



NASC 25th Annual Conference

# Building an Internal Control Framework That's Right for Governmental Entities

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Audit • Tax • Consulting • Financial Advisory •

# Objectives

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1. What are the elements of an effective internal control management program?
2. Why do you need an internal control management program?
3. How do you develop a world-class program?

# Polling Question

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How would you rate your knowledge of internal controls?

1. I am an expert and could teach the topic
2. I know most of what I need to know
3. I have a good working knowledge
4. I'm somewhat familiar with the topic
5. I have very little or no knowledge of this topic
6. Don't Know/Not Applicable

# Objective 1

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What are the elements of an effective internal control management program?

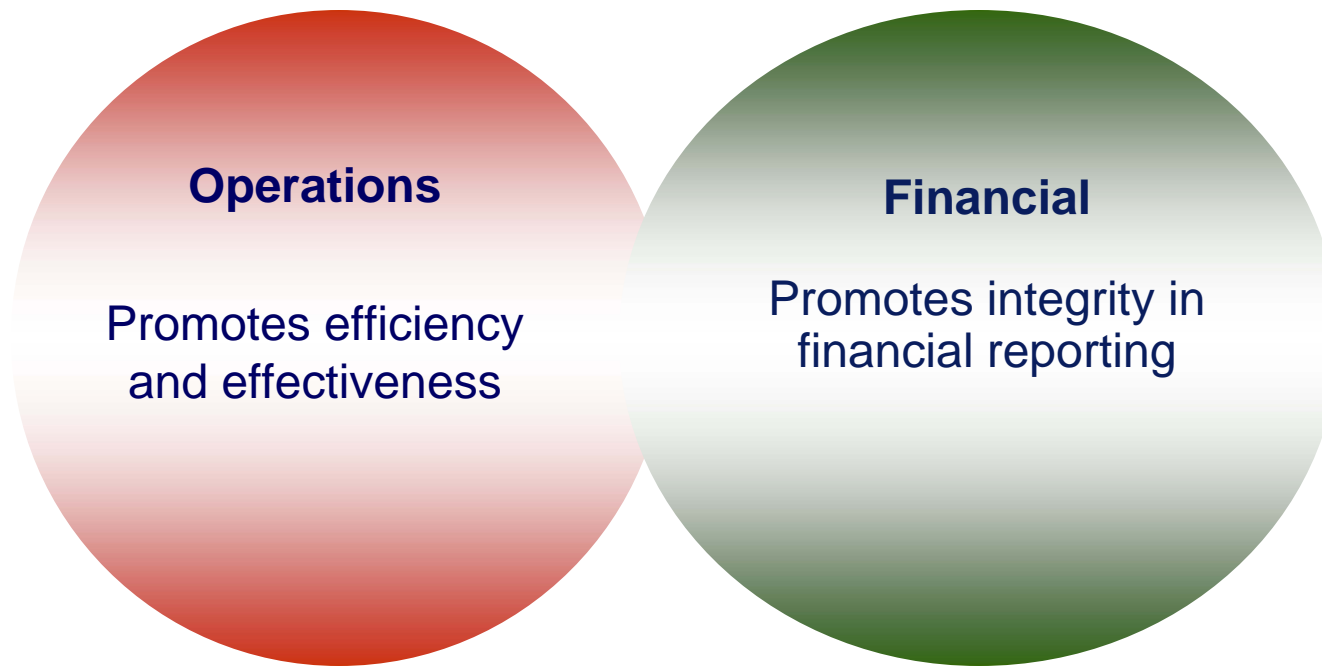
Internal controls help an entity get to where it wants to go and avoid surprises.



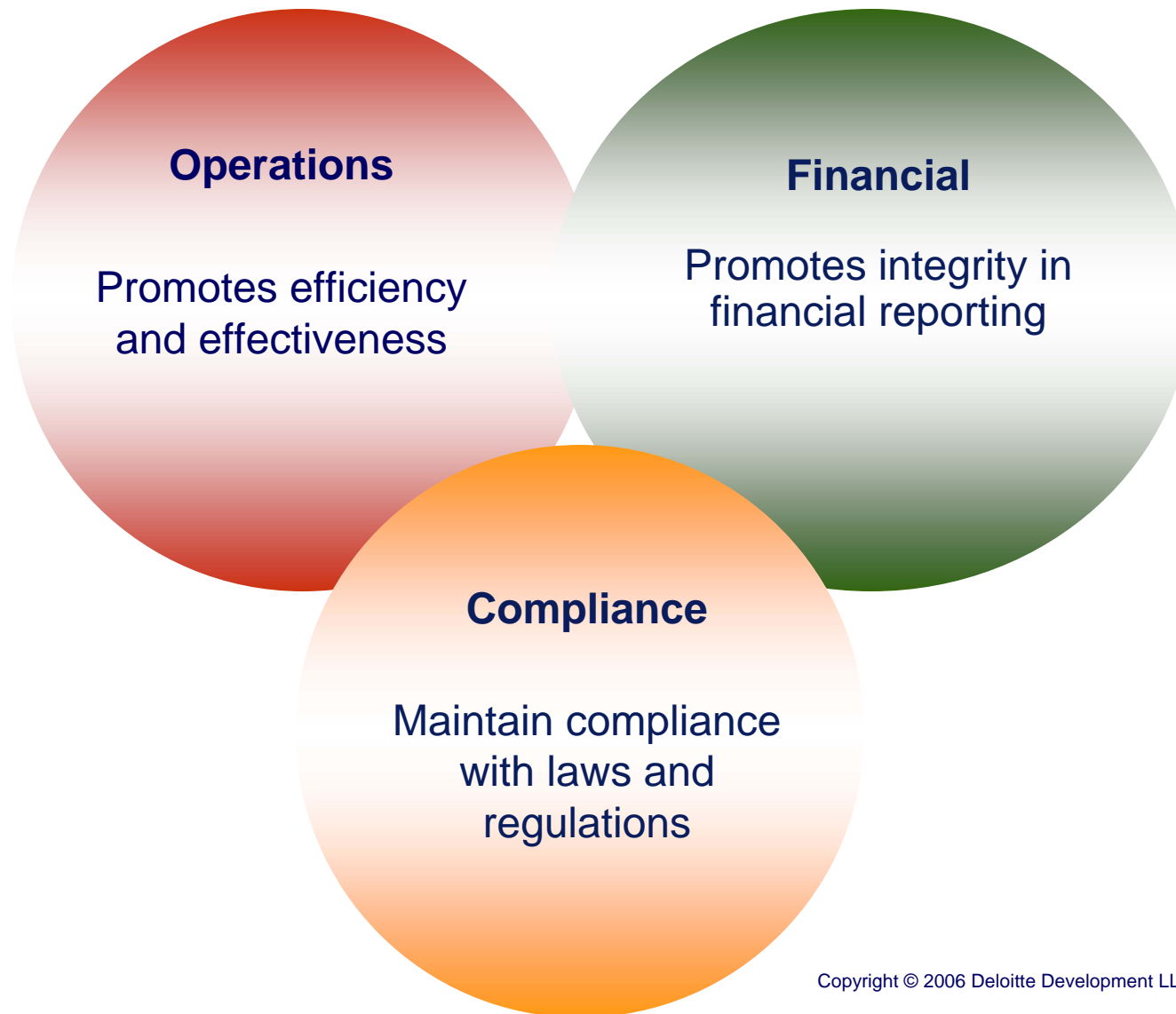
**Operations**

Promotes efficiency  
and effectiveness

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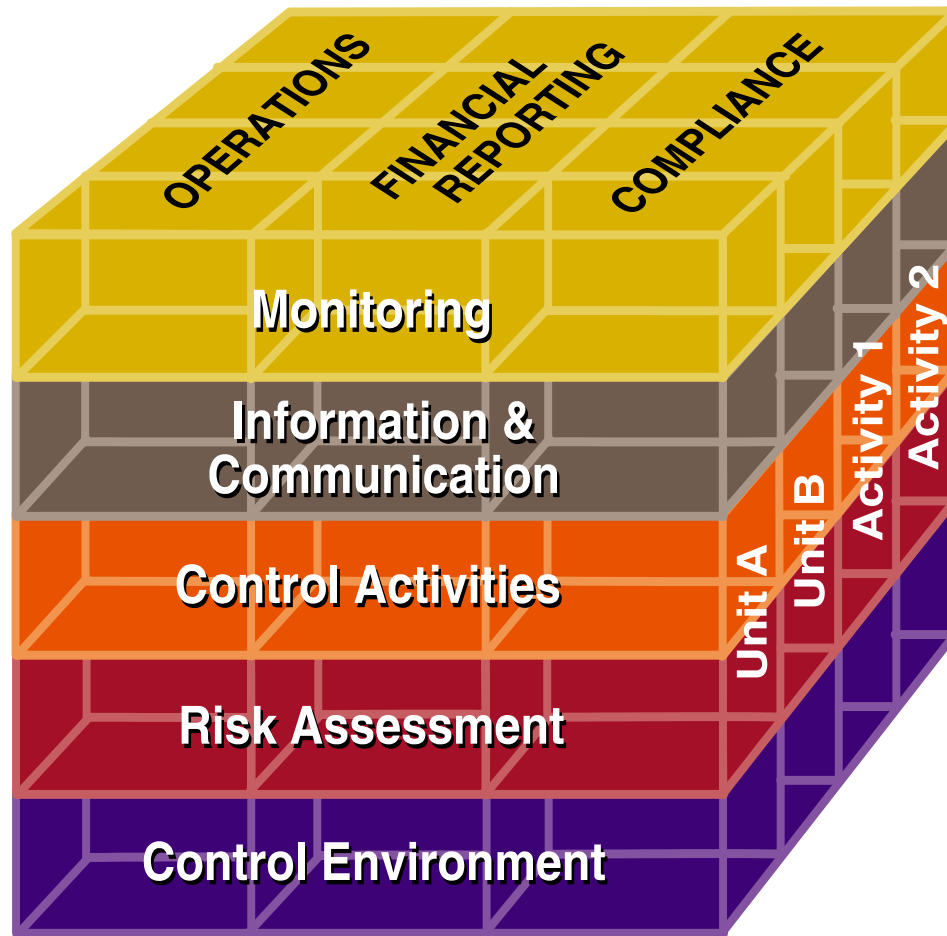


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# The COSO Framework is the Generally Accepted Standard for Internal Controls

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Many have a process, but  
few have a program!

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6. Deficiencies are proactively identified and resolved
7. Program supports management's annual assertion

# Polling Question

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How well does your organization incorporate the seven elements of an effective internal control management program?

1. We are World Class
2. In very good shape
3. Moving along nicely
4. Have made a good start
5. You must be kidding
6. Don't Know/Not Applicable

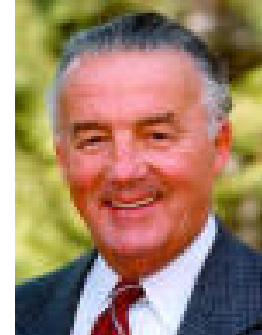
# Objective 2

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Why do we need an internal control management program?

# Internal Control Reviews Required by Sarbanes-Oxley Act of 2002 for Publicly-Traded Companies

- Seeks to restore public trust and enhance the transparency of financial statements
- Requires management to perform annual assessments of internal controls
- Requires external auditor to attest to management's assertion
- Penalties - \$5 Million and up to 20 years in prison



*Senator  
Paul S. Sarbanes  
(MD)*



*Congressman  
Michael G. Oxley  
(OH)*

# Enhanced Internal Control Expectations for Government

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- SOX changed how business thinks about governance and internal controls.
- OMB mandated SOX-like expectations for Federal agencies through OMB Circular A-123 Appendix A
- Bond analysts, rating agencies, and underwriters expect better governance and internal controls
- State and Local governments looking at SOX/A-123 Appendix A
- Some entities voluntarily chose SOX-like Internal Control Management Programs

# Federal Managers Financial Integrity Act of 1982

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Requires:

- Ongoing evaluations of adequacy of internal controls
- Reasonable assurances that --
  - obligations and costs are in compliance with laws
  - funds, property, and other assets are safeguarded
  - revenues and expenditures are properly recorded and accounted for
- Compliance with Comptroller General's (Green Book) standards
- Assertion by agency head on adequacy of internal controls

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What is OMB Circular A-123?

## Similarities between SOX and Circular A-123 Appendix A

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Area	SOX Sec 404	A- 123 App A
Management responsibility for effectiveness of internal controls over financial reporting	X	X
COSO internal control standard	X	X
Materiality criteria	X	X
"Top Down" approach	X	X
Documentation of internal controls	X	X
Testing of control design and operating effectiveness	X	X
Management assertion on internal control effectiveness	X	X
Audit opinion on internal controls over financial reporting	X	

# Government Agencies vs. Publicly-Traded Companies: Different Risks

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- Different Risks
  - Laws governing financial transactions
  - Different motivation
  - Oversight
  - Government workforce
  
- Different Financial Reporting Experience
  - Fed GAAP, State GAAP and Commercial GAAP
  - “Debit” versus “Credit” focus
  - Different financial reporting maturity

# Polling Question

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To what extent is your organization experiencing pressure to enhance internal controls because of increased expectations?

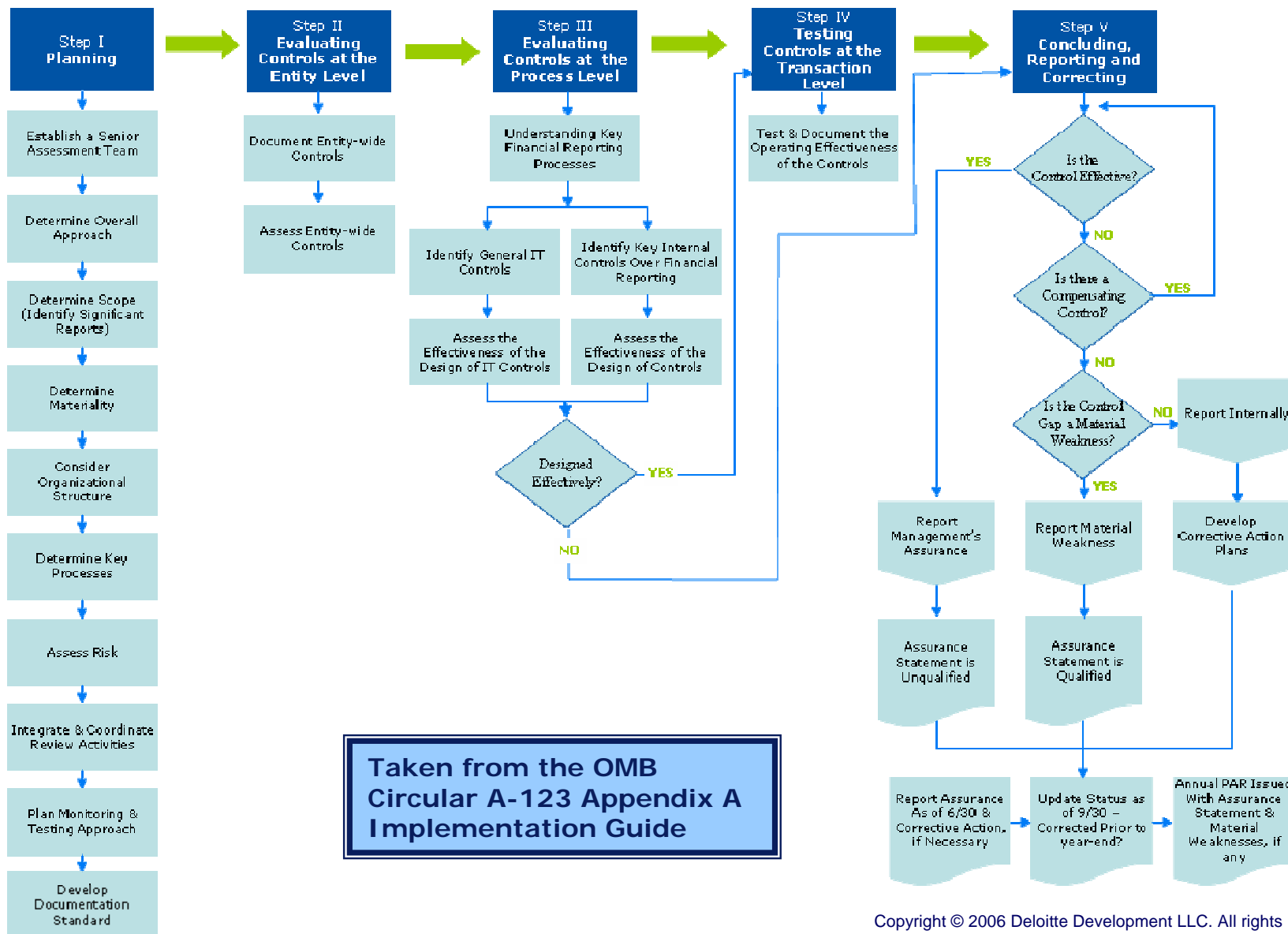
1. Significantly
2. Somewhat
3. Little
4. None
5. Don't Know/Not Applicable

# Objective 3

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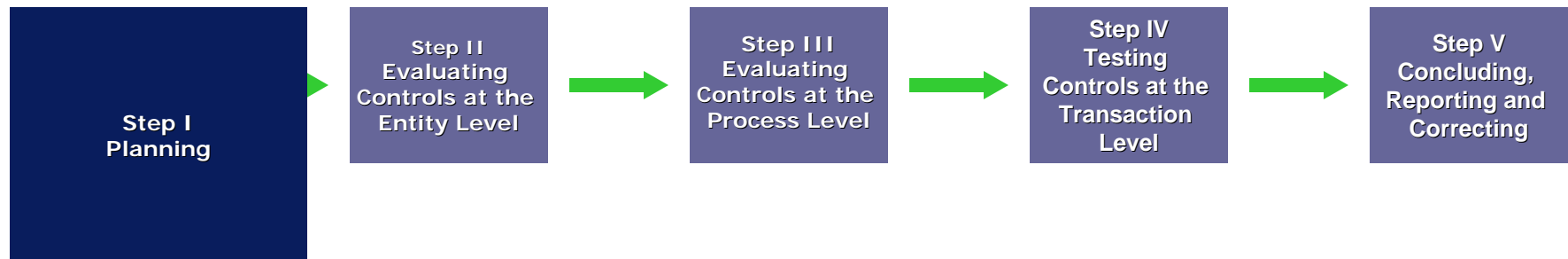
How do you develop a world-class internal control program?

# An Approach to Testing and Evaluating Internal Controls



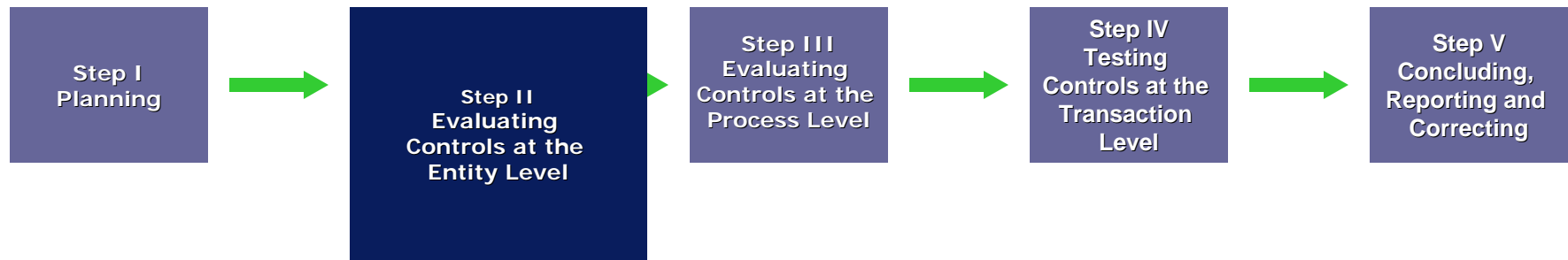
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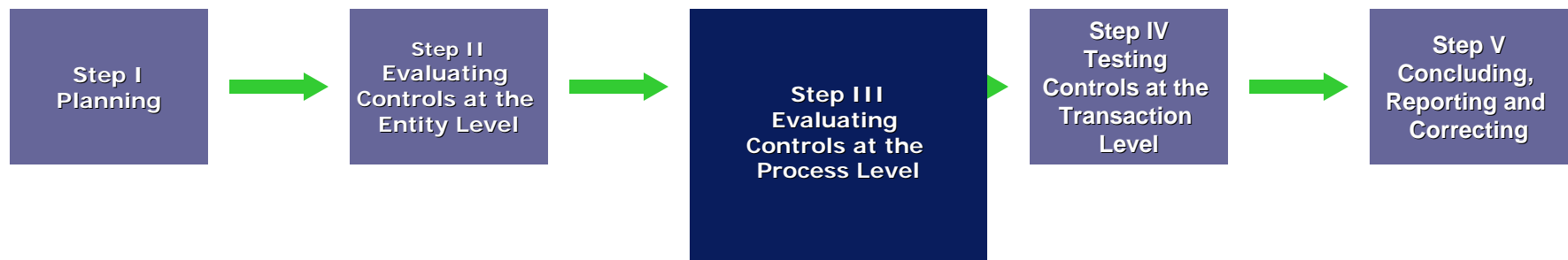
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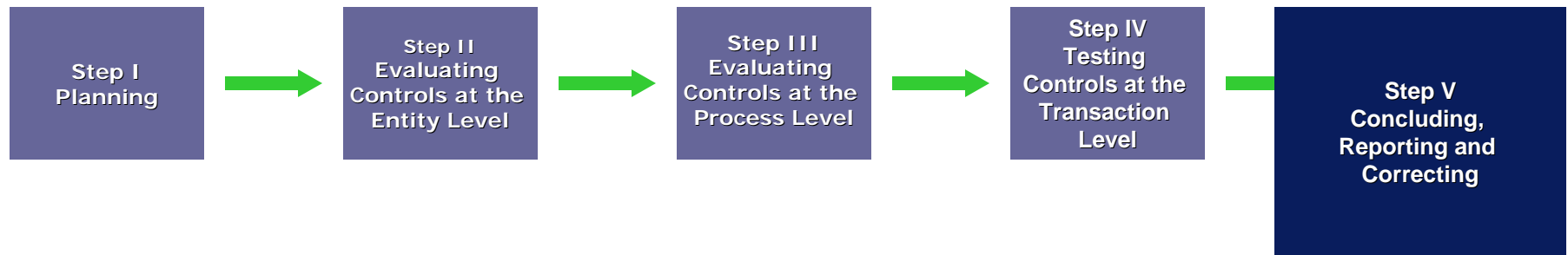
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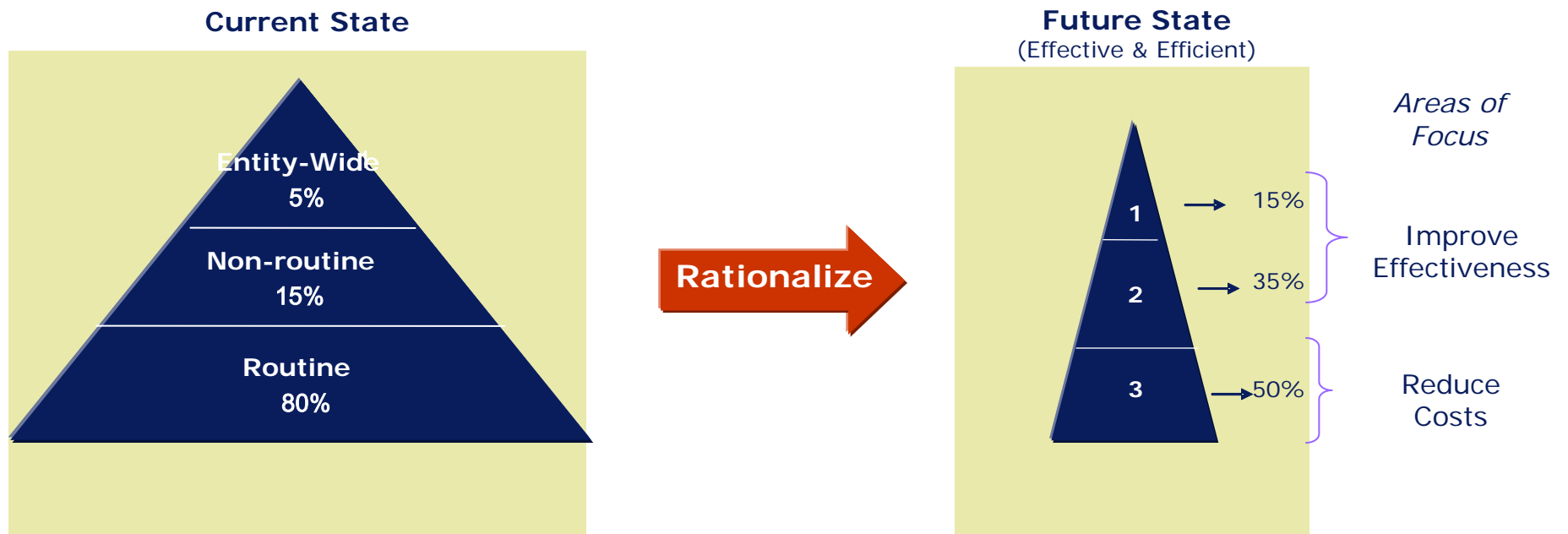
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# Control Rationalization

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# Lessons Learned from Sarbanes-Oxley and A-123

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- 6. Involve the entire organization, not just the financial areas***

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- 5. *Build Institutional Knowledge along the way***

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- 2. *Proper tone from the top is critical to success***

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3. "Ready, Fire, Aim" is not the best approach
2. Proper tone from the top is critical to success
- 1. *Don't do this just to comply with mandates***

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# Questions & Answers