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INTERNAL CONTROLS:
How to Present / Convey Importance to Boards

Presented by:
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Ohio GFOA – 9/2009

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Overview of Topics

- Public officials responsibilities
- Internal Controls
- Compliance with applicable laws
- Budgeting
- Fraud Risk management
- Auditor's communication to Officials
- Public liability Issues

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Public Officials Responsibilities

- Safeguard and Protect public assets –
Public moneys
Public property
- Make responsible financial decisions via budgeting
- Properly manage government resources to achieve goals of government via internal controls

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Ways to Accomplish These Responsibilities

- Safeguard and Protect Assets –
Develop Internal Controls
- Responsible financial decisions –
Budgeting process
- Properly manage resources –
Monitor those Internal Controls to
assure they are in place & operating

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Responsibilities for Controls

- System of Internal Controls should be developed by “Management”
- It is management’s primary responsibility to develop proper controls
- Internal controls assists the government in realizing their mission and objectives

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Who is Management?

- Smaller entities have elected officials such as Board of Trustees or Village Council but no layers of management.
- The elected officials would then function as management and have sole responsibility
- Important tone set by the top on view of Internal Controls

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Who is Management?

- Township Administrator
ORC 505.031-.032
- Village Administrator
ORC 735.271
- These positions however operate under direction of the elected officials

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Ways to Accomplish Goals

- Develop internal controls
 - To protect assets from loss
 - Ensure transactions are authorized
 - Ensure all funds are collected for services provided by the local government
 - Ensure restricted funds used according to allowable purposes

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Types of Internal Controls

- General controls
- Security controls
- Management controls
- Monitoring controls

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Internal Controls

- Management must be committed to development and maintenance of controls.
- Management needs clearly define expectations
- Segregation of duties has cost associated

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Internal Controls (Cont'd.)

- Management must monitor controls
- Management must have understanding of information and be able to ask questions
- Management is front line to find a theft

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Internal Controls (Cont'd.)

- Utility Dept. – Board of Public Affairs did not ask ?? of lack of funds
- Theft later found over \$250,000
- Red Flags existed
- No follow up by Management
- Embarrassing to BPA / Village Officials

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Internal Controls (Cont'd.)

- Mayor's Court– Large variance in receipts
- Mayor supposed to report to council monthly - They did not - Council did not ask why??
- Ended up with a theft
- Red Flags existed but no one followed up – Embarrassing to Mayor / Village Officials

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Identify Applicable Laws – Controls to Assure Compliance

- Audit standards require each public office to develop systems to comply with law, grants, contracts for their entity
- Debt covenants
- Ohio Compliance Supplement
- Local charter requirements
- Grants – Single Audits

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Importance of Budgets

- In order for governments to use their resources wisely there must be a plan or budget to allocate efficient use of their resources
- Officials have primary responsibility for budgetary process as outlined in various sections of the Ohio Revised Code – Chpt. 5705

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Importance of Budgets

- Trustees / Officials responsibilities
 - Approve annual budgets
 - Set / Approve tax rates
 - Set / Approve appropriations
 - Monitor budget through review of monthly financial reports to evaluate adequacy of budget during the year

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Importance of Budgets

Case Study

Village had:

- Limited internal controls
- No monitoring of budgets or expenditures
- New fiscal officer with lack of experience
- New Village administrator

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Importance of Budgets – Case Study

Entity went from having \$3.0 million cash/inv.
to \$1.4 in 3 years

- General Fund Cash fund balance
 - 2005 \$154,064
 - 2006 (110,252)
 - 2007 (279,785)
 - 2008 (485,336)

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Importance of Budgets – Case Study

Entity had increasing utility expenditures but rates not raised

- Enterprise Fund

– 2005	\$1,387,943
– 2006	802,979
– 2007	441,256
– 2008	356,614

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Officials Responsibility for Fraud

Management should assess risks and review fraud risk indicators to develop policies or controls to minimize the risk of a fraud occurring



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Essential to Eliminate Fraud

Loss of public confidence in govt

Loss of reputation of innocent

Punish individual



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Auditor's Responsibility SAS 114

Clarify and expand communication requirements of SAS 61 with client / management



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Communication - Auditor vs. Management Responsibility

- Engagement Letter
- GAGAS – Internal Control – Compliance report
- Representation Letter

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Engagement Letter Communication

- Government's Responsibilities:
- Management and those charged with governance are responsible for: ...
- Reporting fraud and illegal acts of which you are aware to us.
- You are responsible for designing and implementing programs and controls to prevent and detect fraud.
- *You should not rely on our audit as your primary means of detecting fraud.*

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Engagement Letter Communication

Government's Responsibilities:

- Maintaining internal control over financial reporting and over compliance is management's responsibility.
- Appropriate supervisory reviews are necessary to reasonably assure that adopted policies and prescribed procedures are followed.

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Engagement Letter Communication

Government's Responsibilities:

- You are responsible for identifying laws and regulations relating to Federal award programs, and for complying with them.
- You are responsible for compiling the Federal Awards Expenditure Schedule and accompanying notes. You are also responsible for establishing and maintaining internal control sufficient to reasonably assure compliance with laws and regulations relating to Federal award programs and controls related to preparing the Federal Awards Expenditure Schedule.

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Liability of a Public Officer

- **O.R.C. 9.39 states, "All public officials are liable for all public money received or collected by them or by their subordinates under color of office. "**
- **O.R.C. 117.01(E) defines the term 'public officials' as "an officer, employee, or duly authorized representative or agent of a public office. "**
- **O. R. C. 117.01(A) states that the term "color of office, " "means actually, purportedly, or allegedly done under any law, ordinance, resolution, order or other pretension to official right, power, or authority.**

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Liability - Ohio Attorney General Opinion No. 93-004

- Historically, public officials have generally been held liable for the loss or misuse of public money under their control:
- *It has been the general policy . . . With state officers, county officers, township officers and all other public officials to hold the public official accountable for the moneys that come into his hands as such official, and his obligation has been held to be as broad as is the obligation of a common carrier of freight received for shipment; that is to say, that when he comes to account for the money received, it must be accounted for and paid over, unless payment is prevented by an act of God or a public enemy; and burglary and larceny and the destruction by fire, or any other such reason, have not been accepted by the courts as a defense against the claim for lost money.*
- *Seward v. National Sur. Co., 120 Ohio St. 47, 49-50, 165 N.E. 537, 538 (1929)*

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Liability

- Public officials are liable for public funds
- Official may be liable for loss even though not personally at fault
- Public official who authorizes illegal expenditure or supervises accounts from which such illegal expenditure is made is liable
- Mere unidentified shortages of public moneys are sufficient reasons for a Finding for Recovery

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Liability - Finding for Recovery

- Ohio Rev. Code Section 117.28 authorizes the Auditor of State to report a *finding for recovery*
- Under Ohio Rev. Code Section 117.28, a finding for recovery may exist when:
 - Public money has been illegally expended;
 - Public money that has been collected has not been accounted for;
 - Public money that is due has not been collected; or when:
 - Public property has been converted or misappropriated.

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Liability – Finding for Recovery

- Public officials (including fiscal officers) must be aware of their role :
 - approving expenditures
 - safeguarding amounts collected
 - take steps to prevent mistakes, errors or omissions

In the context of an AOS audit, both the

- supervising/approving officer or employee and the fiscal officer may be liable for such losses,
- May be included as a party liable for repaying a *finding for recovery*, even if they did not personally account for the transaction.

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References for Elected Officials

- GFOA – Various Elected Official’s Guides
- Ohio Compliance Supplement
- AOS - Best Practices publications
- ACFE – Assoc. of Certified Fraud Examiners
 - Fraud checkup/tools – <http://www.acfe.com>

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Location of AOS Regional Offices

AUDITOR OF STATE'S OFFICE

Audit Regions Map

- Regional Office Numbers**
- Athens 800-441-1389
 - Canton 800-443-9272
 - Cincinnati 800-368-7419
 - Cleveland 800-626-2297
 - Columbus 800-443-9275
 - Dayton 800-443-9274
 - Toledo 800-443-9276
 - Youngstown 800-443-9271



Always Remember..... 

Auditors are here to help!!

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