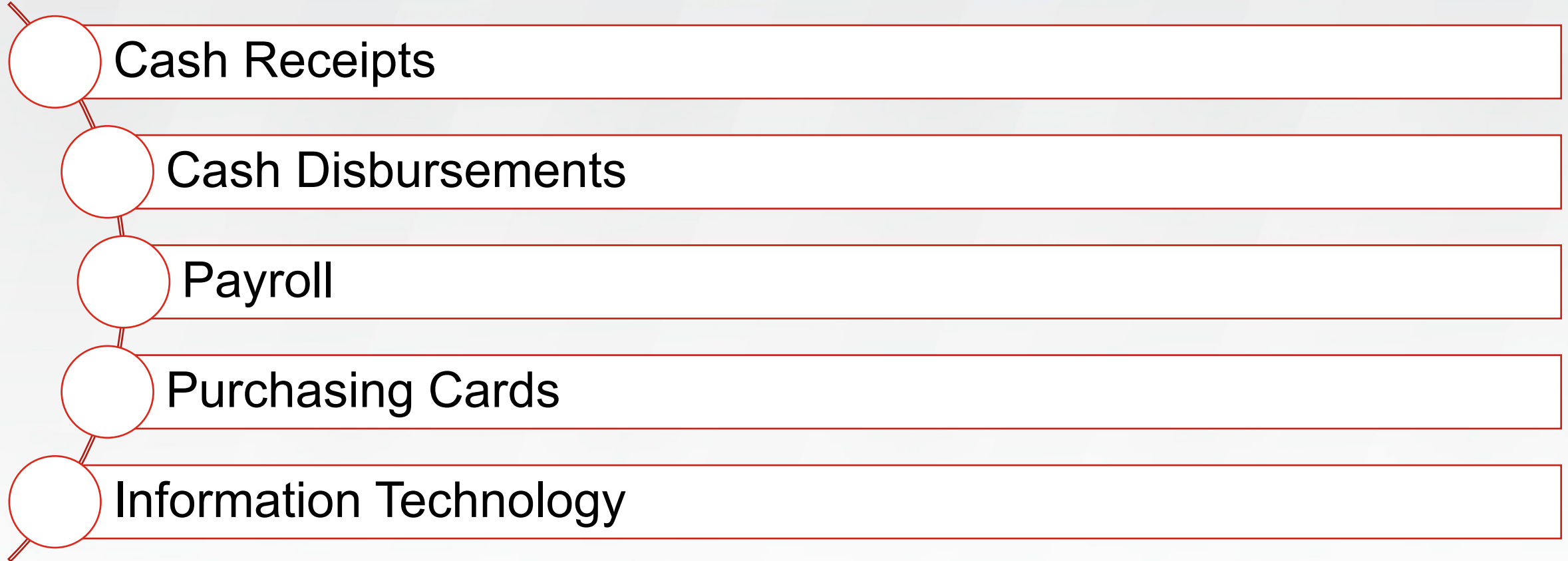
Mitigating Controls
are often Key in a
Small Government

Specific Internal Controls

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Control Activities



Step Process to Understanding Internal Controls

What process is used to complete a transaction?



What could go wrong?



What controls are in place to prevent, detect or correct errors?

Internal Controls over Cash Receipts

What procedures does the entity maintain to ensure cash sales are appropriately captured and recorded?

What procedures does the entity maintain to ensure sales represent valid transactions?

What procedures does the entity maintain to ensure cash receipts are properly processed?

How does the entity maintain procedures to ensure customer returns/refunds are approved and recorded accurately as to account, amount and period?

Segregation of Duties Analysis – Cash Receipts

Sales, Cash Receipts and Accounts Receivable Cycle

ACCESS – ABILITY TO:

- Create a manual shipping/delivery of service document
- Make a computer entry to generate shipping/delivery document
- Authorize shipping/delivery document prepared by others
- Change shipping/delivery instructions after initial preparation
- Receive payments in currency or checks
- Be custodian of currency or checks (including taking deposits to bank)

RECORDING – ABILITY TO:

- Make a computer entry to generate an invoice
- Make a computer entry to generate a credit memo or billing adjustment
- Approve a credit memo or billing adjustment for issuance, including changes to standard prices or shipping terms
- Change computer billing or credit memo files, i.e., customer ledgers or receipts journals, after an invoice has been issued
- Add a customer to (delete a customer from) the master file
- Change master files affecting billings and credit memos
- Prepare cash receipts journal/list of receipts
- Make a computer entry to credit customer accounts for payments received
- Make a journal entry to:
 - Adjust the Accounts Receivable general ledger account
 - Adjust the Cash general ledger account
 - Record bad debt write-offs

MONITORING:

- Responsibility to reconcile:
 - Shipping/delivery records to billing records
 - Cash receipts journal (list) to bank deposit records
 - Customer balances to general ledger/control account
 - Bank balances to general ledger/control account
- Responsibility to issue monthly statements to customers
- Responsibility to review:
 - Account reconciliations related to the Sales, Cash Receipts and Accounts Receivable cycle prepared by others
 - Bank reconciliations prepared by others

Identify any apparent conflict of duties by number

Position Description

	Automated Process	UB Clerk 1	UB Clerk 2	Accountant I	Senior Accountant	Director of Fiscal & Administrative Services	Permit Clerk	Permit Admin												
Not Applicable																				
X																				
X																				
X																				
X																				
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Cash Receipts Transaction Cycle – Analysis of Conflicting Duties and Complementary Controls

Conflict #	Position	Identify potential errors or irregularities that could result	List any complementary controls that mitigate identified conflicting duties, potential errors or irregularities
1	UB Clerk 1	Potential misappropriation of funds due to access and recording capabilities. The UB Clerk 1 could potentially create themselves as a vendor and record a payment to themselves rather than the correct vendor. In addition, the UB Clerk 1 could potentially steal cash by generating a credit memo/billing adjustment and then pocketing the cash received by customers.	Senior Accountant reviews and approves entries to customer accounts and agrees to listing of customer deposits on daily basis. In addition, Director of Fiscal & Administrative Services reviews bank reconciliations prepared by Senior Accountant.
2	UB Clerk 2	Potential misappropriation of funds due to receiving and recording funds.	UB Clerk does not have the same functions as UB 1. UB Clerk 2 can only receive payments and record the payments received. Thus, the control risk is mitigated. UB Clerk 2 appears to be cross trained in the event UB Clerk 1 is unavailable. Senior Accountant reviews and approves entries to customer accounts and agrees to listing of customer deposits on daily basis. In addition, Director of Fiscal & Administrative Services reviews bank reconciliations prepared by Senior Accountant.
3	Permit Clerk	Potential misappropriation of funds due to recording of funds and responsibility to reconcile.	Senior Accountant reviews and approves entries to customer accounts and agrees to listing of customer deposits on daily basis. In addition, Director of Fiscal & Administrative Services reviews bank reconciliations prepared by Senior Accountant.

Complementary/Mitigating Controls over Cash Receipts – Examples

Cashiers receive payments (access control) and lead cashier reconciles payments and makes deposits on daily basis.



Cashier makes computer entry to credit customer account for payments received (recording control) and Accountant reviews and approves entries and agrees to listing of customer deposits on daily basis.



Director of Finance reviews bank reconciliations and bank statements on a monthly basis.

Internal Controls over Cash Disbursements

How does the entity maintain appropriate procedures to ensure that purchases are appropriately authorized and are recorded accurately in the appropriate account?

How does the entity ensure cash payments are recorded accurately and in the appropriate period?

How does the entity ensure cash is disbursed only for authorized and valid purchases and expenses?

How does the entity ensure cash balance records are reconciled regularly to bank statements and differences are investigated?

Segregation of Duties Analysis – Cash Disbursements

Purchases, Cash Disbursements and Accounts Payable Cycle

ACCESS – ABILITY TO:

- Issue a purchase order to a vendor
- Initiate a purchase (when POs are not used)
- Authorize a purchase document or EDI entry prepared by others
- Approve invoices for payment
- Make a computer entry to generate a payment (either check or EFT)
- Authorize a payment by check or electronic funds transfer
- Sign checks
- Access mechanical signature device, *i.e.*, stamp or electronic signature
- Access signed checks to be issued to vendors
- Mail or hand deliver (distribute) checks

RECORDING – ABILITY TO:

- Record accounts payable, including EDI
- Record checks issued
- Record electronic funds transfers
- Change computer entries, *i.e.*, vendor ledgers or disbursements journals for:
 - Accounts payable entries
- Change computer master files affecting:
 - Accounts payable vendors (additions or modifications)
 - Electronic funds transfers
- Make a journal entry to:
 - Adjust Inventory or Expense general ledger accounts
 - Adjust the Cash general ledger account

MONITORING:

- Responsibility to reconcile:
 - Bank balances to general ledger/control account
 - Accounts payable to general ledger/control account
- Responsibility to review:
 - Bank reconciliations prepared by others
 - Account reconciliations related to the Purchases, Cash Disbursements and Accounts Payable cycle prepared by

	Position Description											
Not Applicable	Automated Process	AP Clerk/Accountant I	Accounting Analyst	Senior Accountant	Director of Fiscal & Administrative Services	Department Directors/Managers	Department Secretaries	City Manager				

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Identify any apparent conflict of duties by number

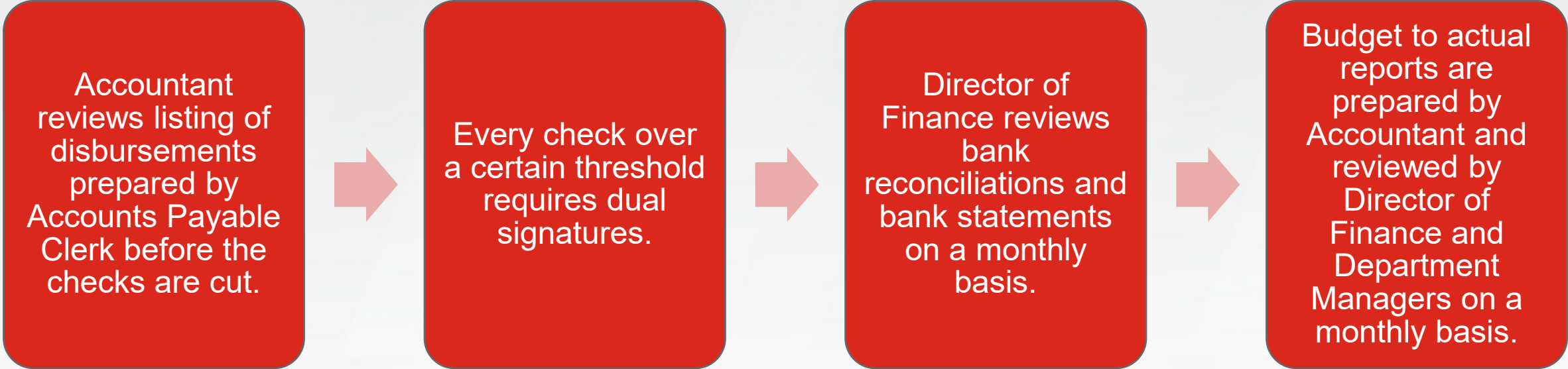
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Cash Disbursements Transaction Cycle – Analysis of Conflicting Duties and Complementary Controls

Conflict #	Position	Identify potential errors or irregularities that could result	List any complementary controls that mitigate identified conflicting duties, potential errors or irregularities
1	AP Clerk/Accountant I	Potential misappropriation of funds due to access to checks and ability to change master vendor file. The AP Clerk/Accountant I could potentially create a fictitious vendor and generate a payment to the fictitious vendor.	Accounting Analyst reviews checks prepared by AP Clerk before they are cut. Additionally, Senior Accountant or Director performs cash bank recons.
2	Accounting Analyst	Potential misappropriation of funds due to access ability to authorize and generate payments and recording ability.	Accounting Analyst is cross trained to perform AP Clerk/Accountant I duties in case of absence. Senior Accountant review checks prepared by Accounting Analyst in AP Clerk's absence. Additionally, Senior Accountant or Director performs cash bank recons.
3	Senior Accountant	Potential misappropriation of funds due to access ability to authorize and generate payments in Accounting Analyst's absence and responsibility for reconciling the bank statements.	Senior Accountant is cross trained to perform Accounting Analyst duties in case of absence. Director of Finance reviews bank recons prepared by Senior Accountant.
4	Director of Fiscal & Administrative Services	Potential misappropriation of funds due to recording ability to change computer entries, master files, and make JEs and responsibility for reviewing bank and account reconciliations. In addition to secondary responsibility for preparing the bank account reconciliations.	Senior Accountant reviews bank recons prepared by Director. She doesn't have the ability to cut checks. AP Clerk/Accountant I cuts and distributes checks.

Complementary/Mitigating Controls over Cash Disbursements – Examples



Internal Controls over Payroll

How does the entity maintain appropriate authorization, approval and documentation procedures regarding changes in employment, in pay rates and in payroll deductions?

How does the entity maintain appropriate procedures to ensure payroll is disbursed to the appropriate employees and recorded accurately, completely and in the appropriate accounting period?

How does the entity maintain appropriate procedures to ensure payroll costs are accurately processed, approved and allocated to the appropriate accounts, programs and other functions?

Segregation of Duties Analysis – Payroll

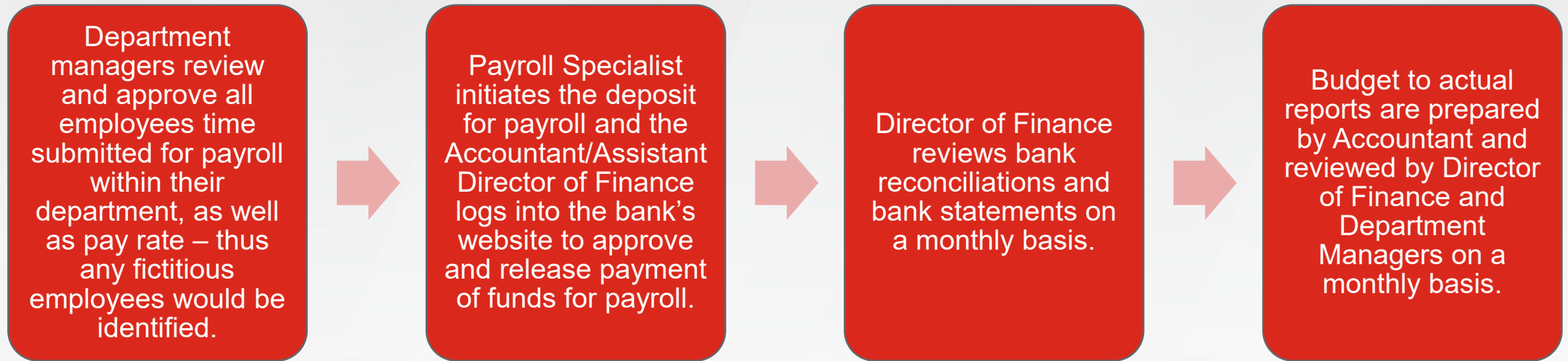
		Payroll Cycle												Position Description																		
	ACCESS – ABILITY TO:												Not Applicable	Automated Process	Accountant I	Senior Accountant	Director of Fiscal & Admin. Services	Department Heads	Department Admin													
	Add an employee to payroll master file													\$	P																	
	Make a computer entry to generate a payroll payment													P	\$																	
	Edit/modify payroll data after initial input, including hours worked													P	P																	
	Authorize a payroll payment prepared by others													P																		
	Sign checks or submit electronic payment													P																		
	Access mechanical signature device, i.e., stamp or electronic signature													P																		
	Access signed checks to be issued													P																		
	Issue/distribute a payroll check													P									P									
	RECORDING – ABILITY TO:													P	\$																	
	Record payroll checks issued													P		\$																
	Record electronic funds transfers, i.e., direct deposit																															
	Change computer entries, i.e., general ledger or subsidiary ledger, for:														P	P	\$															
	Payroll														P																	
	Checks issued														P																	
	Electronic funds transfers														P																	
	Change computer master files affecting:														\$	P																
	Employee payroll information (including direct deposit information)													P																		
	Electronic funds transfers													P																		
	Make a journal entry to:																															
	Adjust Expense general ledger accounts														P																	
	Adjust payroll liabilities general ledger accounts (taxes, accruals)															P																
	Adjust the Payroll Cash general ledger account														P																	
	MONITORING																															
	Responsibility to reconcile:															P																
	Bank balances to general ledger/control account														P																	
	Employee payroll records to control account															P																
	Payroll tax liabilities and payroll accruals to payroll reports															P																
	Responsibility to review:																															
	Hours worked by employees each pay period																						P									
	Account distributions for payroll entries															P																
	Payroll bank reconciliations prepared by others																							P								
	Account reconciliations and journal entries related to the Payroll cycle prepared by others																							P								

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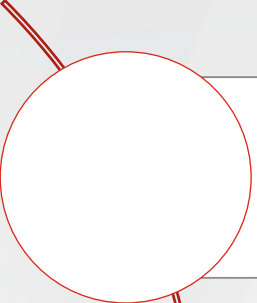
Payroll Transaction Cycle – Analysis of Conflicting Duties and Complementary Controls

Conflict #	Position	Identify potential errors or irregularities that could result	List any complementary controls that mitigate identified conflicting duties, potential errors or irregularities
1	Accountant I	Potential misappropriation of funds due to access to blank checks, electronic signatures, and ability to update employee master file. The AP Clerk/Accountant I could potentially create a fictitious employee and generate a payment to the fictitious employee.	No new hires are created unless there is a Payroll Change Notice completed by the Department Head and entered by Human Resources. In addition, each Department Head reviews payroll expenditures on a monthly basis and would detect any unusual items or discrepancies, based on adopted budget. The Director of Fiscal and Administrative Services reviews the preliminary Payroll Register prior to each payroll run to ensure there are no unusual items or significant discrepancies, in addition to reviewing the bank reconciliations prepared by the Senior Accountant.
2	Senior Accountant	Potential misappropriation of funds due to ability to add employees and modify payroll data, change computer entries, change master files affecting payroll information (including direct deposit information), and responsibly for reconciling bank accounts. The Senior Accountant could potentially create a fictitious employee, generate a payment to the fictitious employee, and go undetected because the Senior Accountant reconciles the bank account.	No new hires are created unless there is a Payroll Change Notice completed by the Department Head and entered by Human Resources. In addition, each Department Head reviews payroll expenditures on a monthly basis and would detect any unusual items or discrepancies, based on adopted budget. The Director of Fiscal and Administrative Services reviews the preliminary Payroll Register prior to each payroll run to ensure there are no unusual items or significant discrepancies, in addition to reviewing the bank reconciliations prepared by the Senior Accountant. While Director of Fiscal and Administrative Services reviews the bank recon after the Senior Accountant prepares it, this is a detection control which occurs after the fact.

Complementary/Mitigating Controls over Payroll – Examples



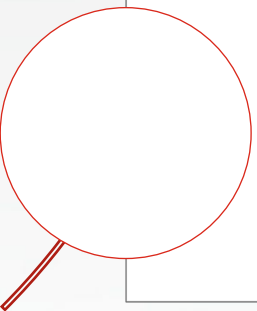
Internal Controls over Purchasing Cards



Ensure your entity has a purchasing card policies and procedures manual that has been adopted. Provide this manual to all employees with purchasing cards and require they sign an acknowledgement form that they've read and understand the policies and procedures.



Ensure there are reasonable transaction limits for all cardholders. Consider having limits established by Finance Department and approved by City Manager.



Ensure all cardholders complete a transaction log (expenditure listing) of all purchasing card charges for the month. A brief explanation for the charge or description should be included along with copies of all receipts and the monthly statement. The transaction log and monthly statement **MUST** balance. These should be submitted to the Purchasing Card Administrator by the end of the month.

Internal Controls over Purchasing Cards

Consider performing a purchasing card audit on an annual basis to verify the following:

Proper records have been maintained

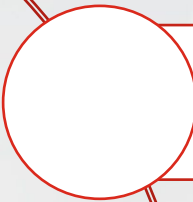
Type of purchase is appropriate

Purchased items are maintained on entity premises



Purchasing Card Administrator should analyze and review activity for all Purchasing Card Account Holders on an annual basis to determine if it is necessary for those employees with inactive accounts to be issued a Purchasing Card.

Internal Controls over Information Technology



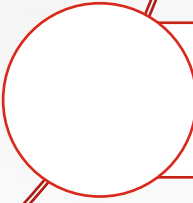
Does an information security policy exist and has been approved by the Board of Directors/City Council?



How are financial reporting systems and associated operating systems appropriately secured to prevent unauthorized use, disclosure and modification of data?



Do procedures exist and are being followed relating to timely action for requesting, establishing, issuing, suspending and closing user accounts?



Does the entity physically restrict access to key hardware components, such as servers in a separate room or restrict access location?

Best Practices and Recommendations

Review and update policies and procedures on an annual basis

Perform a walkthrough of controls either annually or on a rotating basis to determine reliability

Annual review of user access rights

Additional Insights and Complimentary CPE

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