

Welcome to Internal Controls Training

Bety Mena-Ortiz

Courtney Smith

bmenaortiz@finance.nv.gov

courtsmith@finance.nv.gov



1

1

Class Structure

Class consists of:

- Pre-Test
- Presentation
- Post-Test

Test results are used as a
performance measure of this
class



2

2

Presentation Overview

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



3

3

4

4

NAC 353A.100

Who Is Required to Attend?

- Head of each Agency and Employees who administer budgetary accounts within 90 days of being 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

5

5

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*)

6

6

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



7

7

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



8

8

Internal Controls Overview

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



9

9

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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10

10

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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11

11

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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12

12

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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13

13

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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14

14

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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15

15

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.



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16

16

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



17

17

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>



18


18

Internal Controls State of Nevada

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

Including:

- Design
- Implementation
- Monitoring




19

19

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




20

20

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



21

21

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
 - Approval 1 and Approval 2
- Security of Assets
 - Locking up employee files, inventory, etc.



TRUST alone is not a Control 22

22

Detective Internal Controls

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



23

23

Corrective Internal Controls

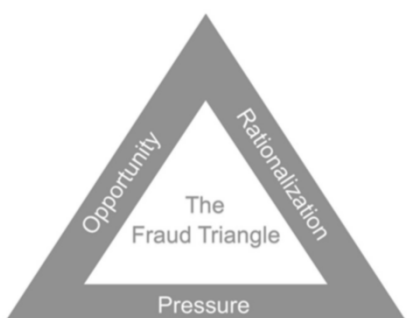
- Requiring a corrective action plan for internal controls not operating as designed
 - No fraud, errors, or abuse detected, but the risk is there
- Monitoring activity through review of reports
 - Compare current performance to budget or forecasts
- Often results from internal or external compliance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



24

24

Fraud Mitigation




The Fraud Triangle

Opportunity

Rationalization

Pressure




25

25

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**




26

26

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.



27


27

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.



28

28


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
- Unusual purchases or purchases not included in an approved budget



29

29

Questions



30

30

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)

31

31

Revenues & Accounts Receivable

Revenue handling consists of four processes:

- Receiving
- Depositing
- Recording
- Reconciling



32

32

Revenues & Accounts Receivable

Receiving:

- Record/log cash and checks immediately
- Endorse checks immediately upon receipt
- Approval by supervisor for all voided/refunded transactions
- ACH Notification of Incoming Funds

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



33

33

Revenues & Accounts Receivable

SAM 2602

Recording:

- Segregate recording from receiving
- CRs (Cash Receipts) should be keyed into the state's accounting system 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



34

34

Revenues & Accounts Receivable

Reconciling:

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



35

35

Purchasing & Expenditures

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



36

36

Purchasing & Expenditures

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)



37

37

Purchasing & Expenditures

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



38

38

Purchasing & Expenditures

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

FRAUD: 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.



39

39

Procurement Cards

SAM 0322

Use of P-cards:

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



40

40

Procurement Cards

SAM 0322

- 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



41

41

Procurement Cards

SAM 0322

- 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



42

42

Procurement Cards

SAM 0322

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



43

43

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



44

44

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



45

45

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



46

46

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*



47

47

Contracts

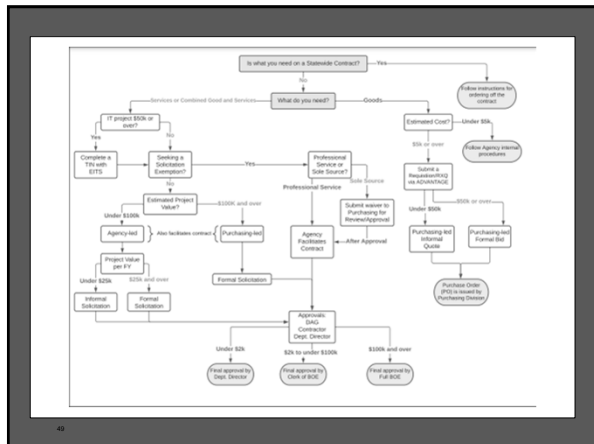
SAM 0300

- 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 still requires a contract.



48

48




49

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)




50

Grants

SAM 3000

- Obtaining Grants - Follow all guidelines put forth by the Nevada Governor's Office of Federal Assistance, ofa.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



51

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



52

52

Grants


SAM 3000

Office of Federal Assistance

775-684-0156

209 E. Musser St.

Carson City, Nevada 89701



53

53

Inventory

SAM 0326


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



54

54

Inventory

SAM 0326

- 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



55

55

Outside Bank Accounts

- Outside bank accounts must be approved by Board of Finance 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



56

56

Petty Cash

SAM 2534

- Petty cash funds must be approved by Board of Examiners (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



57

57

Questions



58

58

Post Test

Thank you for taking this class

**Good luck on the
test!**

If you would like your test results, please send
Bety Mena-Ortiz an email request at
bmenaortiz@finance.nv.gov



59

59

Test Review

1. Internal controls:

- a) Are not people dependent
- b) Are operating standards to make sure the agency runs well
- c) Should be incorporated into the day-to-day responsibilities of employees.
- d) Both b and c



60

60

Test Review

2. Ensuring agency compliance with internal controls is ultimately the responsibility of:
- a) The agency's management
 - b) The Division of Internal Audits
 - c) The agency's fiscal staff
 - d) None of the above



61

61

Test Review

3. Developing written procedures for your agency is the statutory responsibility of:
- a) The Division of Internal Audits
 - b) Your agency
 - c) The Controller's office
 - d) Both a and b



62

62

Test Review

4. If agencies implement adequate internal controls, they are assured to have no fraudulent occurrences.
- a) True
 - b) False



63

63

Test Review

5. The Self-Assessment Questionnaire:
- a) Is a personality quiz for employees
 - b) Is not required to be completed by Executive Branch Agencies
 - c) Must be completed by each state employee
 - d) Must be completed by Executive Branch Agencies



64

64

Test Review

6. Per Statute, agencies are required to review their own internal controls and report the results of their review to the Governor's Finance Office, Division of Internal Audits:
- a) On or before July 1 of every even numbered calendar year
 - b) On or before July 1 of every year
 - c) Whenever they have time
 - d) On or before July 1 of every odd numbered calendar year



65

65

Test Review

7. Which of the following are examples of internal controls?
- a) Segregating receiving and approval to pay functions
 - b) Trusting employees to not steal
 - c) Periodic audits of employees' work
 - d) Both a and c above



66

66

Test Review

8. If Jethro reconciles revenues posted in the State accounting system, he should not have access to:
- a) The initial receipt of the revenue
 - b) The ability to deposit the revenue
 - c) Both a and b
 - d) The cash collected for employee water



67

67

Test Review

9. If Mildred orders the office supplies:
- a) She should take them home for personal use
 - b) She should not also sign as receiving the office supplies
 - c) She should also sign as receiving the office supplies
 - d) She should also distribute the supplies to the employees



68

68

Test Review

10. The most expensive area of employee theft is in the area of purchasing/expenditures:
- a) True
 - b) False



69

69

Test Review

11. Which of the following might be an indication of a billing scam?
- a) The vendor's address is out of State
 - b) Purchases that by-pass the normal procedures
 - c) The vendor sends a fruit cake to the office for Christmas
 - d) Both a and b



70

70

Test Review

12. The Department of Wildlife's current fiscal budget includes funds to purchase \$6,000 of Sage Grouse tracking collars. Prior to this purchase, the agency must obtain proper authorization from the following:
- a) Office of the Treasurer
 - b) Purchasing Division
 - c) The Office of the Governor
 - d) Both b and c



71

71

Test Review

13. When utilizing a procurement card (p-card), agencies:
- a) Must eliminate the use of a purchase order
 - b) Can split transactions to stay under the purchasing limit of \$4,999.99 per transaction
 - c) Must require purchases to have independent verification of merchandise
 - d) Both b and c



72


72

Test Review

14. Since cardholders of p-cards have signed a statement to purchase only items required by the agency, no additional review of purchases is necessary.

a) True

b) False



73


73

Test Review

15. The agency Corporate Travel Card (ghost card) can be used for any travel expenditures as long as it is an approved travel expenditures.

a) True


b) False



74

74

Thank you



75

75
