INTERNAL CONTROL STANDARDS

2020

COUNTY OF ALAMEDA CALIFORNIA

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COUNTY OF ALAMEDA

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I. PURPOSE

The main purpose of this publication is to prescribe internal control standards for all departments and agencies of Alameda County. These standards will be revised from time to time to address changes in the County control environment.

The secondary purpose is to provide the tools for departments and agencies to establish and maintain these standards.

II. PUBLIC ACCOUNTABILITY

The Board of Supervisors and the County elected officials are accountable to their constituents, Federal and State officials and the public at large in conducting the affairs of the County. Department and agency heads are similarly accountable to the County Administrator and other appointed and elected officials.

These various levels of accountability contain the same core elements, which form the essence of **public accountability**:

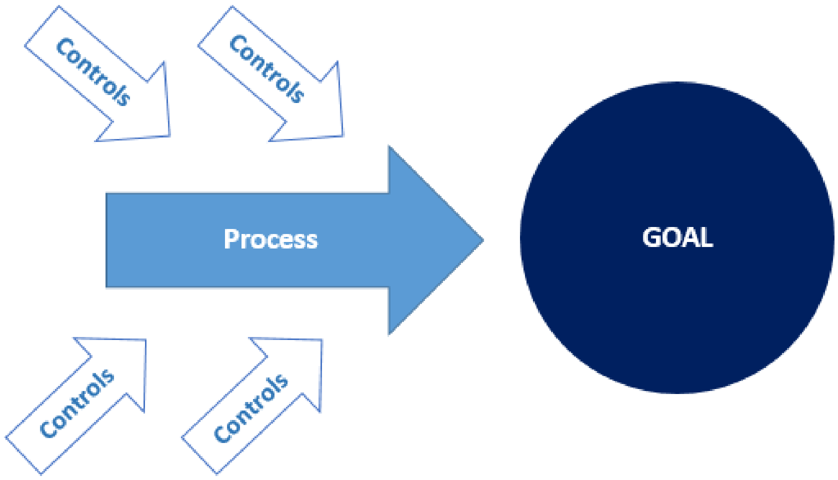
a. Effectiveness and efficiency of operations.
b. Accuracy and reliability of financial reporting for internal and external use.
c. Compliance with applicable laws and regulations.
d. Spending funds as intended.

Elected officials and County management can obtain reasonable assurance that public accountability is achieved by maintaining strong internal controls within the County government.

This publication prescribes standards of internal control towards achieving public accountability.

III. INTERNAL CONTROL STANDARDS

An internal control helps to achieve the goal of a process without being a necessary part of the process – in much the same way as the white and yellow bands delineating freeway lanes help to keep traffic orderly without being necessary for traffic.



A control is labeled internal control to signify that it is an internal mechanism of an entity, as different from one that is imposed by another entity or external element. As a general rule, when "internal" control is adequate, external regulatory forces are less likely to impose "external" controls.

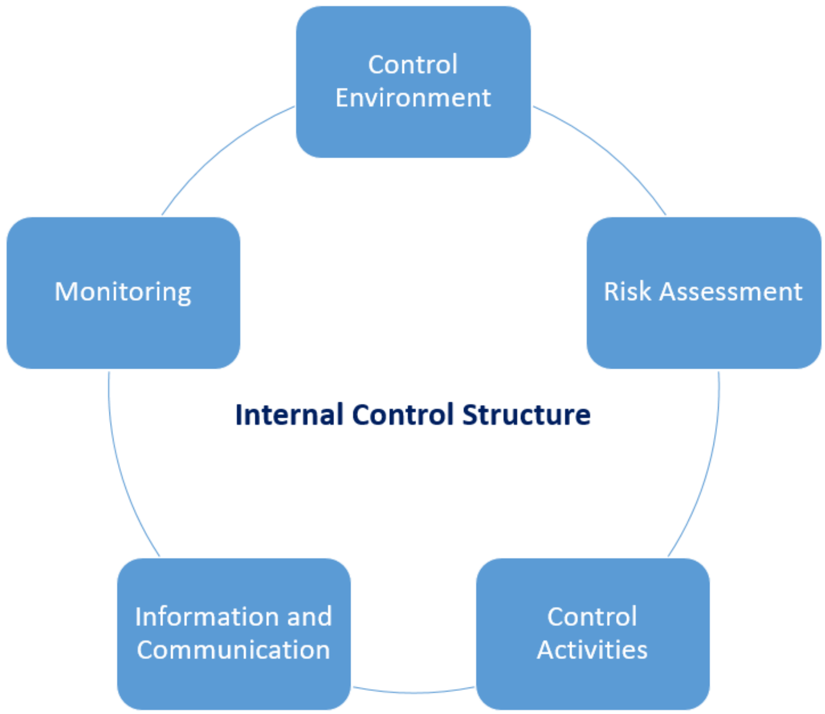
In the context of County government, internal control is any activity undertaken by County personnel that increases the degree of public accountability. In other words, it is an activity that increases assurance that:

- Operations are effective and efficient.
- Financial reports are accurate and reliable.
- Applicable laws and regulations are followed.

Source: GAO. | GAO-14-704G

IV. INTERNAL CONTROL STRUCTURE

In a department, an adequate internal control structure must contain five interrelated components, which represent the highest level of the hierarchy of standards. For an internal control system to be effective, these components must be effectively designed, implemented, and operating together in an integrated manner. The five components of internal control are as follows:



1. Control Environment: The control environment is the foundation for an internal control system. It provides the discipline and structure, which affect the overall quality of internal control. It influences how objectives are defined and how control activities are structured. Management establishes and maintains an environment throughout the organization that sets a positive attitude toward internal control.

   Standard: Management should support and promote a control environment that is conducive to public accountability.

2. Risk Assessment: Risk assessment evaluates the risks, from both external and internal sources, facing an organization as it seeks to achieve its objectives. This assessment provides the basis for developing appropriate risk responses.

   Standard: Management should periodically assess the risk exposures that threaten public accountability.

3. Control Activities: These are the policies and procedures established by management to achieve objectives and mitigate risks in the internal control system, which includes the entity's information system.

   Standard: Management should establish the control activities that reduce the risk exposures to a level that is reasonable to a prudent and informed manager in public service.

   The following categories of control activities are common to most departments:
   a. Top level reviews of actual performance,
   b. Reviews by management at the functional or activity level,
   c. Controls over information systems and the use of technology,
   d. Physical control over vulnerable assets,
   e. Establishment and review of performance measures and indicators,
   f. Segregation of duties,
   g. Proper execution of transactions and events,
   h. Accurate and timely recording of transactions and events,
   i. Access restrictions to and accountability for resources and records, and
   j. Appropriate documentation of transactions and internal control.

4. Information and Communication: Relevant and accurate information about the organization and its operations should be identified, captured and communicated to appropriate personnel to ensure they carry out their responsibilities effectively.

   Standard: Management should establish adequate information systems and communicate relevant information to the appropriate personnel timely.

5. Monitoring: Monitoring consists of activities management establishes and operates to assess the quality of performance over time and promptly resolve the findings of audits and other reviews.

   Standard: Management should regularly evaluate internal control and ensure its proper operation, adapting to risks and changes an organization faces.

There is a direct relationship between objectives, which are what an organization strives to achieve, and the components, which represent what is needed to accomplish the objectives. This relationship is depicted by the three-dimensional matrix developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO):

In this matrix, the three objective categories – operations, financial reporting and compliance – are represented by the vertical columns; the five components are represented by rows (Control Environment, Risk Assessment, Control Activities, Information & Communication and Monitoring Activities); and the units or activities of the organization are depicted by the third dimension of the matrix (Entity, Division, Operating Unit and Function).

Control Environment	1. Demonstrates commitment to integrity and ethical values 2. Exercises oversight responsibility 3. Establishes structure, authority and responsibility 4. Demonstrates commitment to competence 5. Enforces accountability
Risk Assessment	6. Specifies suitable objectives 7. Identifies and analyzes risk 8. Assesses fraud risk 9. Identifies and analyzes significant change
Control Activities	10. Selects and develops control activities 11. Selects and develops general controls over technology 12. Deploys through policies and procedures
Information & Communication	13. Uses relevant information 14. Communicates internally 15. Communicates externally
Monitoring Activities	16. Conducts ongoing and/or separate evaluations 17. Evaluates and communicates deficiencies

V. ASSESSING RISK

In order to ensure that an adequate accountability system exists in the department, management should be aware of the risk factors that threaten accountability. Those risk factors are of three types:

- Factors that affect the effectiveness and efficiency of operations: poorly defined goals, procedures based on antiquated technology, inadequate staff training, etc.
- Factors that affect the reliability of financial reports: weak audit trail, lack of reconciliation procedure, lack of authorization procedure, etc.
- Factors that affect compliance with laws and regulations: lack of monitoring of new laws, lack of enforcement policy, etc.

The method to assess the potential effect of such risk factors involves five steps:

1. Identify the key operational processes.
2. Determine what can go wrong (risk exposures) at each step of the processes.
3. Estimate the likelihood of the threats materializing.
4. Estimate the potential effect of each threat.
5. Determine the materiality of the risk exposures based on their likelihood and potential effect.

The Alameda County Board of Supervisors requires all County departments to evaluate and improve internal controls (assess risks) through the Control Self-Assessment Program (CSA). Departments are required to perform a CSA every three years, with guidance from the Auditor-Controller Agency's Internal Audit Unit. The Control Self-Assessment Work Program in Appendix A outlines this process.

A County department can perform risk assessment at three levels:

- General: Perform an assessment using generic tools to get a general feel for the risk exposures. The internal control questionnaire in Appendix B may be used for this purpose.
- Specific: Perform an in-depth assessment of a specific process.
- Expert consulting: Engage an outside expert to perform a management audit or review on specific areas. County Audit staff can help the department to determine the specifications for such a management audit or review.

After assessing risks, controls are designed to mitigate them.

VI. DESIGNING INTERNAL CONTROL

The purpose of an internal control is to reduce the risk exposures that threaten public accountability to a reasonable level.

There are four steps for designing an effective and efficient internal control:

1. Understand the risk to be mitigated: this is accomplished through a risk assessment as described in Section V.
2. Identify the activity (i.e., the control) which would reduce the risk to an acceptable level.
3. Estimate the cost of implementing and maintaining the control to ensure that it does not outweigh the expected benefit.
4. Establish that activity as an internal control.

Refer to the County's Manual of Accounting Policies and Procedures (MAPP) for information on designing effective internal controls. In addition, internal control design can be approached at two levels using tools created by the Internal Audit Unit for the purposes of the Control Self-Assessment:

- General: The appropriate control procedures can be selected from a generic list such as those provided in the internal control questionnaire in Appendix B and modified as required. Some examples of general procedures to be evaluated include: cash-handling, time keeping, expense reports, segregation of duties, etc.
- Specific: Control procedures are custom-designed to address the specific risks identified in the risk assessment. Some examples of specific processes to be evaluated include: fleet management, issuance of gift cards, work flow procedures, etc.

VII. IMPLEMENTING INTERNAL CONTROL

Once an internal control has been designed, it should be implemented through two mechanisms:

1. Communication: The control should be documented and communicated to all employees and managers affected. Typically, a high-level manager informs employees of the new control through memorandum, and the control is incorporated into a policy and procedure manual.

   Any information related to the operation of the control (such as performance measures, results of audits, etc.) and any subsequent modification to the control should be similarly communicated to staff.

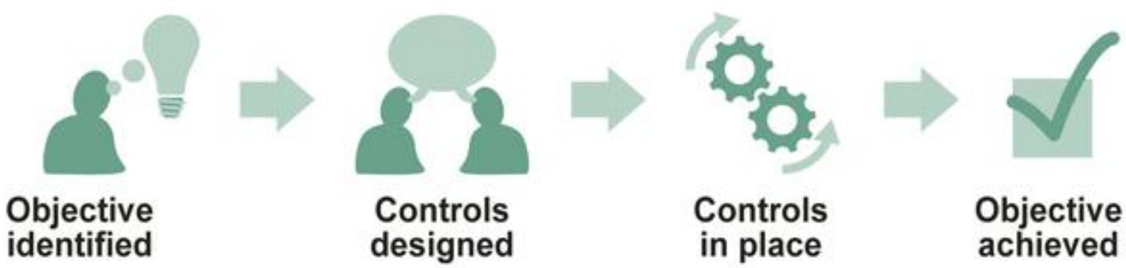
   Internal control fails most often when the proper information is not communicated to the appropriate personnel.

The quality of information should also be considered—it should be accurate, relevant and timely.

2. Monitoring: Internal control deteriorates over time if not properly maintained. Therefore, management should periodically check the functioning of internal control through various mechanisms such as:

   - Continual monitoring.
   - Periodic "check-up" of the internal control structure through a self-assessment process, with guidance from County Internal Audit staff.
   - Review of specific operational areas through management audit or performance audit.

The involvement of top-level management in internal control matters is crucial to the effectiveness of the internal control. Management sets the tone and determines whether the control environment supports the internal control system to function effectively.



Source: GAO. | GAO-14-704G

VIII. EVALUATING INTERNAL CONTROL

The best time to evaluate internal control is when everything seems to run smoothly. The worst time is during or after a crisis. A crisis tends to distort normal perspective and the ensuing reaction will normally result in the installation of inefficient controls.

Four aspects of internal control should be evaluated:

1. Is it valid, that is, does it reduce the risk identified?
2. Is it established, that is, is it established as a formal activity by management?
3. Is it effective, that is, has it been operating as intended?
4. Is it efficient, that is, does the risk reduction provided by the control justify the cost of maintaining the control?

The answers to these questions should be based on:

- Examination of current and past records and other documentation.
- Observation of activities.

- Interviews with knowledgeable and reliable personnel.

A negative answer does not always mean that the control activity fails or should be modified; there may be other compensating factors that work to shore up the apparently deficient control.

An evaluation can be done for each specific control according to the Control Self-Assessment Work Program in Appendix A.

IX. IMPROVING INTERNAL CONTROL

Control activities are often interrelated. The combined effect of a group of control activities may be greater than the sum of the individual effects. Because of this synergy, optimum improvement often requires considering groups of controls rather single control activities.

X. ADDITIONAL RESOURCES & EXAMPLES

For additional guidance on the internal control framework, refer to the Standards for Internal Control in the Federal Government (Green Book), the Internal Control Management and Evaluation Tool, and the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Guidance in Internal Control.

- Standards for Internal Control in the Federal Government (Green Book):
  https://www.gao.gov/products/GAO-14-704G

- Internal Control Management and Evaluation Tool:
  https://www.gao.gov/assets/80/76615.pdf

- COSO Guidance in Internal Control:
  https://www.coso.org/Pages/ic.aspx

The Government Finance Officers Association (GFOA), consisting of federal, state/provincial, and local public finance officials throughout the United States and Canada, developed for all levels of government best practices in various categories:

- Accounting & Financial Reporting
- Budgeting
- Capital Planning
- Debt Management
- Economic Development
- Pension & Benefit Administration
- Procurement
- Risk Assessment
- Treasury & Investment Management

GFOA Best Practices:
https://www.gfoa.org/best-practices

The California State Controller developed internal control guidelines to assist local agencies within the state in establishing effective internal controls:
https://sco.ca.gov/Files-AUD/2015_internal_control_guidelines.pdf

The Internal Control Guidelines include examples of methods that may be used by local government to address:

- Control Environment;
- Risk Assessment;
- Control Activities;
- Information and Communication; and
- Monitoring.[1]

[1] California State Controller's Office. Internal Control Guidelines for California Local Agencies. 2015.