

Internal Controls

Process, People, and Assurance

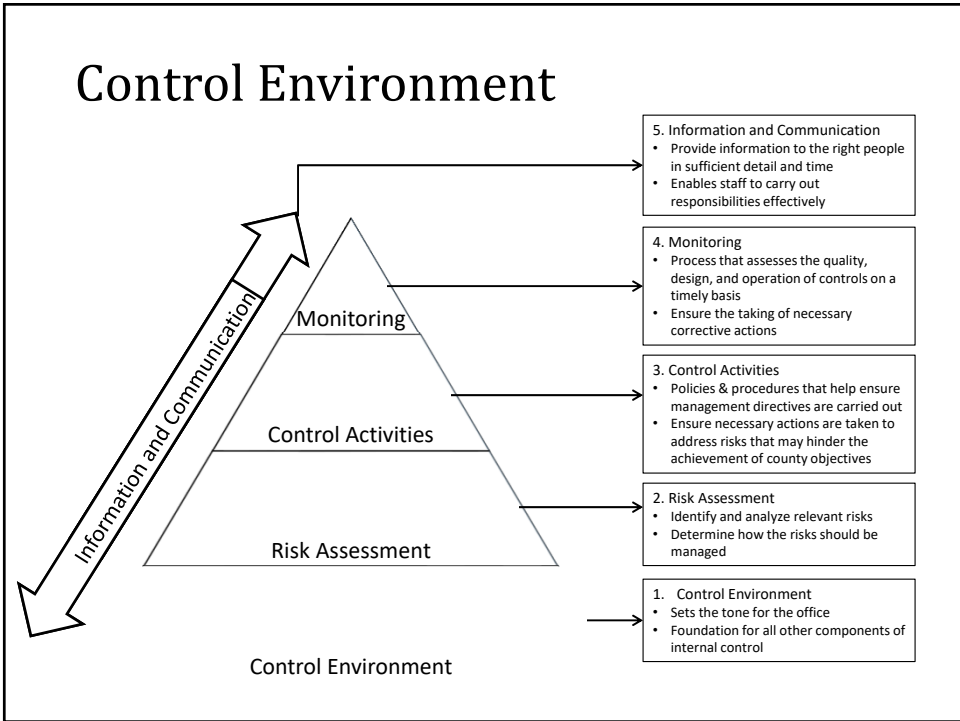
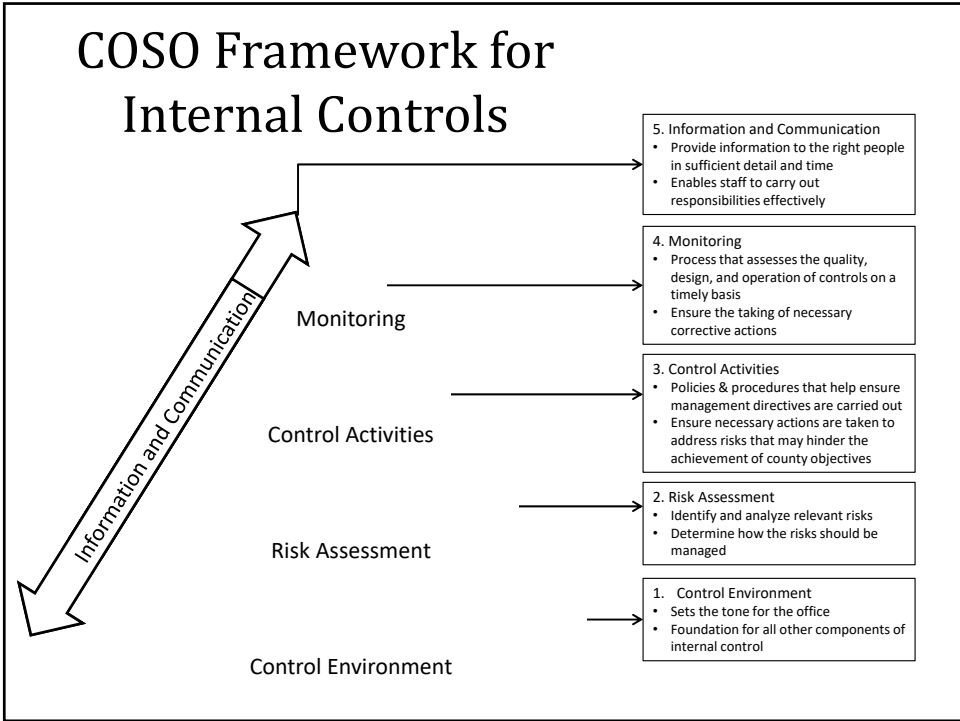
New County Auditor Training May 2022

Madeline Walker CPA, CFE

What Are Internal Controls?

Processes designed to provide reasonable assurance regarding the achievement of county objectives in:

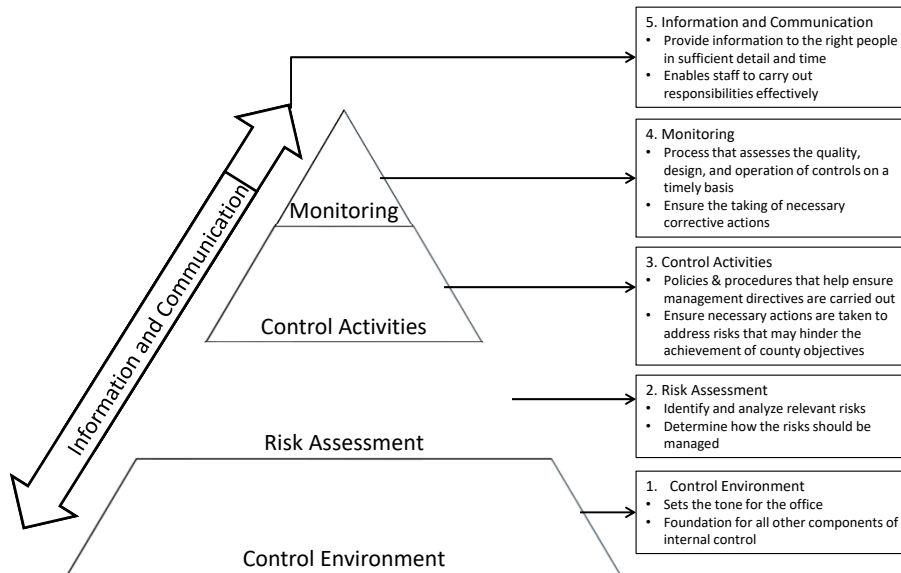
- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with statutes, policies, and procedures



Components of a Strong Control Environment

- Commitment to Competence
- Human Resources Policies and Practices
- Assignment of Authority and Responsibility
- Management’s Philosophy and Operating Style
- Participation of Those Charged With Governance
- Integrity and Ethical Values
- Organizational Network

Risk Assessment



What Are Risks?

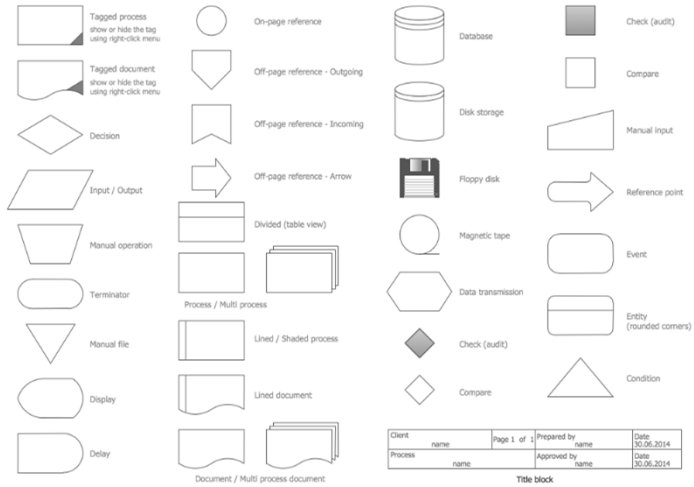
Risks are defined by COSO as “the possibility that events will occur and affect the achievement of strategy and business objectives”

Identifying Risks

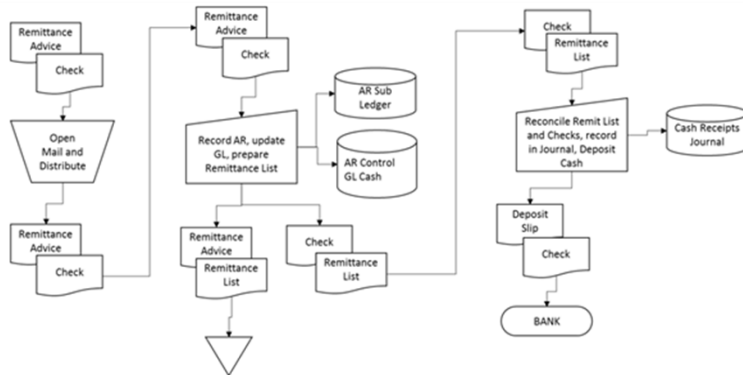
Ways to identify risks include:

- Surveys
- Interviews
- Historical or Documented Knowledge
- Brainstorming
- Checklists
- Direct Observations
- Incident Analysis
- Flowcharts

Common Flowchart Symbols



Flowchart Example



Risk Assessment Example

Internal Control Evaluation

Company Name:	ABC Company LLC
Prepared By:	Julie A. Aydlott, CFE
Date Prepared:	October 8, 2011

Overall Rating

Department	Reasonable / Effective Controls Exist	Opportunity for Improvement	Critical - Lack of Controls	Comments
Payroll		√		Need authorization for each payroll
Human Resources		√		Need a fraud policy with handbook
Accounts Receivable			√	Need AR reconciliation and controls
Accounts Payable			√	Need AP reconciliation and controls
Purchasing			√	Need purchasing procedures
Inventory			√	Need better inventory tracking
Fixed Assets		√		Need fixed asset database and review
Banking and Cash			√	Need controls over banking and cash

Common Risk Areas

Common risk areas for counties:

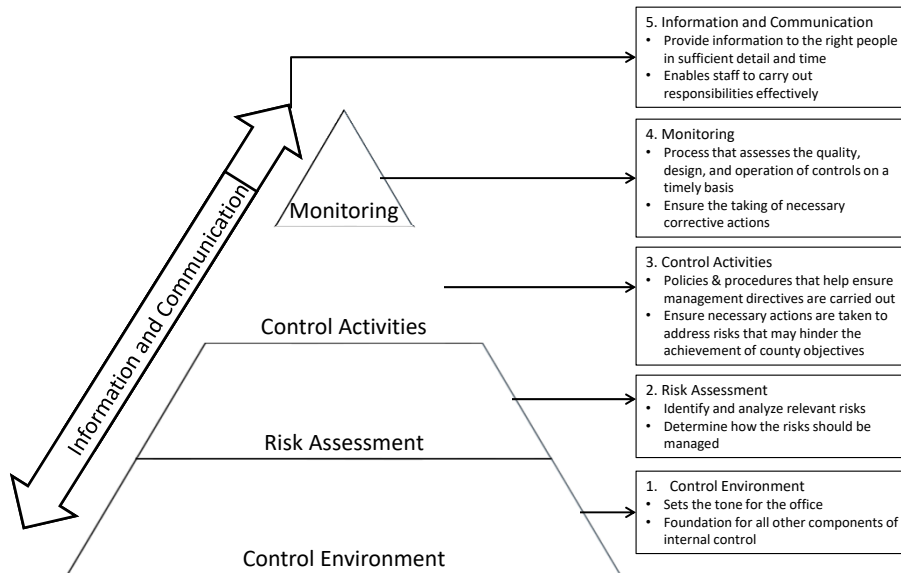
- Cash receipts
- Cash disbursement
- Bank accounts and reconciliations
- Billed receivables
- Procurement
- Payroll
- Employees vs. contractor
- Equipment and consumables
- Information technology
- Outsourced services



Other Factors Affecting Risk

- Changes in operating environment
- New personnel
- New or revamped information systems
- Rapid growth
- New technology
- Changes in economic conditions

Control Activities



Control Activities

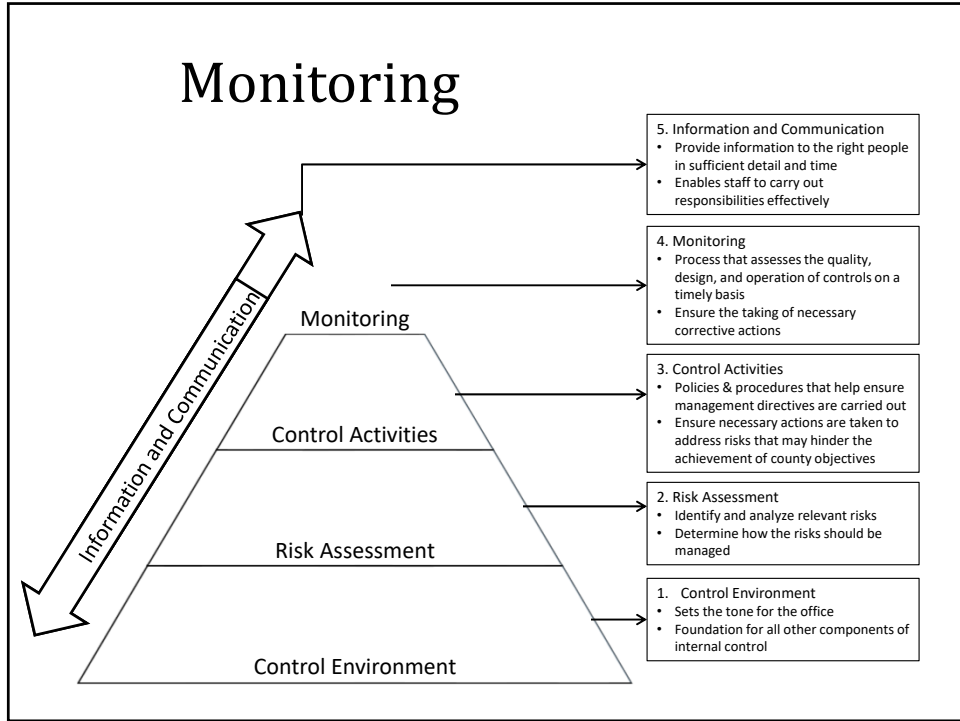
- Controls must be **present** and **functioning** in order to be effective
- **Segregation of duties**

No one person should have access to:

 - Custody of assets
 - Authorization or approval affecting those assets
 - Recording or reporting of related transactions
 - Ex: no one person should be accepting funds, recording the transaction, and reconciling the account related to the transaction
- **Physical security**
 - Ex: safe, lock drawers

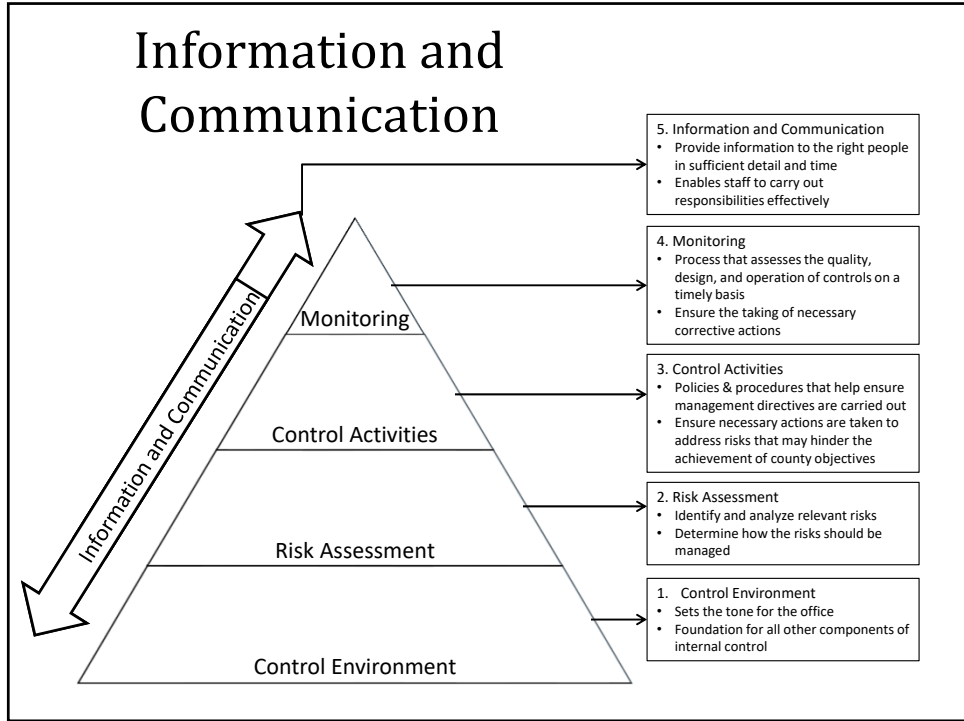
Control Activities

- **Documentation and record retention**
 - Ex: all voided receipts are retained
- **Reconciliation and Review**
 - Ex: monthly bank reconciliations
- **Authorization and Approval**
 - Ex: management approval for all voided receipts
- **Information Processing**
 - Ex: require checks of accuracy, completeness, and authorization of transactions



Monitoring Activities

- Monitoring Activities Include:
 - Ongoing activities built into normal recurring actions such as supervision, possibly combined with separate evaluations
 - Internal audits and reviews
 - Consideration of communication from external parties



Information and Communication

- Information and communication activities are used to:
 - Maintain accountability
 - Measure and review performance
- **Information:**
 - Information can include internal and external sources of data
 - High quality and relevant information is the most appropriate
 - Cost/benefit of obtaining information should be considered
- **Communication:**
 - Effective flow of information between departments
 - Includes providing employees with an understanding of their roles and responsibilities

Internal Controls and Technology

How do we apply the COSO Framework of Internal Controls in an increasingly cyber-centric workplace?

Apply Considerations at Every Level of the COSO Framework

- **Control Environment**

- Do the officials and department heads understand the county's cyber risk profile and are they aware of how the county is managing the risks?

- **Risk Assessment**

- Have the county's operations been evaluated for cyber risks against its objectives?
 - Effectiveness and efficiency of operations
 - Reliability of financial reporting
 - Compliance with statutes, policies, and procedures

Apply Considerations at Every Level of the COSO Framework

- **Control Activities**

- Have control activities been put in place over technology?
- Are both preventative and detective controls being utilized?
- Have these activities been implemented through formal policies and procedures? And if so, were they implemented county-wide?

- **Monitoring Activities**

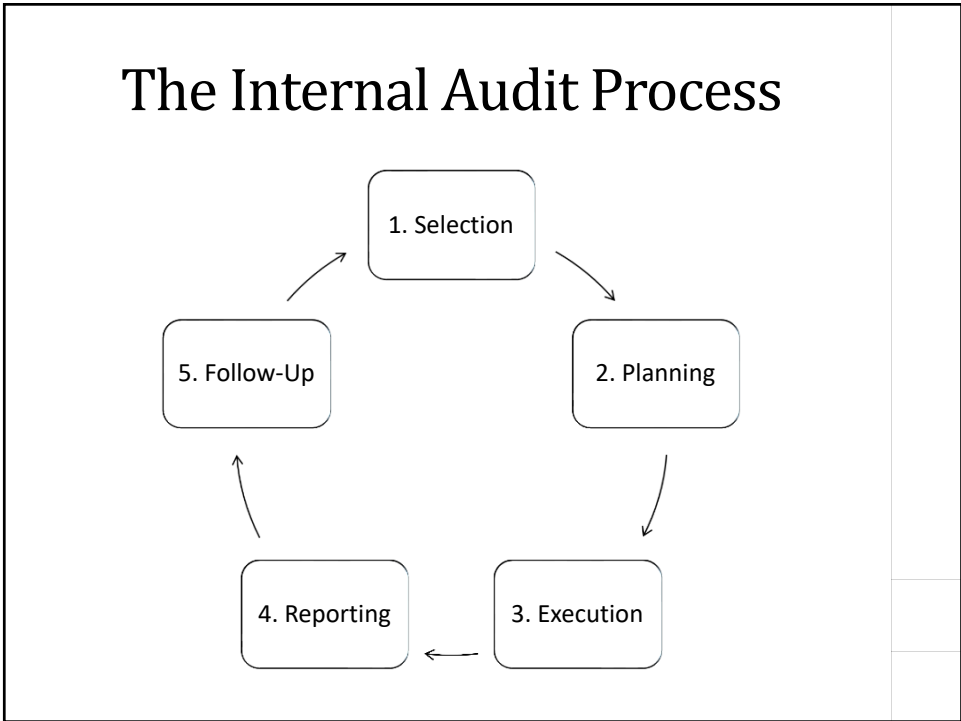
- How will the county select, develop, and perform evaluations to monitor the effectiveness of controls over cyber risks?
- When issues or deficiencies are identified, how are they communicated and prioritized for corrective action?
- What is the county doing to monitor its cyber risk profile?

Apply Considerations at Every Level of the COSO Framework

- **Information and Communication**

- Have information requirements to manage internal control over cyber risks been identified by the county?
- How will the county respond to, manage, and communicate a cyber risk event?

INTERNAL CONTROLS AND THE AUDIT PROCESS



Selection

- Broad assessment of risks for the county
- Audits are chosen based on risk, statute, or other concerns

There are 3 types of risk to consider:

1. Inherent risk
2. Control risk
3. Detection risk

- The Audit Plan is set

Planning

- Set the scope and objective of the audit
- Initiate contact with client
- Set estimated timing of fieldwork
- Compile background information
 - Internal control interview
 - Statistical analysis
 - Flowcharts
 - Organizational charts
 - Statutes, policies, and procedures

This is the stage where most internal controls (or lack of internal controls) will be identified

Execution

- Fieldwork is executed (testing)
- Prepare audit work-papers
- Internal controls identified in the planning stage are tested for compliance and effectiveness
- Additional internal controls are identified

Reporting

- Audit report is issued to client for review
- Hold exit conference with client to go over the audit and address any questions/concerns they may have
- Receive client response
- Audit report is submitted to Commissioners Court or appropriate oversight board



Follow-Up

- Within one year
- Some components may need to be reviewed sooner depending on materiality
- Continual or ongoing monitoring is performed when possible
- Can be formal or informal

INTERNAL CONTROLS AND PEOPLE

Tone at the Top

Management's opinion of internal controls can affect:

- Control environment
- Employees understanding of importance
- Attitude

Management must establish clear lines of communication regarding employee responsibilities and limits of authority.

Auditor to Client Communication

- Communication with the client begins at the time of the surprise cash count or with the delivery of the engagement letter
- Auditor should remain in constant communication throughout the course of the audit
- Establishing positive working relationships and earning the client's trust can improve controls and processes outside of the audit period



"Did you get any feedback on that audit report?"

Internal Control Interview

Etiquette

- Arrive on time
- Be prepared
- Practice active listening
 - Eye contact
 - Nodding
 - Paraphrasing and restating
- Stay concise and on topic
- Keep a positive attitude
- Record interview as soon as possible



Internal Control Interview

Questions

- Break the ice
- Start general and drill down
- Avoid closed questions
- Avoid leading questions or questions with “right answers”
- Keep it conversational
- Refrain from professional jargon
- Allow the interviewee to explain their processes/procedures completely, without interruption

Internal Control Interview

Closing the Interview

- Thank the interviewee for their time
- Recap and summarize
- Go over document list
- Schedule additional time
- Explain what comes next



INTERNAL CONTROLS AND ASSURANCE

Audit Guidelines

Audit guidelines are the principles, approach, and processes for regulating audit practices

Why are they important?

- Work-papers are easy to follow
- Year to year comparison
- Office to office comparison
- Set standards for all auditors
- Provide template for all new and existing audits
- Ensure adequate documentation

Audit Guidelines

Examples of audit guidelines from Galveston County
(See attachments)

- [Internal Control Interview Procedures](#)
- [Internal Audit Cash Count Procedures](#)
- [Internal Audit Work-paper Guidelines](#)

Limitations to Internal Controls

Even the best internal controls can only provide

reasonable assurance

Limitations are due to:

- Cost and time restraints
- Collusion
- Management override
- Human judgement
- Cost/benefit balance

QUESTIONS?