



Internal Controls
State and Local Government Finance Division

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 North Carolina Department of State Treasurer
State and Local Government Finance

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Law

- Whose Responsible for Internal Controls?
- Does anyone work in an organization were the Finance Officer does not play a lead role in Internal Controls?

Why Do We Need Internal Controls?

- A Unit of Government had \$300,000 taken using on-line banking - units banking ID, passcodes and digital certificate were used
- Cash was taken by a person collecting cash– person issued receipt from receipt book they bought at a local store
 - Person checking receipt numbering didn't fully understand what they were doing
- Cash taken from safe – safe was not locked – it wasn't convenient to lock safe



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Why do We Need Internal Controls?

- Barings Bank Failure in 1995
 - Britain's oldest Mercantile Bank
 - Napoleonic wars, the Louisiana purchase, and the Erie Canal. Barings was the Queen's bank
 - One Person brought it down
- Cyber Attackers Empty Business Accounts in Minutes
- **OIG recover more than \$2.4M due to fuel fraud**



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COSO – Committee Of Sponsoring Organizations

- 2013 – updated the 1992 internal control framework
- Evolutionary not revolutionary
- Effective internal controls requires the five components and 17 relevant principles be present and functioning (principles are new)



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Internal Control Definition

“process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance.”



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Three Objectives - COSO

- **Operations Objective** – related to the effectiveness and efficiency of the entity's operation, including operational and financial performance goals, and safeguarding assets against loss.
- **Reporting Objective** - related to internal and external financial and non financial reporting to stakeholders, which would encompass reliability, timeliness, transparency, or other terms as established by regulators, standard setter, or the entity's policies.
- **Compliance Objectives**- related to adhering to laws and regulations that the entity must follow.



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Five Components of COSO

1. **Control Environment** – set of standards, processes and structures that provide the basis for carrying out internal control across the organization
 - Commitment to integrity and ethical values
 - Bd. Of Directors exercises oversight in development and performance of IC
 - Mgmt. establishes with board oversight, structures, reporting lines and appropriate authorities
 - Commitment to attract, develop, and retain competent individuals
 - Holds individuals accountable



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Five Components of COSO

2. Risk Assessment – involves dynamic and iterative process for identifying and analyzing risks to achieving the entity's objectives, forming a basis for determining how risk should be managed. Management considers possible changes in the external environment and within its own business model that may impede its ability to achieve its objectives.

- Clear objectives
- Identifies risk to achievement of objectives, analyzes risk, how they should be managed
- Potential for fraud
- Identifies and assesses changes that could impact system of IC



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Five Components of COSO

3. Control Activities - actions established by policies and procedures to help ensure mgmt.'s directives to mitigate risk are carried out – performed at all levels of the entity, various stages of the business process, include the technology environment. Activities are preventive, detective, include manual and automated, authorizations, approvals, verifications, reconciliations, business reviews, segregation of duties.

- Control activities that mitigate risk
- General control activities over technology
- Deploys control activities through policy/procedures



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Five Components of COSO

- 4. Information and Communication** – Information is necessary for the entity to carry out internal control responsibilities in support of achievement of its objectives. Communication occurs both internally and externally and provides the organization with the information needed to carry out day-to-day internal control activities. Communication enables personnel to understand internal control responsibilities and their importance to the achievement of objectives.
- Relevant, quality information is used to support the functioning of internal control
 - Internal communications including objectives and responsibilities of internal control is necessary to support functioning Internal controls.
 - Communications with external parties about matters affecting functioning of internal controls



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Five Components of COSO

- 5. Monitoring Activities** – Ongoing evaluations and/or separate evaluations, are used to ascertain whether each of the five components of internal control is present and functioning. Findings are evaluated and deficiencies are communicated in a timely manner, with serious matters reported to senior management and to the board.



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Areas of Risk

- Developing policy and procedures in a constantly changing environment but your procedures do not contain a process for keeping up with new developments
 - Rapid change in technology makes this difficult
 - Changing Accounting standards
- Evaluate each cash collection site
 - Each site should have an independent way to tie to expected revenue



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Areas of Risk

- Fictitious vendors
 - Verify new adds
 - Make sure A/P can't add vendors
 - Verify SSN and TIN for every new vendor
- Make sure persons accounting and reconciling cash cannot write journal entries
 - We all have the account that no one would be able to tell if there were a few inappropriate JE's in the account



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Areas of Risk

- Very tight controls over ACH banking information
- ACH fraud control
- Positive pay for all checking accounts
- Monitor bank accounts more often than just the monthly bank recon



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Areas of Risk

- What is the structure for sending wires / ACH's in your office
 - Two persons must approve a template
 - Templates can go out with one person
 - Templates have a not to exceed amt.
 - Freeform wires require two individuals
- What kind of security does your bank have over transactions



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Areas of Risk

- Contract Vendors – internet providers for cash collection – PCI
- When and if you change banks could you contact all the institutions that deposit money into your bank and notify them of the bank change
- Stealing funds electronically
 - Because time is of the essence in being successful in getting back funds stolen electronically, do we need to have person review all non-check disbursements before the end of each day?



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What Can I Do?

- Hire internal audit staff or perform the function with existing staff
- Hot Line-Meet with financial staff all over the County to inform them of a number to call to report anything they are not comfortable with. Don't have to leave your name.
- Meet with staff to evaluate the greatest areas of risk in your environment
- Charge all Finance staff to be responsible for internal control – put on their workplans



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What Can I Do?

- Before any new process is put into place evaluate internal controls, document controls and train
- Use tokens instead of digit certificates for on-line banking
- Don't let employees perform on-line banking from home using their personal PC's
- Let them VPN(Virtural Private Network) using work PCs



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What Can I Do?

- Embrace your red flag rules and PCI compliance – make this a management issue not a finance issue. – Involve IT, Attorney, Depts.
- Have Department Head sign an internal control plan for their department and make them name a person who is responsible for ensuring it is followed
- Have Internal Audit review compliance with internal control plan
- Banks now requiring that online banking transactions must use a separate machine that has limited access
- EMV (chip technology) required as of 10/1/2015
- Unit of government can not act on change in payment information from a vendor without calling the vendor to verify the change.



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I/C that Affect the Control Environment

- Make sure management is not overriding controls
 - Split PO's
 - Unauthorized p-cards purchases
 - Stick the contract in the middle of the pile and maybe finance won't see it
- Organizational Chart – Matrix of authority with backups
- Governing Body should participate in day- to – day operations – small units – memo 569
- Monthly reports should be generated and understood by management



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I/C that Affect the Control Environment

- Ethical and Professional Standards
 - Who teaches ethics in your unit
- Cross train employees to perform duties when person is out.
- Staff must be adequately trained
- Listen to Auditor suggestions



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I/C in Accounting System

- Books should be balanced and timely
- **Timely bank reconciliations**
- **Control accounts should be reconciled**
- Accounting procedures should be documented and easily accessed by staff
- **Transactions should be posted timely**
- All journal entries should be approved and explained- not made by anyone that deals with cash
- Records need to be in secure place / backups
- What are you going to do when Bird flue/flooding prohibits your employees from coming to work?



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I/C for Federal and State Grants

- Funds are recorded and expended in compliance with program requirements
- Distinguish contractors from sub-recipients
- Monitoring and indirect cost
- Document the filing of grant reports
- Make sure your reviewing subrecipient audit reports
- Following procurement procedures



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I/C for Cash Receipts

- Record cash at earliest possible point
- Cash must be tied back to an independent system – cash receipts alone is not the best system
- Person keying accounting entry should not be person collecting cash
- Everyone involved needs to understand what they are doing and why
- Who issues your deposit slips and receipt books?
- Have Internal Audit review banking, cash and investment procedures



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Internal Controls Over Investments

For Purposes of this discussion, Investments refers to investments other than NCCMT, CDARS, Finistar, and ICS

Must have Controls

- Investment policy
 - Types of investments, length of time, diversified portfolio, what types/amount of money can be invested?
- Broker / Dealer Agreements
 - Can only sell you legal investments for NC local governments and in accordance with your investment policy
 - Get References from other NC local governments
- Custodial Agreements – Investments reside in the Trust area of the bank.
- Safekeeping Agreements – Investments reside in the commercial side of the bank
- See memo 2013-03 *Custody and Proper Safekeeping of LG Investments* on State Treasurer's web site
<https://www.nctreasurer.com/slq/Memos/2013-03.pdf>



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Internal Controls over Investments

Issues

1. General Fund operating fund balance is invested in 15 year agencies
2. Investments are being held by a custodian/safekeeping agent that has no signed contract with a local government unit
3. Brokers have sold investments to local governments that are not authorized by general statutes.

This all happened during this past fiscal year

It is not uncommon for brokers to approach the governing board about improving interest earnings



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Internal Controls over Investments

Before you set up an investing program you need to set up proper internal controls over the investment activities. Contact Becky Dzingeleski at 919-814-4287.

Become a member of the NC Local Government Investment Association

- They can provide you a mentor to help you set up your investment program or help you evaluate a suggestion made by a broker.

- <http://www.nclgia.org/>

Review the NC State Treasurer Website for sample cash and investment policy and broker/dealer questionnaire.



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Red Flag Rules

- Joint Committee of the OCC, Federal Reserve Board, FDIC, OTS, NCUA and the Federal Trade Commission passed the final legislation for Section 114 of the **Fair and Accurate Credit Transactions Act**
- Aimed to prevent or mitigate identity theft associated with customer accounts
- Cover accounts - A personal account that involves or is designed to permit multiple payments or transactions - utilities



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Red Flag Rules – Guide for Business

The Red Flags Rule tells you how to develop, implement, and administer an identity theft prevention program. A program must include four basic elements that create a framework to deal with the threat of identity theft.

1. A program must include **reasonable policies and procedures to identify the red flags of identity theft** that may occur in your day-to-day operations. Red Flags are suspicious patterns or practices, or specific activities that indicate the possibility of identity theft. For example, if a customer has to provide some form of identification to open an account with your company, an ID that doesn't look genuine is a "red flag" for your business.



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Red Flag Rules – Guide for Business

2. A program must be designed to detect the red flags you've identified. If you have identified fake IDs as a red flag, for example, you must have procedures to detect possible fake, forged, or altered identification.
3. A program must spell out appropriate actions you'll take when you detect red flags.
4. A program must detail how you'll keep it current to reflect new threats.

Red Flag rules expire December 31, 2015 – Federal Trade Commission has proposal out to extend for three more years.
Comment period closed October 19, 2015



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Payment Card Industry Data Security Standard – PCI DSS

- **ALL** companies that **process, store** or **transmit** credit card information maintain a secure environment.
- https://www.pcisecuritystandards.org/security_standards/pci_dss.shtml
- If you already do credit card business you are aware of these rules. If you are thinking about accepting credit cards make sure you understand PCI before you commit to any particular process
- If you need to hire a consultant to help you with PCI compliance the State has CoalFire on contract at a state rate.



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Recommended Practices & Roles

- Internal Audit
- Audit Committees
- Disaster Recovery Plan
- Accounting Policies and Procedures



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Who's Responsible for IC?

Management (includes governing board) has the responsibility for the establishment and maintenance of adequate internal controls.



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Thank You!

Together we can build and maintain a fiscally strong and prosperous North Carolina.

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