

Welcome to Internal Controls Training

Maria Moreno
Heather Domenici

maria.moreno@finance.nv.gov
hrdomenici@finance.nv.gov



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Class Structure

Class consists of:

- Pre-Test
- Presentation
- Post-Test

Test results are used as a
performance measure of this
class



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Presentation Overview

- Internal Controls – Overview
- Internal Controls Statutory Requirements – State of Nevada
- Major Fiscal Areas
- Other Fiscal Processes



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Pre-Test



Internal Controls Overview

NAC 353A.100

Who Is Required to Attend?

- Head of each Agency and Employees who administer budgetary accounts within 90 days of hired/promoted/transferred will attend training
- Any other employees required by the agency

Also Recommended:

- Any staff coming into contact with financial transactions
 - Initiators of Purchase Orders
 - Receivers



Internal Controls Overview

Definition of Internal Controls

- Internal controls are the mechanisms, rules, and procedures implemented by a company (agency) to ensure the integrity of financial and accounting information, promote accountability, and prevent fraud. (*Investopedia*)
- Internal control is a process designed to provide reasonable assurance that specific entity objectives will be achieved. Internal control is affected by the actions of individuals within the organization as well as policies and procedures. (*Government Finance Officers Association*)



Internal Controls Overview

Internal Controls:

- Affect every aspect of an agency
- Are not stand-alone practices; they should be incorporated into day-to-day responsibilities
- Must make sense within each agency's unique operating environment
- Strong internal controls provide a level of assurance but do **NOT** guarantee an absence of error or fraud



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Internal Controls Overview

Effective Internal Controls can help an agency to:

- Safeguard the agency's assets
- Ensure records are accurate and complete
- Promote operational efficiency and effectiveness
- Encourage adherence to policies



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Internal Controls Overview

- Internal controls are the responsibility of all employees
- Internal controls only work with the cooperation of employees
- Not an automated process



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Internal Controls Overview

Development of Internal Control Concepts

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) created an Internal Control framework which includes 5 *essential* and interrelated components:

- Control Environment
- Risk
- Control Activities
- Information and Communication
- Monitoring



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Internal Controls Overview

COSO Component: Control Environment

- The foundation for all other components of internal control, providing discipline and structure
- Includes:
 - Integrity and ethical values
 - Organizational structure
 - Management operating style and philosophy
 - Expectations of upper-level managers



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Internal Controls Overview

COSO Component: Risk Assessment

- The process by which areas of potential weakness are identified and are assigned a likelihood of incidence
- Common areas of high risk:
 - Cash handling
 - Travel
 - Purchasing



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Internal Controls Overview

COSO Component: Control Activities

- Procedures put into place to mitigate risk
- These include:
 - Policies and procedures
 - Written controls
 - Security measures
 - Compensating controls
 - Outsourcing
 - Segregation of duties



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Internal Controls Overview

COSO Component: Information & Communication

- Information and communication practices are the way in which management communicates the culture of compliance and the specific policies employees are required to follow
 - Information is necessary to carry out internal control responsibilities to support agency objectives
 - Communication is the continual process of providing, sharing, and obtaining necessary information



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Internal Controls Overview

COSO Component: Monitoring Activities

- A way for managers to monitor processes or internal controls within the organization
- Includes:
 - Biennial internal control review (SAQs)
 - Self-auditing of transactions
 - Reconciliation of BSR reports
 - Proper authorization
 - Adequate documents and records
 - Reporting



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Internal Controls Overview

The Coso Framework also consists of the 5 integrated components and 17 principles associated with the components.

The Operations, Reporting, and Compliance objectives directly relate to the 5 integrated components of internal control.



Internal Controls State of Nevada

- State of Nevada has adopted a statute with similar requirements to the COSO Control Activities
SAM 2416 – Internal Control
- Statutory Requirement
NRS 353A – Internal Accounting and Administrative Control



Internal Controls State of Nevada

- Pursuant to NRS 353A.020, agencies are required to develop written procedures to carry out the uniform system of internal accounting and administrative controls
- The uniform system of controls is documented through the Self-Assessment Questionnaire (SAQ) and can be found at:

<http://budget.nv.gov/iAudits/About/FinancialMgmt/SAQ>



Internal Controls State of Nevada

Responsibility of internal controls falls
on **agency management**

Including:

- Design
- Implementation
- Monitoring



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Internal Controls State of Nevada

Internal Monitoring Requirements:

- NRS 353A.025 - Agency Self Assessment
 - Agencies periodically self-assess internal controls
- SAM 2418
 - Biennially complete SAQ's by July 1st on each even numbered year
 - Biennially complete the Testing of Transactions
- Review:
 - Written procedures
 - Actual processes



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Types of Internal Controls

There are three types of Internal Controls that are essential for an effective system:

- Preventative - *Before*
 - Minimize opportunities for unintentional errors or intentional fraud
- Detective - *After*
 - Discover small errors before they become big problems
- Corrective - *Detect Risk and Respond*
 - Detect if a risk is present and elicit a response and/or corrective action



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Preventative Internal Controls

- Segregation of Duties
 - Revenues - Receiving of funds and depositing of funds
 - Purchasing - Ordering of goods and receiving of goods
- Approvals and Authorizations
 - Purchase Order approvals
 - Pend 3 and Pend 4
- Security of Assets
 - Locking up employee files, inventory, etc.



TRUST alone is not a Control 22

Detective Internal Controls

- Reconciliations
 - BSR; Bank reconciliations; A/R reconciliations
- Conduct physical inventories
- Audits and reviews
 - Internal or external



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Corrective Internal Controls

- Requiring a corrective action plan for internal controls not operating as designed
 - No fraud, errors, or abuse detected, but the risk is there
- Monitoring activity through review of reports
 - Compare current performance to budget or forecasts
- Often results from internal or external compliance audits or reviews




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Fraud Mitigation

The
Fraud Triangle

Opportunity Rationalization
Pressure




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Fraud Mitigation

Detection of fraud

- Can come from a variety of sources: an entity's internal controls, an internal or external audit, an internal or external whistleblower, surveillance, or even by accident
- Most common source is usually from a whistleblower tip by **fellow employee**




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Fraud Mitigation

High Profile Fraud Cases

- Enron – Hid financial losses on its financial statements by buying assets, such as power plants, and immediately claiming the future projected revenues from those power plants on its books even though \$0 dollars had been made from electric sales.
 - When the company was forced to restate their earnings, it showed to have losses of \$590 million and was \$630 million in debt.
- WorldCom –Hid failing profits by overstating revenues and recording expenses as "investments" on their financial statements.



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Fraud Mitigation

Resulted in...

- The Sarbanes-Oxley Act (2002)
Developed to protect investors from fraudulent financial reporting from corporations. The act required broader disclosure requirements for publicly traded companies along with higher penalties for accounting fraud. Under the Act a company's CEO could be held personally liable for errors in accounting and financial reporting.



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State Fraud, Waste, & Abuse Hotline (775) 687-0150 iaudits@finance.nv.gov

What to Report:

- Creating fictitious employees/vendors
- Falsifying invoices or transactions
- Executing related party transactions
- Receiving kickbacks
- Excessive travel not consistent with duties of a job
- Incomplete support for payments, i.e. no hotel receipt for a travel claim or receiving report for office supplies
- Unusual purchases or purchases not included in an approved budget



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Questions?



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Major Fiscal Processes

- Revenues & Accounts Receivable
- Purchasing & Expenditures
- Procurement Cards
- Travel
- Contracts



Internal Controls for these processes are covered in detail through their respective Self-Assessment Questionnaires (SAQ)

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Revenues & Accounts Receivable

Revenue handling consists of four processes:

- Receiving
- Depositing
- Recording
- Reconciling



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Revenues & Accounts Receivable

Receiving:

- Record/log cash and checks immediately
- Endorse checks immediately upon receipt
- Approval by supervisor for all voided/refunded transactions

Depositing:

- Segregate depositing from receiving
- Secure funds in locked cabinet/safe until deposit
- NRS 353.250 - Bank Deposits
 - Deposit funds at least weekly on/before Thursday
 - \$10k or more - next working day



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Revenues & Accounts Receivable

SAM 2602

Recording:

- Segregate recording from receiving
- CRs (Cash Receipts) should be keyed into Advantage the same day of deposit
 - Never later than 2 days after deposit
 - Date of deposit is the date of record
- Enter into internal budget tracking



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Revenues & Accounts Receivable

Reconciling:

- Segregate from receiving and depositing
- Reconcile cash/check logs to deposits (CR)
- Reconcile deposits to BSR
- Monthly – Review accounts receivable aging reports
 - A/R payments – limit access to ledger
- Sales
 - Permits, tags licenses– secure inventory, use pre-numbered forms



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Purchasing & Expenditures

SAM 1500

Control Procedures

- Segregate approving, ordering, and receiving functions
 - Ensuring a minimum of three separate employees perform these tasks
- Ensure Purchasing Division guidelines are followed.
 - Purchases over \$5,000 require RXQ
 - Purchases must be tax exempt
 - Refer to State Purchasing Division's guidelines www.purchasing.nv.gov



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Purchasing & Expenditures

SAM 1500

Control Procedures

- Ensure approval to order and budgetary authority
- Verify items received
- Match - P.O., invoice, receiving document prior to payment
- Obtain supervisory approval for invoice payments
- Verify actual expenditures to Budget (DAWN)



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Purchasing & Expenditures

SAM 1500

Purchasing & Expenditures – Fraud Risks

- Red Flags
 - High volume of purchases from a new vendor
 - Purchases that bypass the normal procedures
 - Vendor's address same as employee's
 - Invoices for unspecified consulting or poorly defined services



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Purchasing & Expenditures

SAM 1500

Billing schemes - Most expensive type of employee theft

- Purchase real items for personal use
- Purchase non-existent items from fake vendors
- Fake claims or reimbursements
- Purchases that by-pass normal procedures



Tal "Pete" Smith a former NDOT employee pled guilty to fraud after an investigation found he made more than \$250,000 in illegal purchases and resold items for profit. Mr. Smith, was sentenced to 18 to 48 months in prison and was ordered to repay \$250,639 to NDOT as part of a plea agreement.

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Procurement Cards

SAM 1556

Use of P-cards:

- Must follow Purchasing processes
 - Approval to purchase
 - Receiving of goods/services
 - Approval to pay



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Procurement Cards

SAM 1556

- Agency determines if PO's are required and if so, at what \$ amount (*up to \$4,999.99*)
 - Should be documented in P&P's
- Purchases must be tax exempt



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Procurement Cards

SAM 1556

- Independent verification of receipt of merchandise
 - If independent verification cannot be obtained immediately, then compensating controls must be in place
- Only cardholder may utilize card if card is in individual name
 - Card may be in the agency's name
 - Agency cards must use checkout logs



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Procurement Cards

SAM 1556

Review of P-card Statement:

- Supervisor should review statement
 - Split transactions
 - Billing errors
 - Sales tax
- Disputed charges
 - Statement must be paid in full
 - Disputes should be resolved in subsequent months



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Travel

SAM 0200

Reimbursements:

- Agency should ensure P&P's are complete
 - Process for incidentals reimbursement
 - Use of correct GSA rates and per diem
 - If mileage is requested, is an independent verification of miles performed (i.e., google maps attached to claim?)
- Hours that meals may be claimed



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Travel

SAM 0200

Reimbursements:

- Claims must have supporting documentation attached for all line items
- At least annually, audit a sample of employee's claims to ensure:
 - P&P's are being followed
 - Claims are mathematically correct
 - Sufficient documentation exists



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Travel

SAM 0200

- Corporate Travel Card (Ghost) **must** only be used for airfare
- Individual Travel Cards must only be used for travel related items normally reimbursed by the state
- Both cards' activities can and should be reviewed in WORKS



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Contracts

SAM 0300

- Every agency entering into contracts must have a current certified Contract Manager.
 - Must be certified through State Purchasing class Contract Management Certification
- *Contract processing takes time! Please allow sufficient time to initiate contracts*



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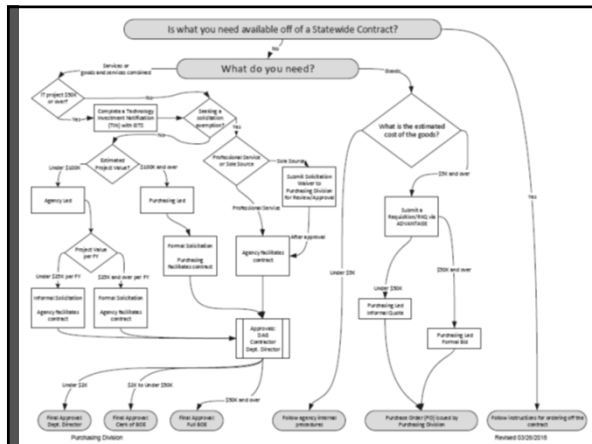
Contracts

SAM 0300

- All purchases of services OR goods and services require a contract
 - This includes one-time purchases such as on-site training costing more than \$2,000
- For services under \$2,000 per year, Purchasing Division no longer requires a contract
 - **However** DIA strongly recommends obtaining contracts for these purchases to protect the interests of the State and its vendors




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Other Fiscal Processes

- Grants
- Inventory
- Outside Bank Accounts
- Petty Cash

Internal Controls for these processes are covered in detail through their respective Self-Assessment Questionnaires (SAQ)




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Grants

SAM 3000

- Obtaining Grants - Follow all guidelines put forth by the Nevada Office of Grant Procurement, Coordination, and Management, www.grant.nv.gov
- Receiving Funds - Same as any other revenue. Follow revenue receiving internal control procedures
- Expending Funds - Ensure all expenditures are allowable under the terms of the grant. Follow purchasing and expenditure internal control procedures



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Grants

SAM 3000

- Monitoring
 - Verifying invoices for proper costs
 - Ensuring funds are available in correct budget category
 - Ensuring sub-recipients comply with all grant terms
- Reporting - Follow all state and federal guidelines for grant reporting



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Grants

SAM 3000

Office of Grant Procurement, Coordination,
and Management

775-684-0156

grants@admin.nv.gov

406 E. Second Street, 1st Floor
Carson City, Nevada 89701



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Inventory

SAM 1544

- Capital assets valued at \$5,000 or more and a useful life of more than two years will be carried on the statewide inventory tracked in DAWN
- Non-capital asset inventories
 - Permits/Licenses for sale
 - Shop stock
 - Merchandise



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Inventory

SAM 1544

- Inventory must be safeguarded and access limited to authorized staff
- Inventory counts must be performed by at least 2 members of staff, no less than annually
- Unexplained variances between actual count and inventory list must be investigated and documented
- Items suspected as stolen must be reported to Capitol Police



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Outside Bank Accounts

- Outside bank accounts must be approved by BOE or statutory authority
- Purpose of bank account must be documented in agency policies and procedures
- Name of the account and financial institution must be submitted to the State Treasurer's office
- Must follow state internal control procedures for revenues and expenditures



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Petty Cash

SAM 2534

- Petty cash funds must be approved by BOE or statutory authority
- Purpose of fund must be documented in agency policies and procedures
- Petty cash funds should be adequately safeguarded in a secure location with access limited to authorized personnel
- Disbursements from petty cash must be supported by original receipts



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Questions?



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Post Test

Thank you for taking this class

**Good luck on the
test!**

If you would like your test results, please send
Heather Domenici an email request at
hrdomenici@finance.nv.gov



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