

# Internal Controls and Segregation of Duties in a Small Office Environment

March 21, 2014

RIGFOA Winter Training

James D. Wilkinson, CPA/CITP,  
Partner, Assurance Services

Robert J. Civetti, CPA  
Director, Assurance Services

**MARCUM**  
ACCOUNTANTS ▲ ADVISORS

# Internal Controls

1. What are Internal Controls?



2. Assessing Risks and Establishing Internal Controls?

3. Why do we need Internal Controls?



# What are Internal Controls?

- **Internal control is defined** as – a process for assuring achievement of an organization's objectives in operational effectiveness and efficiency, reliable financial reporting, and compliance with laws, regulations and policies.
- 1992 the Committee of Sponsoring Organizations of the Treadway Commission (COSO) produced the internal control framework which is used to develop and assess the internal control system. The Framework has five elements:
  - Control Environment
  - Risk Assessment
  - Control Activities
  - Information and Communication
  - Monitoring Activities

# Internal Controls

- **According to COSO** – the three primary objectives of an internal control system are to ensure (1) efficient and effective operations (2) accurate financial reporting and (3) compliance with laws and regulations.
  - **Control Environment** – Provide the foundation for the internal control system – fundamental discipline and structure.
  - **Risk Assessment** – Analysis by Management (not the auditor) of relevant risks that interfere with achieving the objective.
  - **Control Activities** – policies, procedures, and practices that ensure managements objectives are achieved and risk is mitigated. Segregation of duties, review and verification procedures, etc.

## Internal Controls

- **Information and Communication** – Supports all other control components by communicating control responsibilities to employees and by providing information in a timely manner so that employees can carry out the assigned tasks to mitigate risk.
- **Monitoring** – internal and external oversight by management or others to ensure that controls are effective and that processes and procedures are being complied adhered to.



# COSO 1992 Framework for Internal Controls



# COSO 2013 – Framework for Internal Controls

Control Environment	Risk Assessment	Control Activities	Information and Communication	Monitoring Activities
<ol style="list-style-type: none"> <li>1. Demonstrates commitment to integrity and ethical values.</li> <li>2. Exercises oversight responsibility.</li> <li>3. Establishes structure, authority, and responsibility.</li> <li>4. Demonstrates commitment to competence.</li> <li>5. Enforces accountability.</li> </ol>	<ol style="list-style-type: none"> <li>6. Specifies suitable objectives.</li> <li>7. Identifies and analyzes risk.</li> <li>8. Assesses fraud risk.</li> <li>9. Identifies and analyzes significant change.</li> </ol>	<ol style="list-style-type: none"> <li>10. Selects and develops control activities.</li> <li>11. Selects and develops general controls over technology.</li> <li>12. Deploys through policies and procedures.</li> </ol>	<ol style="list-style-type: none"> <li>13. Uses relevant information.</li> <li>14. Communicates internally.</li> <li>15. Communicates externally.</li> </ol>	<ol style="list-style-type: none"> <li>16. Conducts ongoing and/or separate evaluations.</li> <li>17. Evaluates and communicates deficiencies.</li> </ol>

Strong Internal Controls will hopefully help you to avoid having this happen:

Copyright 2003 by Randy Glasbergen.  
www.glasbergen.com



**“Our books are balanced. 50% of our numbers are real and 50% are made up.”**



## Where to Begin? Thoughts? Ideas?

- Establish/identify your goal and objective –
  - Perhaps safeguarding of assets, completeness and accuracy of internal financial records/general ledger, and compliance with Town/City Charter and budget ordinance.
- Identify the high risk areas within your community that may result in misappropriation of assets, or material misstatement to financial reporting.
  - Collections – centralized and decentralized
  - Assessments
  - Payroll processing
  - Cash Disbursements
  - Account reconciliations
  - Journal Entries
  - Compensated Absences, Long-term Debt Obligations, and Capital Asset records.

# Where to Begin? Thoughts? Ideas?

- Collections – centralized and decentralized
  - What controls are in place to reconcile collections to source documents? Receipts, permits issued, licenses issued...
  - Reconciling deposits to computer reports noting composition of receipts – cash versus check (lapping of funds).
  - Review system for voided transactions and establishing protocols for voiding transactions.
- Assessments
  - Controls to ensure proper assessment of taxes, fees etc.
  - Who has controls to remove/abate assessments.
  - Ability to review reports reflecting changes to valuations and assessments.

# Where to Begin? Thoughts? Ideas?

- Payroll processing
  - Approval of time reports/cards.
  - Approval of payroll once processed – approving payroll registers.
  - Controls over who can add personnel.
  - Controls over who can change pay rates.
  - Applying data extraction software to search for duplicate direct deposit accounts, fictitious social security numbers, or other unusual items.

# Where to Begin? Thoughts? Ideas?

- Cash Disbursements
  - Approval of vendor invoices.
  - Process for adding vendors to the system.
  - Maintenance of check stock.
  - Maintenance of electronic signature key for electronically signed checks.
  - Control over disbursing checks once processed.
  - Process to ensure no missing checks (maintain a check log).

# Where to Begin? Thoughts? Ideas?

- Account reconciliations
  - As foolish and as simple as it may sound – reconcile cash accounts on a **monthly basis**.
  - Reconciliation should be completed by someone independent of the cash disbursement function.
  - Reconciliations should be compared to the General Ledger, signed by preparer, and also approved and signed by the Finance Director or other responsible party.
  - Reconciliation of other significant balance sheet accounts should also be completed on a monthly or at a minimum, quarterly, basis – receivables, payables, **interfund transactions**, accruals....



# Where to Begin? Thoughts? Ideas?

- Journal Entries
  - Journal entries are a way that management or others may try to manage/manipulate the bottom line or cover up a fraud/misappropriation.
  - When possible, journal entries should be kept to a minimal.
  - Utilize all modules within the accounting system to their potential.
  - All journal entries should be signed by the preparer and approved by someone independent of the preparation process. Documentation should be maintained to support all journal entries.
  - In order to monitor the controls over journal entries management should generate a report of journal entries, review the report on a periodic basis, and select entries to review supporting documentation.
  - Management should save the reports to document the monitoring of the control activities.
- Compensated Absences, Long-term Debt Obligations, and Capital Asset records.

## Where to Begin? Thoughts? Ideas?

- Compensated Absences, Long-term Debt Obligations, and Capital Asset records:
  - This is another common area of deficiency noted in controls.
  - Communities operate using current measurement focus and therefore generally are not concerned with long-term assets or liabilities until year end.
  - Should be updated and monitored on an ongoing basis – recommend that be updated at least quarterly.
  - Although misstatements may not impact the operating surplus and fund balance it does impact accuracy of financial reporting.

Lack of strong internal controls will eventually catch up to you.



## Q & A-

- Real world situations you have addressed
- Current issues in your offices



Thank You.

[James.Wilkinson@Marcumllp.com](mailto:James.Wilkinson@Marcumllp.com)

[Robert.Civetti@Marcumllp.com](mailto:Robert.Civetti@Marcumllp.com)

