

COSO Internal Control Framework

2025 Annual Conference
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Local Government Accountants Are Calm and Composed Because They Have Strong Internal Controls - Presenter



David Alvey, CPA
Partner

davida@mazeassociates.com

Kevin Mizuno, CPA
Finance Manager
kmizuno@centralsan.org



Phil Leiber, CPA
Deputy General Manager (Finance and
Administration)
pleiber@centralsan.org

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Topics to be Covered

- Background
- Integrated framework of internal control
- Five elements of internal control
- Tips and tricks for maintaining internal controls
- Purchasing and purchasing card policies
- Resources

SCO's Internal Control Guidelines

- California Government Code Section 12422.5 required the SCO to develop internal control guidelines applicable to each local agency
- See the Guidelines at:
 - [http://www.sco.ca.gov/Files-AUD/2015 internal control guidelines.pdf](http://www.sco.ca.gov/Files-AUD/2015%20internal%20control%20guidelines.pdf)

EFFECTIVE
1/1/2015

SCO's Internal Control Guidelines

“...to assist local agencies in establishing a system of internal control to safeguard assets and prevent and detect financial errors and fraud.”

Internal Control Guidelines



California
Local
Agencies

SCO's Internal Control Guidelines

Overview:

- Based on current internal control standards and practical guidance published by various organizations (AICPA, GAO, OMB, COSO, IIA...etc.)
- Contain suggested methods to address the components of internal control
- **However**, these are only guidelines

An abstract graphic featuring a complex network of white lines and dots on a dark blue background. The network forms a wavy, undulating shape that spans the width of the image, with some nodes highlighted in a light blue or yellowish glow. The overall effect is one of a dynamic, interconnected system.

Integrated Framework of Internal Control

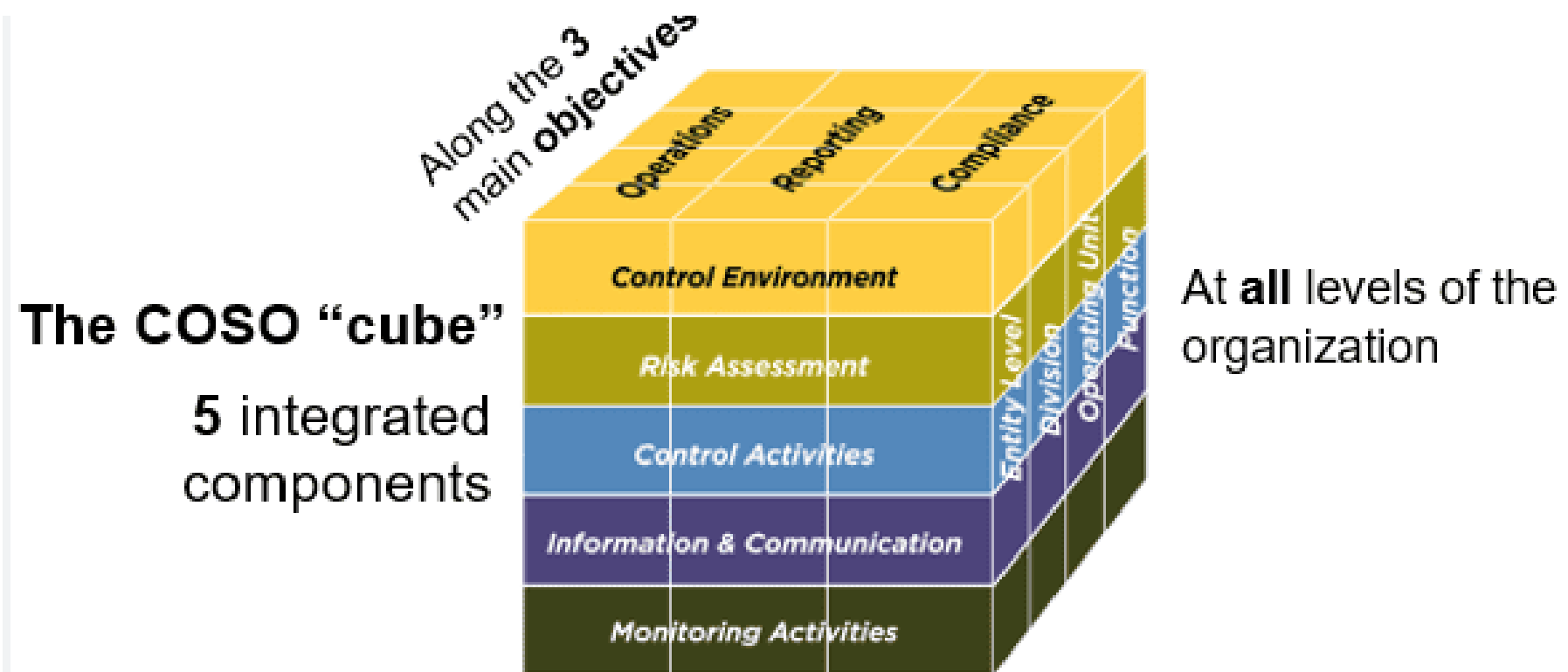
Five Components - CRIME

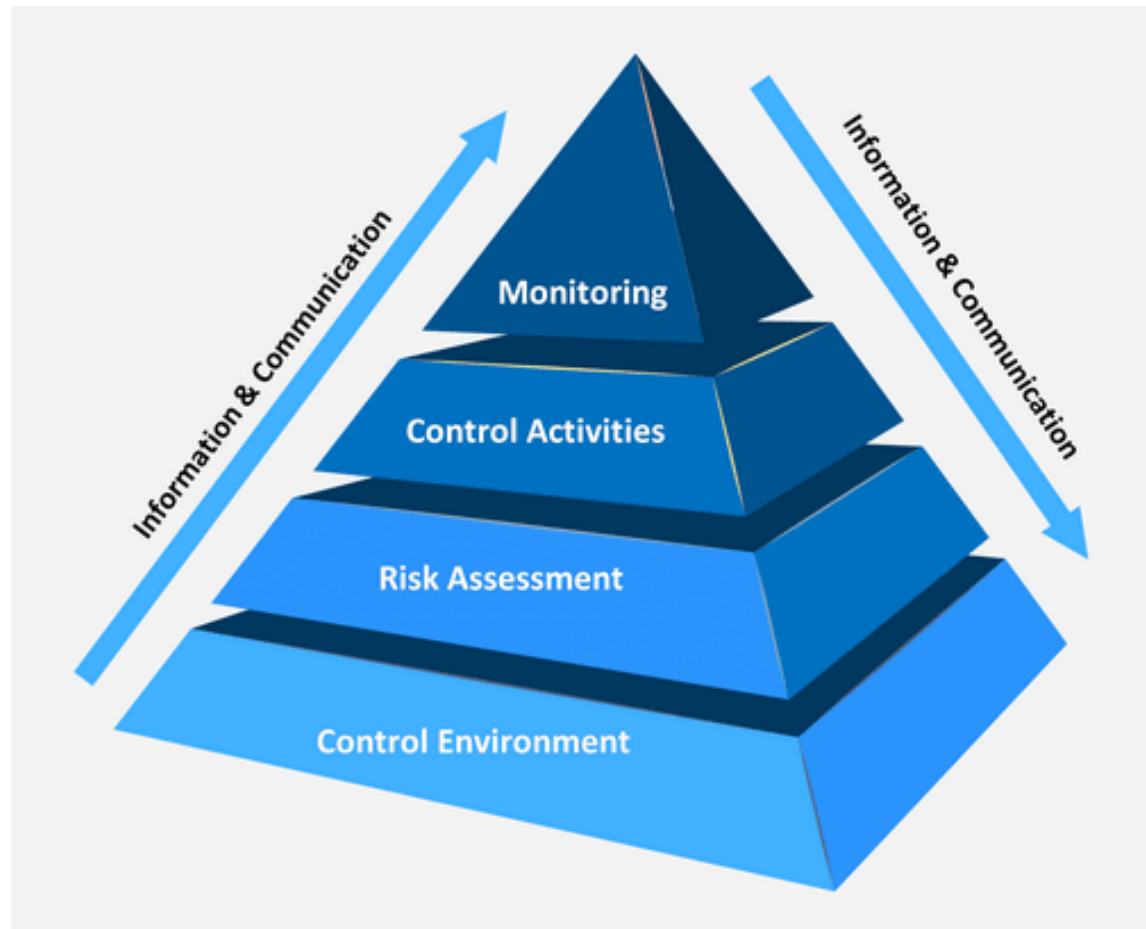


Integrated Framework of Internal Control Must Provide For:

- **Favorable** *control environment*
- **Periodic** *risk assessment*
- **Effective** *control activities* (design, implementation and maintenance)
- **Effective** *information and communication*
- **Ongoing** *monitoring*

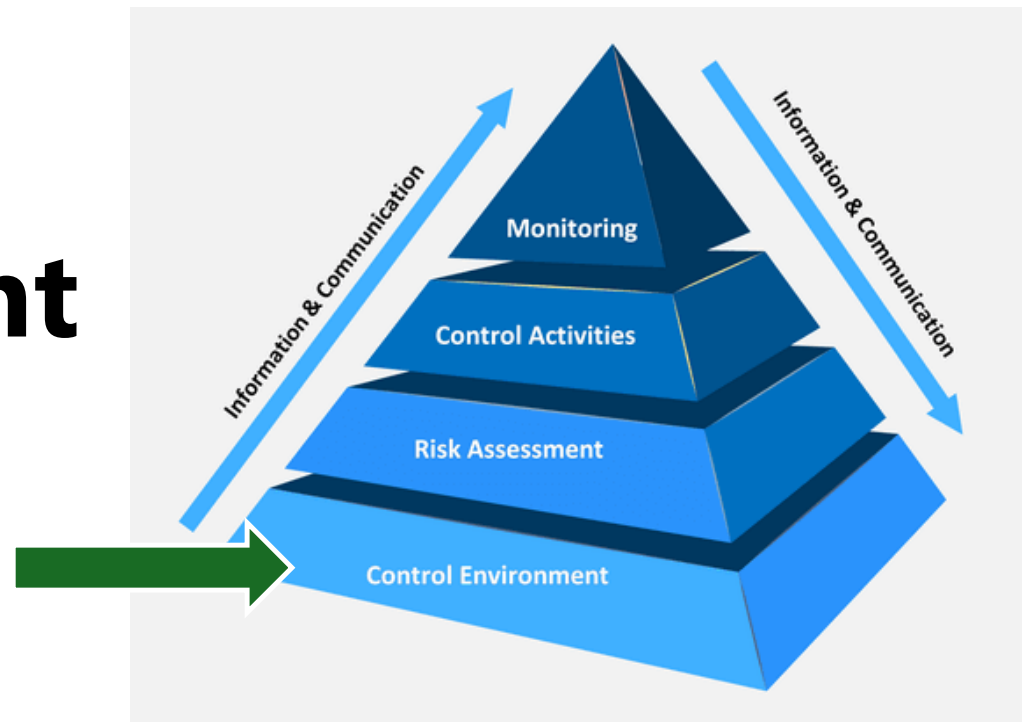
The COSO Cube





Five Elements of Internal Control:

Control Environment



Control Environment - Elements

Should include some or all of the following elements:

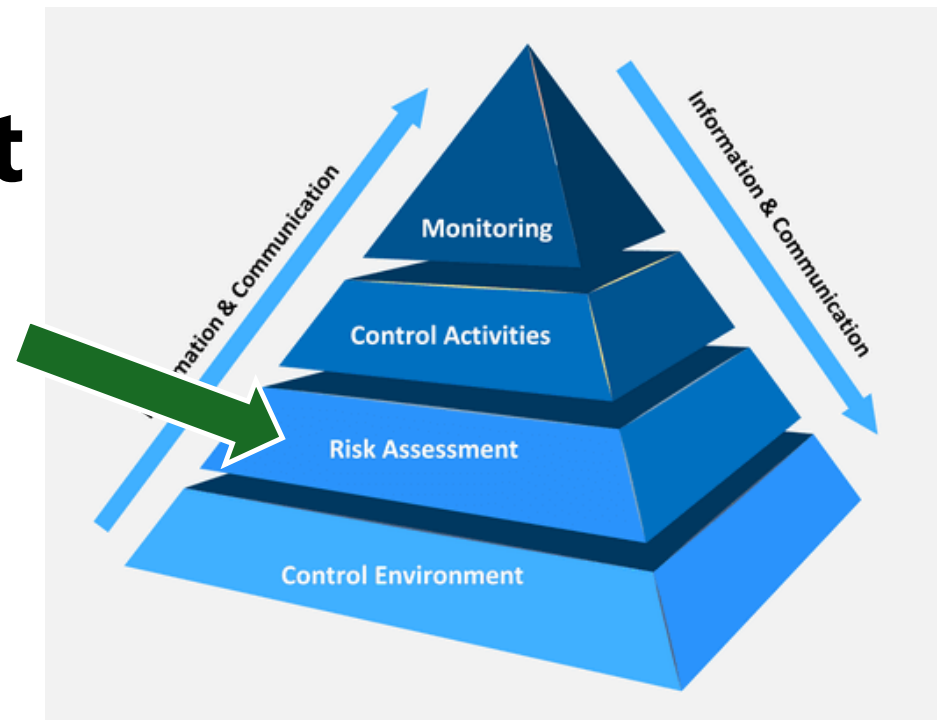
1. Organization's **integrity and ethical** values
2. Governing board's **oversight responsibilities**
3. **Assignment** of authority and responsibility
4. Process for **attracting, developing, and retaining employees**
5. Measures, incentives and rewards to drive **accountability** for performance

Control Environment - Pitfalls

- Lack of clear assignments for review and approval processes
- Lack of activities of oversight committees
- Skillset of those in charge of governance
- High turnover of employees at any level

Five Elements of Internal Control:

Risk Assessment



Risk Assessment - Definition

- Identification, analysis, and management of risks relevant to the preparation and fair presentation of financial statements



Risk Assessment - Process



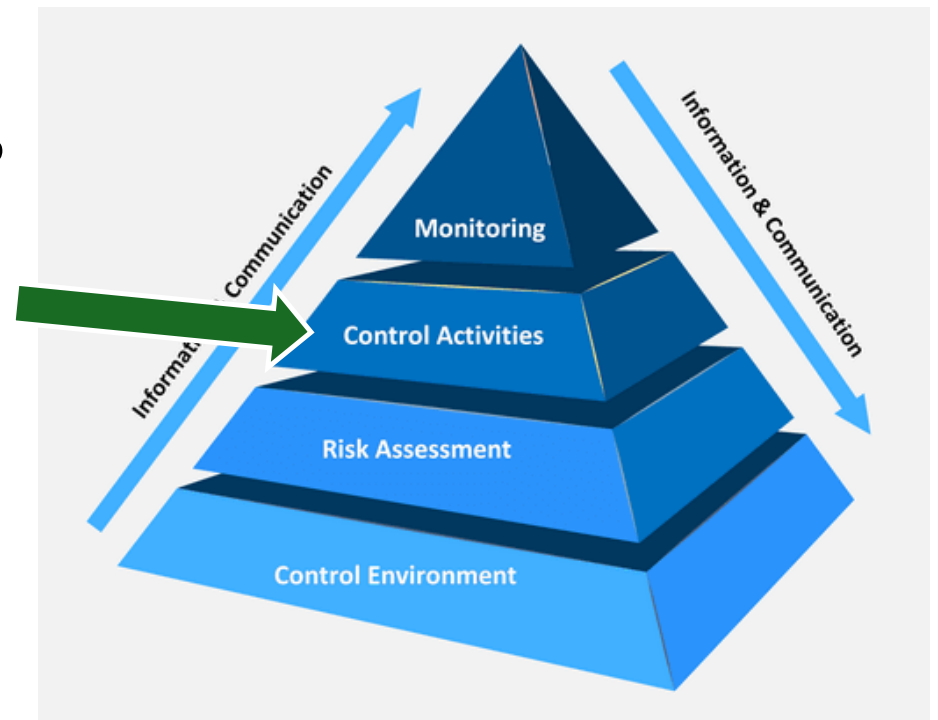
Risk Assessment – PITFALLS



- Lack of staff training at various levels to assist in managing risks
- Changes in software not evaluated
- Holes in the year-end closing process
- Insufficient training for new staff, new grant programs, or new operations
- Hidden risks, such as –
 - Cyber Risk
 - Bypassing procedures (procurement and others)

Five Elements of Internal Control:

Control Activities



Control Activities – Definition

- Policies and procedures that help ensure that management directives are carried out.
- Established through policies and procedures to:
 - Achieve management directives
 - Respond to identified risks in the internal control system

Control Activities – Overview

Benefits vs. Cost

- Benefits > Cost of control activities
- For smaller governments, an appropriate second person may be a member of the governing body

Control Activities – Types

1. Authorization

- Activities should be authorized in accordance with local government's policies and procedures

2. Performance reviews

- Local governments should perform analyses of financial data

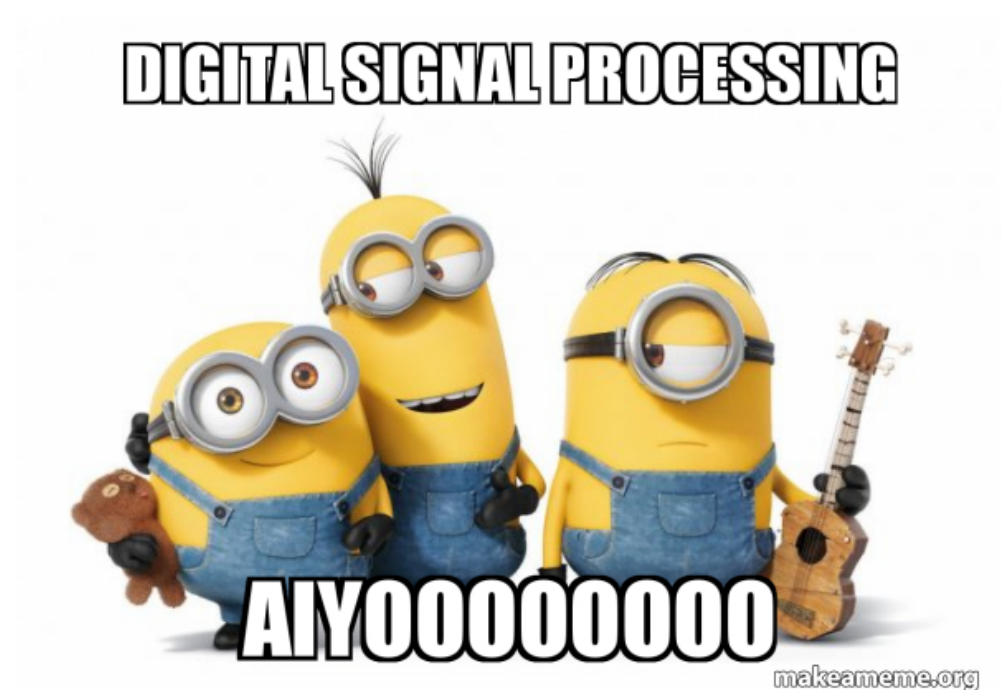
Control Activities – Types

3. Information processing

- Application controls
- General IT controls

4. Physical controls

- Tangible + Intangible



Control Activities – Types

5. Segregation of duties

- Should segregate:
 - Authorization
 - Recording or reconciling
 - Custody of assets



Lack of segregation of duties



Lack of compensating or mitigating controls and/or monitoring of controls, when segregation of duties are absent



Inappropriate access to systems unchecked

Control Activities – DIFFICULTIES when understaffed

Failure to formally document review procedures (physically and/or timely)

Unreconciled differences that go unchecked

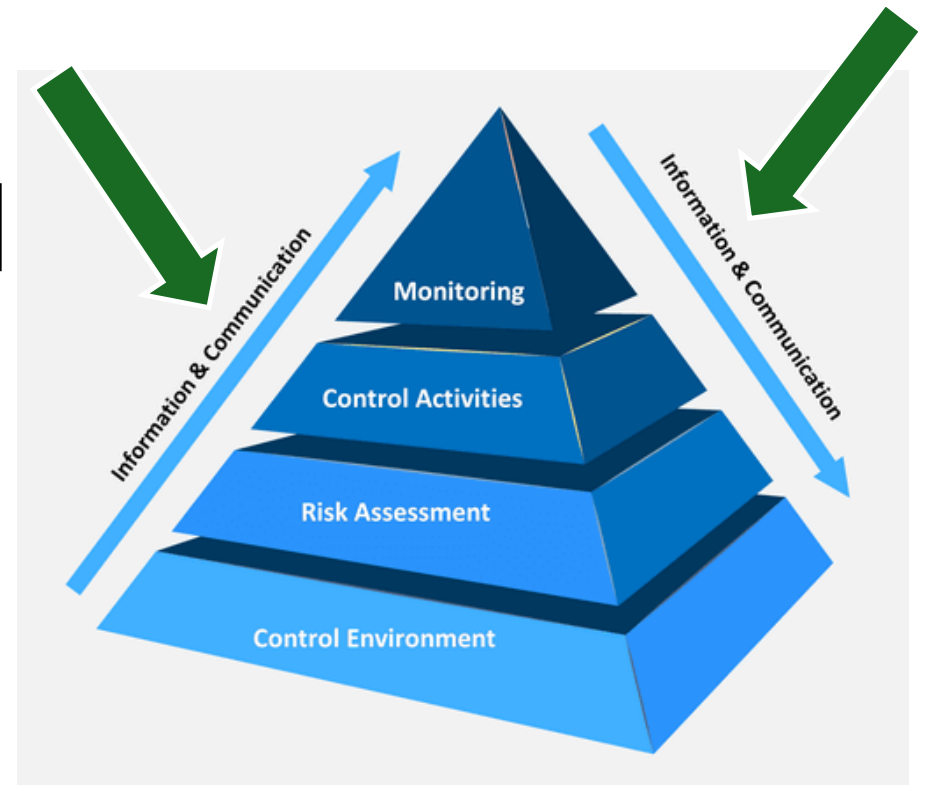
Unreconciled differences that cause a backlog – when “stuck” – move forward!

Key reconciliations not completed timely (bank reconciliations and others)

**Control
Activities –
DIFFICULTIES
when
understaffed**

Five Elements of Internal Control:

Information and Communication



Information & Communication – Definition

Information System

- Enables the organization to obtain, generate, use and communicate transactions and information in order to maintain accountability and measure and review the organization's performance or progress toward the achievement of objectives
- Involves people, processes, data and/or technology (not just the IT system)

Information & Communication – Definition

- Information System includes:

Record
Transactions

Resolve Errors

Process &
Account for
Overrides

Transfer
between
Systems

Capture other
Information

Ensure FS
Reporting
Accuracy

Information & Communication – Overview



Effective flow of information and good communication is the key

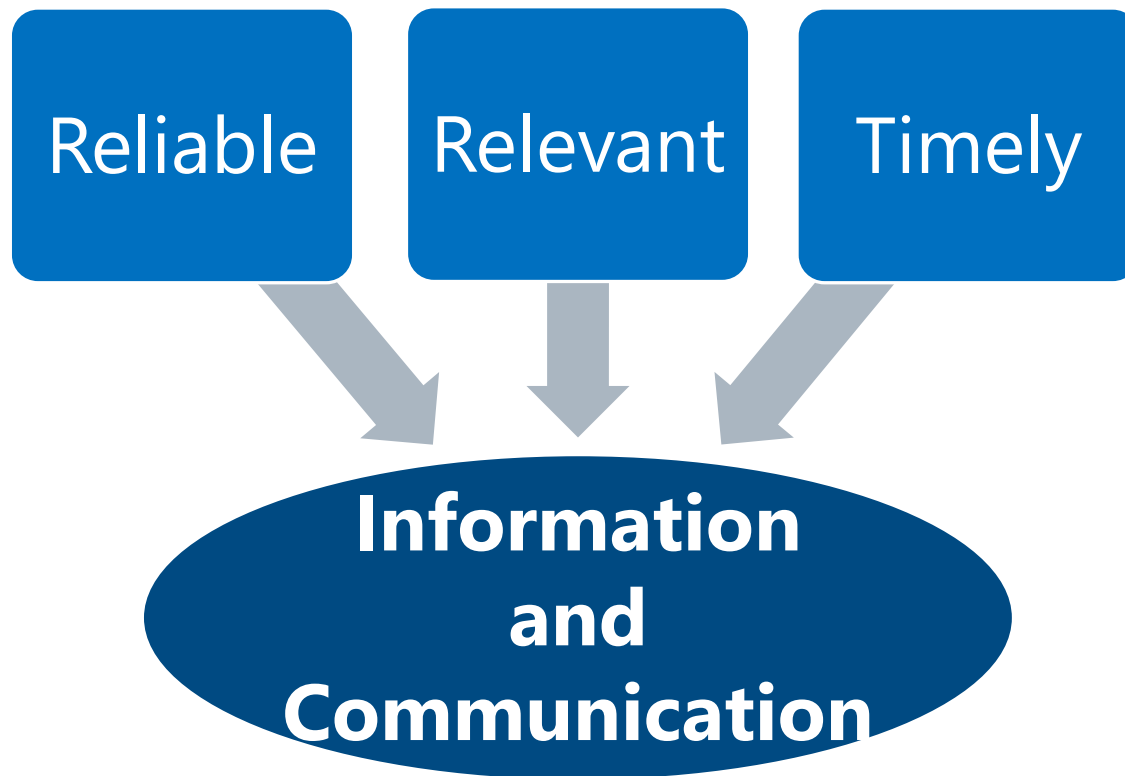


Communication should be multidirectional and lateral



There should also be a way for external parties to provide feedback to the local government

Information & Communication – Elements



Information & Communication – How to Apply?

Job descriptions for all personnel

- Documented?

Policies and procedures

- Detailed expectations and actions?
- Articulate distinct responsibility and accountability of each involved?
- Communicated to the appropriate personnel periodically?

Information & Communication – How to Apply?

Monthly or quarterly reports

- Available for review by management and governing body?

Board agenda items and decisions

- Reviewed regularly by staff to make sure that they are carried out?

Information & Communication – How to Apply?

- **Staff meetings**
 - Feedback welcome?
- **Reporting channels for wrongdoing**

Information & Communication – Pitfalls

Delayed reporting or failure to report throughout the year

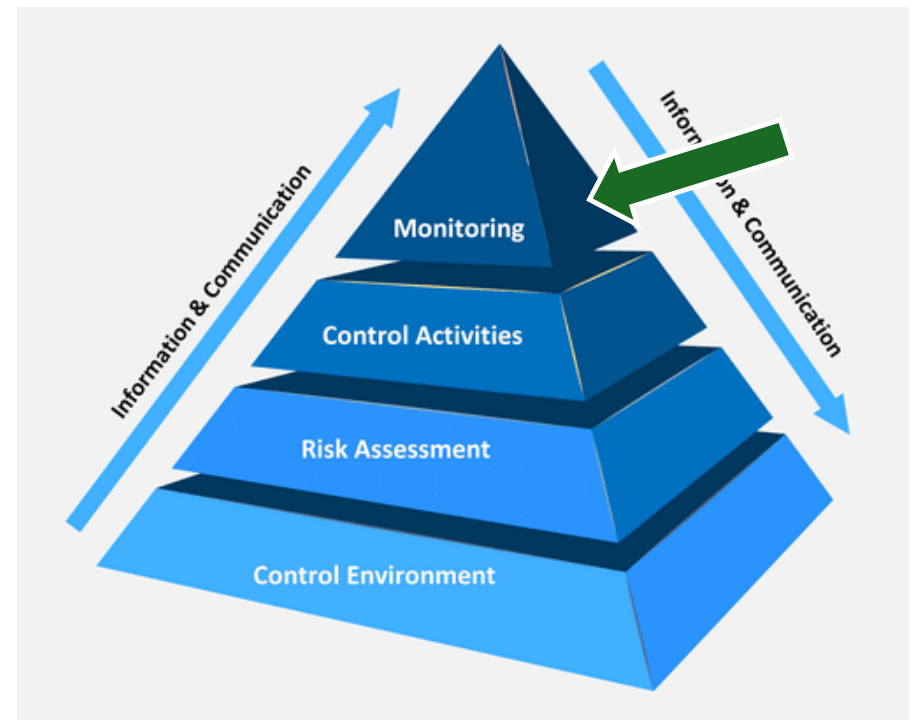
Lack of formal policies and procedures

Ineffective FS Closing Process – fail to analyze and support all balances

Inconsistent fee schedules

Five Elements of Internal Control:

Monitoring



Monitoring – Definition

A process that is used by management to **assess** the effective operation of internal controls over time

Should be done on an **on-going basis** and taking **remedial actions** when necessary

Monitoring – How to Apply?

Policies and Procedures

- Have they been updated to adequately address new challenges?

Control Activities

- Are they functioning properly?

Audit findings

- Have they been resolved?

Monitoring – Difficulties When Understaffed

Outdated policies or procedures that do not correspond with current practices

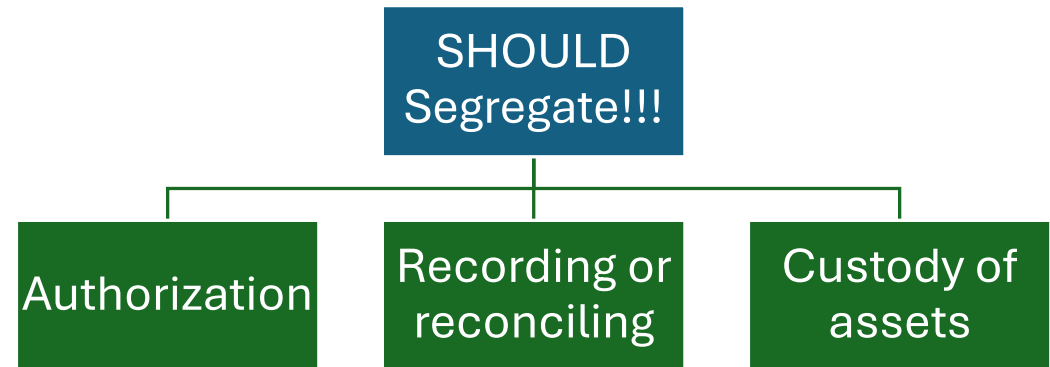
Review procedures that are ineffective

Audit findings that go unresolved

Prioritizing critical tasks can be daunting

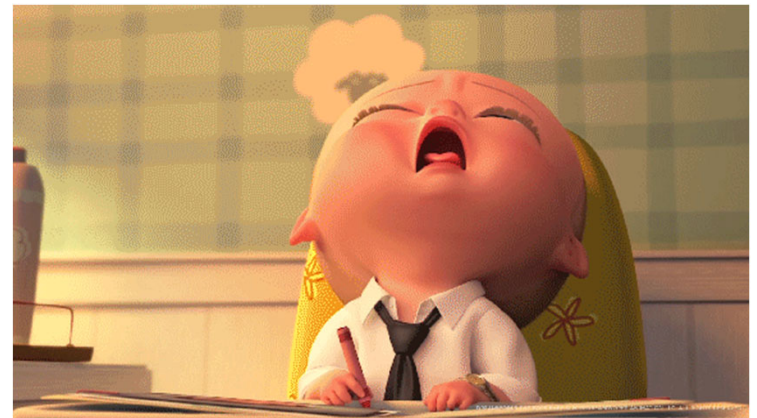
INTERNAL CONTROLS

- Segregation of duties
- General ledger change access – is it appropriate?
- Clear assignments
- How to deal with turnover
- How to deal with remote working
- Who is responsible?
- What is the auditor looking for?



Help! We are struggling with maintaining internal controls!

- Prioritize critical reconciliations and tasks, including, but not limited to –
 - Bank reconciliations
 - Payroll processing
 - Accounts payable
- Segregation of duties – if it is not even close to perfect, you may need to get creative and implement additional processes/procedures to validate transactions/changes
 - How can your system help automate that process?
- Pay attention to customer (and employee) complaints
- Third party consultants – ask for help early!



Purchasing and Purchasing Card Policies



Establish a vision and values for financial condition.



Define the problem the policy will address.



Draft the policy.



Reflect on how people will react.



Initiate an executive team review.



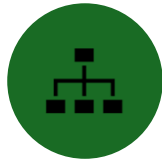
Consider elected officials' involvement with the Policy and public comment, if required.

STEPS TO DEVELOPING A FINANCIAL POLICY (GFOA)

Purchasing policy - Things to consider before you start



Brainstorm and get input from key members of your purchasing department.



Consider your current structure – centralized or decentralized?



Get input from executive management.



Consider ERP system functionalities for approval processes.

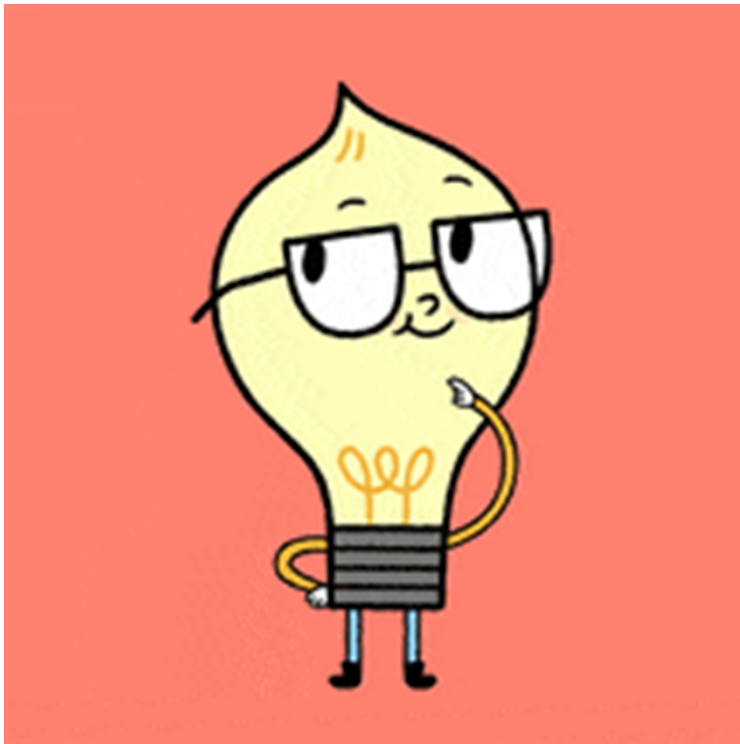


Think about timing...



Benchmark-What are peer agencies doing/GFOA Best Practices

Tips for Brainstorming



- Keep it as simple as possible!
- Consider efficiency alongside internal control processes already in place.
- Consider combining all types of procurement policies into one (example: including public works, purchasing card and grant funded purchases into one policy).
- Rethink previously used approval thresholds and reasonableness.

GFOA Best Practices - Purchasing Card Policies

- GFOA best practices indicate to align the purchasing card policy as a component within the entire purchasing policy, and in compliance with state and local law.



GFOA Best Practices - Purchasing Card Policies



- GFOA best practices state, at minimum, the program should:
 - Define the scope of allowable purchases
 - Address fraud prevention
 - Require and define training for users (with a documented manual)
 - Have a card provider selection process

GFOA Best Practices - Purchasing Card Policies



Best Practices
Learn from the mistakes of others!

- Other suggested policy provisions:
 - Require each user to sign an agreement
 - Define appropriate travel use and limits
 - Define consequences of non-compliance
 - Define prohibited transactions and uses
 - Define emergency uses and limitations
 - Define the approval / review / ratification process

INTERNAL CONTROL RESOURCES



Governmental Accounting Auditing, and Financial Reporting (2020) (the Blue Book), Chapters 41 & 42, or the eGAAFR (<https://www.gfoa.org/egaafr>)



GAO's Internal Control Standards, Internal Control Management and Evaluation Tool (<https://www.gao.gov/assets/gao-01-1008g.pdf>).



COSO's Internal Control – Integrated Framework 2013. Executive Summary can be downloaded from COSO's website (<https://www.coso.org/Shared%20Documents/Framework-Executive-Summary.pdf> OR <https://www.coso.org/SitePages/Internal-Control.aspx?web=1>)

Procurement Resources

- GFOA Best Practices - <https://www.gfoa.org/best-practices/procurement>
- GFOA Financial Policy Examples – Procurement - <https://www.gfoa.org/fpc-procurement>
- GFOA 10 Steps to Developing a Financial Policy - <https://www.gfoa.org/materials/10-steps-financial-policy-gfr>



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