# A Practical Internal Control Discussion

IASBO

Internal Control Seminar

September 30, 2016

# Internal Control Requirements of the Statute

- IC 5-11-1-27
  - (e) – "The internal control standards and procedures shall be developed to promote government accountability and transparency."

  - (g) – Any time after June 30, 2016, the School Board shall be able to ensure that (1) the minimum internal control standards have been adopted. (2) shall ensure that "personnel" have received training on the minimum internal control standards.

  - (h) – Any time after June 30, 2016, the fiscal officer shall be able to certify in writing that (1) the minimum internal control standards have been adopted. (2) that "personnel" have received training on the minimum internal control standards. The certification shall be filed electronically as part of the Gateway Annual Financial Report.

# Internal Control Requirements of the Statute

(continued)

- IC 5-11-1-27
  - Consequences of not following subsections (e) through (h)
    - (i) – If SBOA finds that the School Board has not adopted the minimum standards or that personnel have not received training, then a comment is required to be included in the audit report. If SBOA finds the same problem in a subsequent audit, then the School has 60 days after notification to correct the problem. If the School chooses not to correct the problem, then the SBOA is required to notify the DLGF.
    - IC 6-1.1-17-16.2(b) – DLGF may not approve a budget for a unit if the SBOA has notified them a School Corporation has not corrected a violation of IC 5-11-1-27(i).

# Areas of Greatest Risk

# Evaluate Objectives

- Ideas of common areas to review:
  - External reports – Financial Statements; Schedule of Expenditures of Federal Awards; Federal grant financial reports
  - Receipt of revenue
  - Disbursement of funds (vendor claims, payroll, credit cards)
  - Security of assets and property
  - Compliance with federal grant requirements
  - Extra-Curricular Accounts

# Best Practices

# Control Environment

- Establish a culture within the School system that internal control activities are important and beneficial for the overall administration of the School Corporation.

  - Pass a local ethics policy

  - Create a confidential reporting system for employees and citizens to report fraud and abuse

  - School Board evaluate and pass policies recommended by administration that address the internal control risks identified

- School Board and Administration establish a organizational chart and define duties for each position.

- Administration create a basic plan for recruiting, hiring, and retaining qualified employees.

- Administration develop formal evaluation system to assess employee performance of their internal control responsibilities.

# Risk Assessment

- For each objective:
  - Determine and Evaluate the likelihood a risk would cause the objective to fail.
    - Things to consider include complexity of the activity; susceptibility to fraud; amount of judgement involved; size and volume activity
  - Determine the proper response to the risks identified.
    - Examples include accept the risk; eliminate processes to avoid the risk; institute control activities; comply with statutorial requirements that address risks
  - Determination and Evaluation must be performed on a continual basis.
    - Administration should consider whether changes involving the objective create new risks that weren't considered in the initial evaluation.

# Control Activities

- For each risk identified for the objective:
  - Administration should develop procedures to minimize the risk.
    - Administration should consider both prevention and detection procedures
  - Administration need to consider the ability to segregate duties when developing control activities.
    - If duties can not be segregated, then administration should develop compensating activities.  Examples would include additional levels of review; random review of selected transactions.  In extremely small schools administration should consider the necessity to involve School Board as a level of review.
  - Administration may use a computerized system with built in control activities.
  - School Board may formalize the procedures developed by the Administration into policies that are required to be followed by school employees.

# Information and Communication

- Administrators should develop a chain of communication and/or written policies to provide employees with information concerning their duties and responsibilities.

- Administration should develop procedures to pass along rules and regulations to applicable employees concerning their duties and responsibilities.

  - For example, ensure employees have information contained in applicable grant agreements, statutes (and amendments), School Bulletin articles, etc.

- Administration should encourage employees to provide feedback on control activities that are instituted.

- Administration should develop a system to document external communications and share the relevant information with applicable employees.

  - For example, if the ECA Treasurer sends a question to the SBOA about ECA issues, then there should be procedures in place that the information provided is shared with applicable ECA employees.

- Administration should develop procedures to ensure information provided to the public is accurate and timely.

  - For example, develop deadlines and cross checking requirements for federal grant expenditure reports, ECA SA-5 reports, etc.

# Monitoring

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- Administration could perform periodic checks/tests to ensure that employees are performing control activities established.  In addition, document and correct any deficiencies noted in the internal control system.

- Determine which control activities can be also utilized as a monitoring function.

  - For example, reviewing a claims docket to ensure the claims and approvals were included for accuracy and compliance with statute could be a control activity and reviewing it to ensure the proper employee completed the control activity could be a monitoring function.

- Establish a regular discussion between the School Board and the Administration to go over any control weaknesses and determine appropriate corrective action.

# Miscellaneous Questions

- Will audits covering the time period prior to July 1, 2016, include internal control audit?

  - **Every audit should have some level of internal control review. I believe audits with the period starting July 1, 2016 to June 30, 2018, would not include comments that the Internal Control Standards were not adopted and that personnel were not trained.**

- Does the SBOA anticipate providing other training materials?

  - **We will continue to provide in person presentations at meeting when requested. However, at this point I don't believe we have had discussions to complete any additional statewide webinars.**

- Will there be a requirement to provide training every year (or another time period)?

  - **Our interpretation of the statute is that each person that meets the definition of "personnel" in IC 5-11-1-27 would be required to get training on the minimum standards. The statute does not include a term like "annual". However, we strongly encourage units to develop training about their own customized internal control system, especially the control activities, as necessary.**

# Miscellaneous Questions (continued)

- What is the practical reality and what suggestions do the SBOA have for districts that have not met the reasonable level of IC processes (E.g. a small school district that cannot meet the division of duties because they have a small staff)?

  - **I believe the expectations for School Corporations that can not properly segregate duties, would be for them to develop sufficient mitigating controls.**

- Since districts have the ability with current technology to have electronic files (reports, etc.) how will that affect IC audits regarding sign-off to show division of duties?

  - **Ideally, the School Corporation could work with the software developer to have the ability to sign-off electronically either with unique usernames, identification numbers, etc.**

# Internal Control Scenarios

# Preparation of SEFA

# Preparation of Financial Statements

# Compliance with Federal Grants

# Payroll Disbursements

# Bank Reconciliation

# Disbursements

# Textbook Rental Receipts

# Lunch Receipts