

ILCMA 2017 | SUMMER CONFERENCE

**PUTTING TOGETHER AN
ALL-STAR TEAM:**

Every Day is Game Seven.



Eagle Ridge Inn & Resort
GALENA, IL

JUN
14-16
2017

REGISTER BY JUNE 7

If Only We Had More Staff!

Practical Fraud Prevention on a Limited Budget



Agenda

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- › Key elements of the internal control framework.
- › Overview of fraud
- › What is the principle of separation of duties.
- › Separation of duties matrix.
- › Small staff and compensating controls
- › Apply to your organization

What is Internal Control?

1. **Internal control is a process. It is a means to an end, not an end in itself.**
2. **Internal control is not merely documented by policy manuals and forms. Rather, it is put in by people at every level of an organization.**
3. **Internal control can provide only reasonable assurance, not absolute assurance, to an entity's management and board.**
4. **Internal control is geared to the achievement of objectives in one or more separate but overlapping categories.**
 1. Achieve Board and organizational objectives
 2. [Prevent misappropriation of assets \(fraud\)](#)
 3. Maintain legal compliance
 4. Ensure reliability of financial reporting

Limitations of Internal Controls

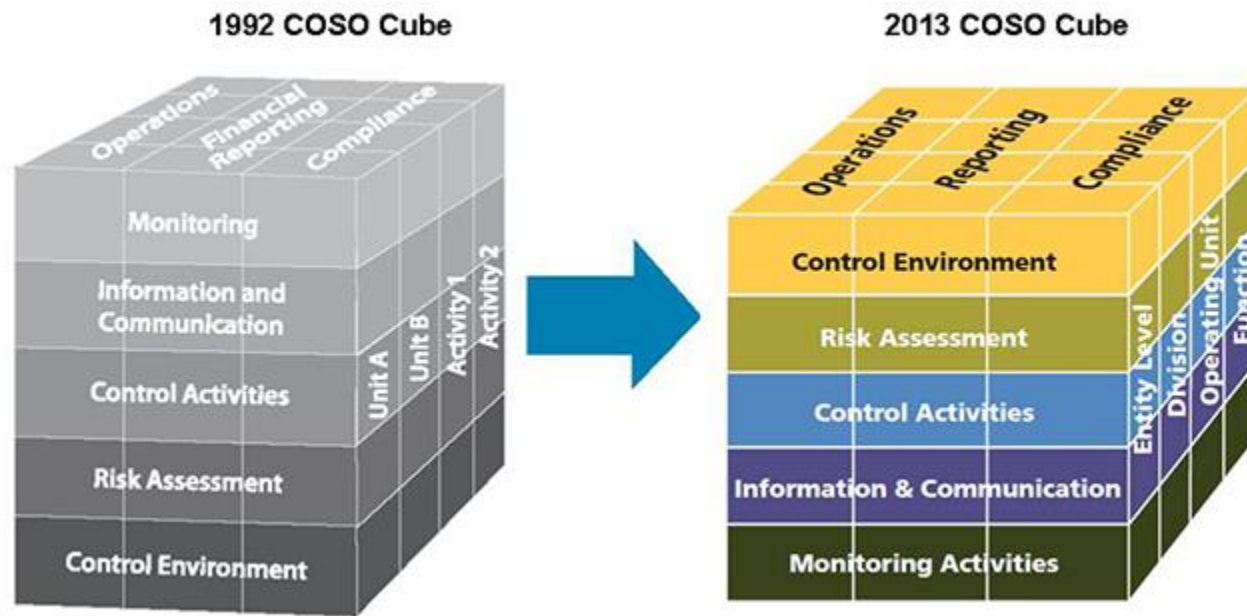
- › **Inadequate knowledge of policies**
 - › “I didn’t know that was the policy”
- › **Inadequate segregation of duties**
 - › “We trust “X” who performs all those duties”
- › **Inappropriate access to assets**
 - › Passwords shared, cash not secured....
- › **Form over substance**
 - › “You mean I am supposed to do something besides initial it?”
- › **Control override**
 - › “I know that’s the policy, but we do it this way”

Who is COSO?



The Association of
Accountants and
Financial Professionals
in Business

COSO Internal Control



GFOA Definition of Internal Control

- › ***Plan of organization and the methods and procedures used to safeguard assets and other resources, and to assure that those assets and resources are used – as effectively as possible – as directed by the governing board and management. (Municipal Finance Officers Association).***
- › ***Coordinated set of policies and procedures that reflect a comprehensive strategy for achieving management objectives. (Evaluating Internal Controls: A Local Government Manager’s Guide (GFOA)).***

Responsibility

› **Governing Board**

- › Sets mission, values and objectives
- › Responsible for ensuring management fulfills its duty
- › Primary responsibility for creation of control environment

› **Management**

- › Establish and maintain internal controls
- › Accountable to Board

› **Auditors**

- › Assist management and the Board fulfill their responsibilities
- › Large players in monitoring function
- › No primary responsibility for creation or operation of internal control system

Evaluating Internal Controls

- › **Risk-based assessment**

- › What is the risk of loss?
- › What is the risk of error?
- › What is the risk of misuse?

- › Eliminates testing or inventory of controls that may not be necessary.

- › **Higher risk areas will require a greater degree of required controls.**

Internal Control: The Big Picture



Internal Controls



Framework: Control Environment

1. **Integrity and Ethical Values**
2. **Board – Must set tone at the top**
3. **Board accepts responsibility to monitor and improve**
4. **Management Philosophy and Operating Style**
5. **Organizational Structure**
6. **Financial Reporting Competencies**
7. **Authority and Responsibility**
8. **Human Resources**

Source: Committee on Sponsoring Organizations of the Treadway Commission (Internal Control – Integrated Framework)

Whistleblower System

A reliable system must be assure to the person reporting:

- › Anonymity
- › No fear of reprisal
- › That the complaint will be acted upon

- › **Means to report that is well publicized**

- › **Procedure to evaluate complaints and act upon those that are credible**

- › **See Whistleblower Information in Binder**

Separation of Duties

- › **Control system that seeks to separate the record keeping function from operational responsibility and from physical access to asset**
- › **Goal: No one person can make an error or commit fraud that is not caught downstream in the normal course of business**
- › **The principle ensures that fraud is more difficult to commit and that errors will be found more quickly**

Separation of Duties

- › **Divide the four functions:**

- › Authorization
- › Custody
- › Record keeping
- › Reconciliation

- › **The Map**

- › Identify indispensable function
- › Assign steps
- › Divide crucial steps by use of a matrix

Separation of duties

- › **Often limited staff makes complete separation of duties impossible**
- › **Rules:**
 - › No one performs more than two crucial duties
 - › No one performs record keeping and reconciliation
- › **Compensating controls: A control put in place where known control weaknesses exist**

Case study

- › **The Finance Director of Sunnyvale, Donna, is working with a small staff of two persons and finds that she has to jump into daily operations because the work is overwhelming. Joe has worked for the Village for twenty years but has never qualified for promotion past Clerk III. Jenny was recruited two years ago as a Clerk II, has attended numerous accounting and controls seminars and has a great attitude. The Mayor attended an ILCMA seminar on fraud and wants answers on the state of internal controls in the check handling function. Donna takes her matrix and evaluates the situation.**

Separation of Duties

› Segregation of Duties Matrix

Activity	Authority	Custody	Record Keeping	Reconcile
Pick up mail at Post Office		Joe		
Open mail, separate and log checks		Joe		
Post checks to ledger			Jenny	
Reconcile ledger				Jenny
Issue credit memo	Jenny		Jenny	Jenny

Separation of Duties

› Segregation of Duties Matrix

Activity	Authority	Custody	Record Keeping	Reconcile
Pick up mail at Post Office		Donna		
Open mail, separate and log checks		Joe		
Post checks to ledger			Jenny	
Reconcile ledger				Donna
Issue credit memo	Donna		Jenny	Joe

Mapping the System

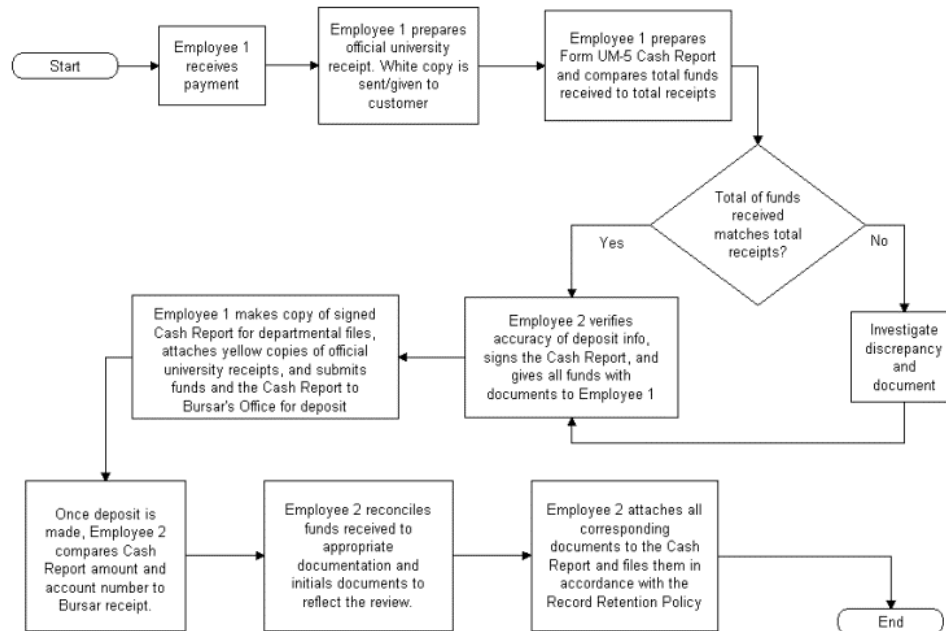
- › **Create a visual map of the system of internal controls for a particular function**
- › **Use standardized symbols**
- › **Note flow of activities, forms (paper and automated), files and person responsible for activity**
- › **Review for redundancy, gaps and poor separation of duties.**
- › **Rework map toward a more satisfactory flow.**
- › **See example in course notebook.**

Mapping the System

› Documenting Controls

› Narrative Memorandum

› Flowchart



Questions?

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