

Making Internal Control a Priority in Local Government



By: Vicki Urbanik, CGFM, CPA, EA

Internal control can greatly enhance the success of government units of any size, whether a large metropolitan city or a small rural library district. Local government managers who establish a control environment emphasizing ethics, regulatory compliance and high-quality staff performance send a message to the public that they are committed to accountability and transparency. Local government managers who implement risk assessment procedures define their risk tolerances, potential for fraud, and external and internal influences that could negatively impact accomplishment of their objectives. Those who require staff segregation of duties, proper record keeping, administrative oversight in payroll functions and other control activities improve the effectiveness and efficiency of their offices. By enacting controls, local government units can enhance their financial management and overall performance.

Recognizing the importance of internal control in government, Indiana state legislators passed new control requirements affecting government units statewide. Under House Enrolled Act 1264, adopted in 2015, municipalities, county governments, schools and other political subdivisions must adopt, at minimum, the internal control standards established by the Indiana State Board of Accounts (SBOA). Local government units must also provide training on the standards to practically all employees who handle public money, specifically those whose duties include “receiving, processing, depositing, disbursing, or otherwise having access to [public] funds.”¹ Furthermore, government fiscal officers must certify compliance with the internal control requirements when they submit their unit’s annual financial report, beginning in early 2017. If they do not provide such

verification, or if the state auditing body finds that the internal control standards have not been adopted, local government units could ultimately face rejection of their annual budgets. In short, local government managers in Indiana must now get serious about internal control, not just because state law requires it, but also because they have a very real budgetary incentive to do so.

Implementation Challenges

Internal control can greatly enhance accountability and transparency, but implementing controls can pose unique challenges for local government.

For one, local government managers may lack formal training in accounting, auditing or other academic areas that introduce internal control. Local officials unfamiliar with controls may feel the topic is too broad or abstract in scope to have relevance for their departments. After all, a city park superintendent’s mission is to run a park system, a county treasurer’s priority is the collection of local taxes and a township manager’s top objectives include administering aid for the indigent. These and other officials at the most local levels of government may feel they lack the time or resources to implement control risk assessment or monitoring. Even if top managers enthusiastically adopt internal controls, training their employees could be quite a different story. Office employees might recall accounting scandals like Enron and Tyco, but it’s much more unrealistic to expect the rank-and-file in local government to be versed in the five control components or key documents such as COSO’s *Internal Control — An Integrated Framework* or the U.S. Government Accountability Office’s *Standards for Internal Control in the Federal Government*. Training

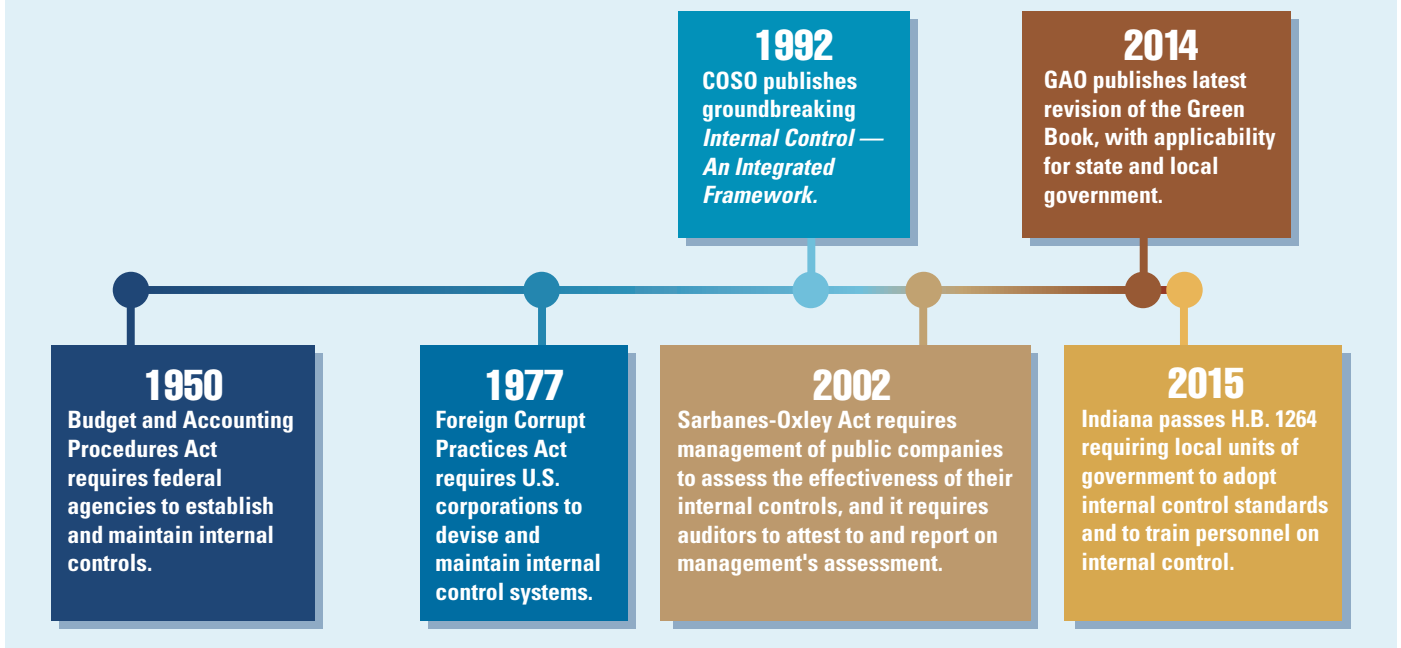
“Local government managers in Indiana must now get serious about internal control, not just because state law requires it, but also because they have a very real budgetary incentive to do so.”

staff on internal control standards can prove frustrating for managers struggling with subpar employees or long-time employees resistant to change.

Demystifying Internal Control

Local government managers can overcome the challenges of training a staff unfamiliar with internal control by introducing the topic in small, but meaningful phases. That is the approach being taken this year in the county auditor’s office in Porter County, Indiana’s ninth largest county (population, 167,000), located in the northwestern corner of the state. In Indiana, county auditor offices are often thought of as one of the busiest in county government with responsibilities that include county financial reporting and property tax administration. If any county office is in need of a sound internal control system, it is arguably a county auditor’s office. The Porter County Auditor’s Office early on embraced Indiana’s new internal control requirements, in part because prior state audits found material control weaknesses in financial reporting, payroll and grants administration. The need for effective

Figure 1. Internal Control: A Brief Timeline



controls was clear; the challenge, however, was the introduction and implementation of new controls in a small but very busy office, in which most employees were unfamiliar with control concepts.

Training began at monthly staff meetings, with internal control topics introduced in small segments. Initially, training focused on the definition of internal control as stated in the *Uniform Internal Control Standards for Indiana Political Subdivisions*, a document prepared by the SBOA following adoption of the 2015 state law. The SBOA's standards emphasize the role that employees play in controls: "Ultimately, it is the people at every level of the organization that are instrumental in ensuring the success of the internal control process. Accordingly, internal controls integrate the attitudes and actions of people within the organization into the processes."² The

“It makes little sense for management to adopt policies that staff find unworkable. Employees need to know that their input is valuable and that for controls to be effective, ‘we are all in this together.’”

county auditor's office emphasized that even though management has profound responsibilities in internal control, staff involvement is crucial. By emphasizing that internal control

is not a set of rigid rules but a process that needs a buy-in from staff to make it work, employees were given ownership of this important endeavor. It makes little sense for management to adopt policies that staff find unworkable. Employees need to know that their input is valuable and that for controls to be effective, “we are all in this together.”

Early training efforts in the county auditor's office also introduced staff to key developments in the regulatory history of controls, as illustrated in **Figure 1**. Staff discussions explored the accounting scandals that led to the Sarbanes-Oxley Act and the internal control audit requirements that resulted. By tying events that had national significance to their

daily workplace, the local auditor staff gained a deeper understanding of the need for, and benefits of, internal control. Employees were also introduced to the GAO's “Green Book,” including the GAO's efforts to make the federal standards applicable to state and local governments.³ While internal control concepts were presented to the auditor staff in a concise, summary manner, the topic wasn't dumbed down, either. Employees were treated as professionals who were expected to help make a significant contribution toward the effective and efficient operation of their office.

Implementation Challenges

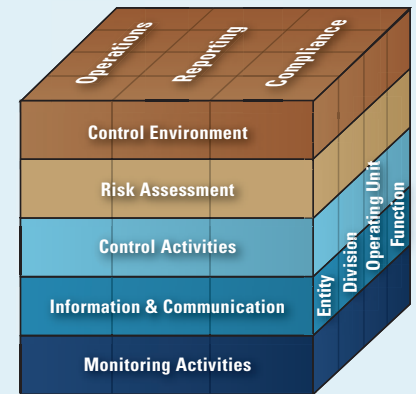
Getting employees to understand what internal control is, and what it isn't, is one matter. Actually implementing controls is another. To introduce the five control components, employees in the county auditor office learned about the control cube, as pictured in **Figure 2**, which gives a visual representation of how the components interrelate with each other, with the entity's organizational structure, and with the reporting, compliance and operations objectives. Discussion topics included an analysis of how most of us implement controls in our daily

lives. The simple act of locking our doors at night or taking our vehicles for routine oil changes are control activities intended to achieve objectives of keeping our home safe and our cars in good order. Given that most employees in the county auditor's office are also parents, one training exercise applied an internal control thought process to an objective that parents have: Keeping their children healthy. The environment most parents have established in their household incorporates personal responsibility for one's well-being. Parents assess the risk that their children might get cavities, due to their proclivity to like sweets and their unwillingness to brush and floss as often as their parents want them to. To minimize this risk, parents take their children to the dentist every six months, even if nothing is wrong with their teeth. Parents seek reliable information when choosing their dentist or the treatment plans recommended. And parents monitor their children's dental health; if repeated cavities occur, parents might imple-

ment new activities, such as giving their children incentives to brush and floss more regularly.

By understanding how internal control systems have relevance to our daily lives, employees should be more apt to recognize the need for enhanced controls at the workplace. Once employees are comfortable with the definition and components of internal control, they can then be introduced to the 17 principles that represent the requirements for an effective control system.⁴ Staff can then integrate these principles in their daily responsibilities. For example, one function in a county auditor's office is to process payroll. The objective is clear: No employee should be paid more or less than their approved salary, and tax withholdings and benefit deductions must be correct. But what is the risk that this objective will not be met? For some counties, the risk of payroll errors might be attributed to archaic or faulty payroll software programs or to a lack of available payroll staff. To minimize this risk, staff can be cross-trained in

Figure 2. COSO Internal Controls Cube



Source: blog.aicpa.org/2012/01/internal-control-integrated-framework-20-years-later.html#sthash.tXBB8Kt4.dpbs

payroll processing, and a non-payroll employee could be assigned to cross check payroll reports with the pay levels set in the annual salary ordinance. Department heads could be required to sign off on their employee pay prior to the issuance of paychecks,

LEVERAGING DATA ANALYTICS FOR SUCCESS

Analysts estimate the world's data will grow 50 fold in the next five years. Federal government agencies already produce and house massive amounts of data, collected from a variety of sources. Most of this data is unstructured, and deemed too large or raw for analysis.

Many federal agencies struggle with successfully mining data out of separate systems to capture processes and search for anomalies to understand where internal controls are absent or weak.

We Partner with Industry Leaders to Implement Innovative Continuous Monitoring Software

AOC Solutions brings a cadre of experienced federal financial professionals who have successfully assisted federal agencies in tackling "Big Data" challenges.

AOC is partnering with industry leaders to bring **Continuous Monitoring** suites of applications to federal Agencies in line with OMB's call for innovative methods to identify, prevent, detect, and correct erroneous and improper transactions.

With our **Continuous Monitoring** and data mining solutions and our extensive experience in the design and implementation of data, process and system reviews, AOC Solutions can help Agencies gain traction in leveraging their data for success.



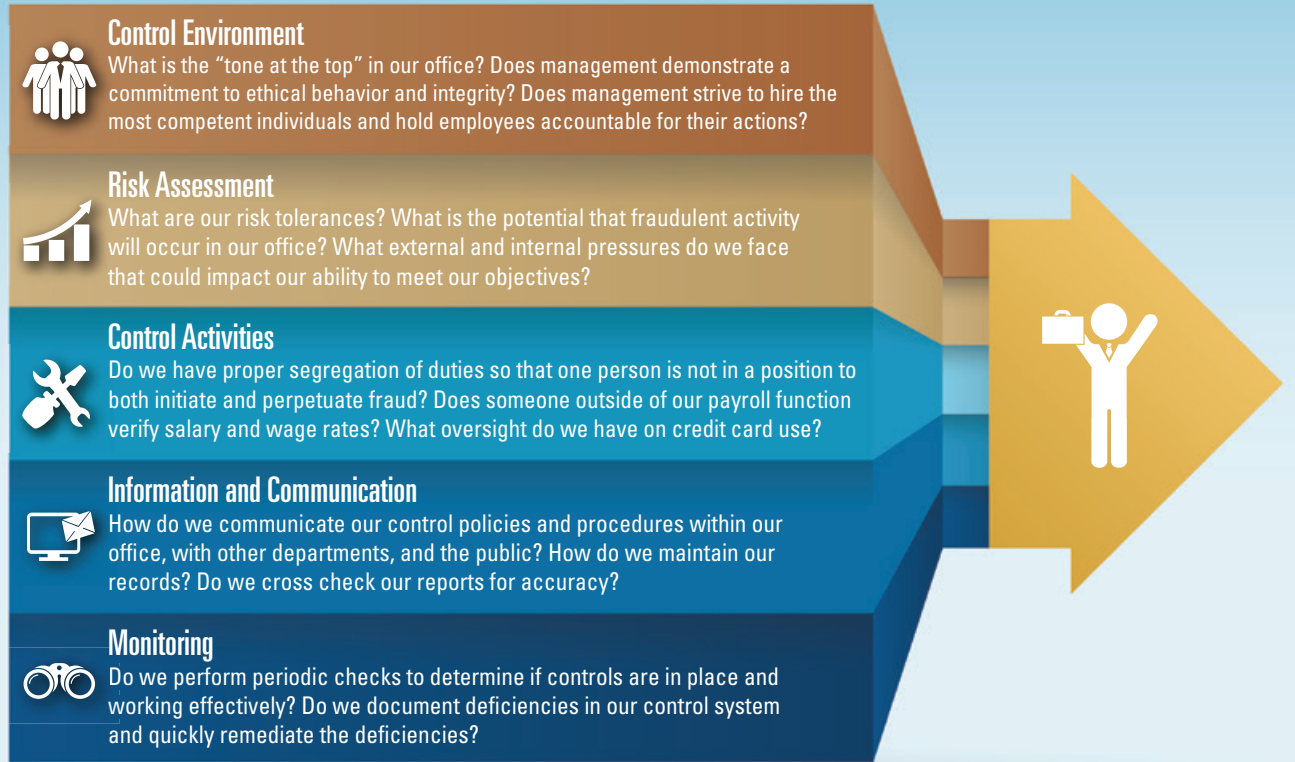
AOC Solutions

703.234.6300 | www.aocsolutions.com

EXCELLENCE WITHOUT EXCEPTION

A Service Disabled Veteran-Owned Business

Figure 3. The Control Cube: Considerations for Government Managers



and a tracking system could be implemented to keep tabs on which department managers consistently meet this responsibility. Communication with department heads should stress the importance of administrative review of timecards. The payroll process should be monitored closely, with adjustments enacted immediately and a strategy developed to help prevent the mistakes from recurring.

Preparation of an easy-to-read and readily accessible document on internal control is also important, since the document can give employees and management a clear outline of their responsibilities. In Indiana, local government units can comply with the new internal control requirements by adopting the SBOA’s

“By understanding how internal control systems have relevance to our daily lives, employees should be more apt to recognize the need for enhanced controls at the workplace”

minimum standards, which encompass both COSO’s framework and the GAO’s Green Book. Local government may also adopt other standards or procedures tailor-made for their own needs. The approach taken in the Porter County Auditor’s Office has been to develop its own internal

control procedures to augment the standards adopted at the countywide level. The functions unique to the auditor’s office in need of enhanced controls were identified, and controls were developed for each. At staff meetings, employees discuss the objectives of each office function and identify the threats they feel could impede the accomplishment of those objectives. The

open discussion is important not just to achieve staff acceptance of new or enhanced controls, but also to help employees understand the challenges faced by their colleagues who may have different job duties than their own.

One component of internal control that may be particularly helpful in gaining staff acceptance is the control environment, as explained in Figure 3. By documenting in writing a commitment to ethics, accountability and transparency, management makes it clear what is expected of staff. However, this expectation works both ways. It is up to management to set a responsible “tone at the top.” Employees who do not perceive their managers as being engaged or responsible may not feel they must provide outstanding work. On the other hand, managers who lead by example provide the foundation necessary for an effective internal control system.

Local government managers who emphasize to their employees that internal control is an objective-driven

process that is ongoing and adaptable may also gain greater staff involvement. Control activities that aren't working can be replaced or modified, and those that are functioning well can be improved. If employees are invited to play a role in continually improving office functions, they may be more inclined to share their suggestions and take ownership in their work product. Obtaining such a buy-in from employees is a key ingredient for an effective internal control system.

Summary

Indiana's law requiring adoption of internal control standards in local government is being implemented for the first time this year. City councils, school boards, county commissioners and other governing bodies throughout Indiana must adopt internal control standards identifying their responsibilities over the control

environment; risk assessment; control activities; information and communication; and monitoring. Local officials must adopt the minimum state standards but may also implement additional procedures they deem necessary for a control system to suit their needs. Employees who handle public funds must undergo training on the new standards by the end of the year, and fiscal officers in each unit must certify that training has occurred. Government managers and employees who previously were unfamiliar with the concept of internal control are now gaining the knowledge necessary to implement controls to help achieve their objectives. Indiana's new requirement is based in the principle that by demonstrating a commitment to internal control, managers and employees at all levels of local government can achieve greater accountability, transparency and effectiveness on behalf of the taxpayers they serve. ■

Endnotes

1. Indiana State Board of Accounts (2015). *Uniform Internal Control Standards for Indiana Political Subdivisions*, page 4.
2. *Ibid.* p. 1.
3. U.S. Government Accountability Office (2014). *Standards for Internal Control in the Federal Government*, p. 20.
4. *Ibid.* p. 8.



Vicki Urbanik, CGFM, CPA, EA, began her term as Auditor of Porter County, Ind. in January 2015. Prior to working for county government, she was a journalist

who reported extensively on local government finance.

Already Achieved Your DoD FM Certification?

Let Management Concepts help you maintain it.

We offer more than 100 courses aligned by the DoD, Office of the Under Secretary of Comptroller, to the DoD approved Financial Management and Leadership competencies.

www.ManagementConcepts.com/DoD



Haven't achieved your Certification yet?

Use our free online tool, **FM Connect**, to determine the courses you need to get certified.

www.ManagementConcepts.com/FMConnect



**MANAGEMENT
CONCEPTS**

888.545.8574 | www.ManagementConcepts.com

Reproduced with permission of copyright owner. Further reproduction prohibited without permission.