



GAO Green Book

May 12, 2020
Spring Symposium



Session Outline

- What is internal control and why is it so important?
- What tools can I leverage to design and implement an effective system of internal control?
- How do I apply the GAO Green Book?

What is internal control?

- An integral component of an organization's management that provides reasonable assurance that the objectives of the organization are being achieved
- Objectives and related risks can be broadly classified into three categories:
 - Efficient and effective operations
 - Reliable reporting
 - Compliance with laws and regulations
- Includes the plans, methods, policies, procedures used to fulfill the mission, strategic plan, and objectives of the organization

Fundamental concepts

- Geared towards the achievement of objectives
 - Operations
 - Reporting
 - Compliance
- A process that is continuously evolving
- Effected by the organization's people and the actions they take (or fail to take)

Fundamental concepts (cont.)

- Provides reasonable, but not absolute, assurance
- Adaptable and flexible
- Comprised of the five components working in an integrated manner
 - Control environment
 - Risk assessment
 - Control activities
 - Information and communication
 - Monitoring

Why is internal control important?

- Helps managers achieve desired results
 - Efficient program operations (delivering public services to us - the citizens)
 - Effective stewardship of public resources (our taxpayer dollars)
- Provides reasonable assurance that the amounts and disclosures reported in the organization's financial statements are materially accurate
 - Necessary in achieving a "clean" audit opinion with no reportable internal control deficiencies

OK, but why is internal control really important?

- Serves as the first line of defense in safeguarding assets and preventing fraud
 - Misappropriation of cash and other assets
 - Fraudulent financial reporting (perhaps to cover up misappropriation or to achieve a desired outcome)
- Helps to deter public corruption

*Avoid embarrassment, public humiliation
and ending up on the front page of the
newspaper!*

The Trusted Treasurer - Rita Crundwell



<https://www.youtube.com/watch?v=WAYtaFxlw3M>



<https://www.allthequeenshorsesfilm.com>

Rita Crundwell

- Grew up on a family farm near Dixon, Illinois (population ~15,000)
- Appointed treasurer/comptroller of Dixon in 1983
- Embezzled ~\$53 million from the city from 1990 to 2012
 - 1991 - \$181,000
 - 2008 - \$5.8 million
- Arrested April 17, 2012; pled guilty Nov 14, 2012
- Sentenced to 19 years, 7 months in prison on February 14, 2013

How Did She Do It?

- Opened a bank account called Reserve Sewer Capital Development Account (RSCDA) with herself as the only signatory
- Moved City funds into a legitimate City account - Capital Development Account (CDA)
- Created phony invoices that she paid with CDA checks payable to 'Treasurer'
- Deposited checks into the RSCDA
- Used funds to run her thoroughbred horse farm and business

Rita's \$2.1 Million Motor Coach



How Did She Get Caught?

- While Rita was away at a horse show, another city employee discovered the RSCDA account



FCI WASECA

A low security federal correctional institution with a detention center.

Dixon, IL – Monetary Impact

- \$10 million – attorneys fees for investigating the fraud and negotiating settlements with accounting firms and the bank
- \$35.15 million – settlement with the CPA firm that assisted Dixon with accounting and financial management
- \$1 million – settlement with the CPA firm that performed Dixon's annual audit since 2006
- \$3.85 million – settlement with the bank where Dixon's accounts were maintained and where Crundwell set up the RSCDA account

Dixon, IL – Net Loss

Amount misappropriated	\$54 million
Attorneys fees	<u>\$10 million</u>
Loss to Dixon	\$64 million
Recovery from asset sale	\$10 million
Settlement with CPA firms, bank	\$40 million
Dixon's net monetary loss	<u>\$14 million</u>

No price can be set for the loss of faith in the city's public officials

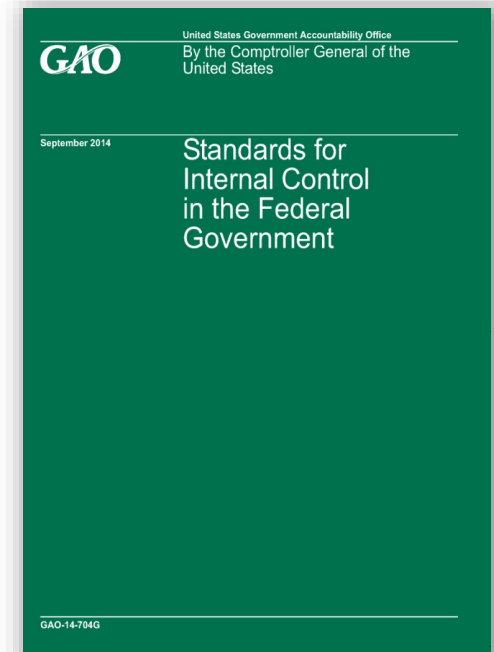
What could Dixon have done?

- A study of reported occupational fraud cases in public sector entities published in the *Journal of Government Financial Management** noted the following top three internal control weaknesses:
 - Lack of management or independent reviews
 - Abuse of authorizations to access cash, other assets or to information systems
 - Inadequate level of transaction recordkeeping / documentation
- Dixon could have leveraged the GAO Green Book to design, implement and maintain an effective system of internal control
- Even on a small (\$7-8M) budget, the city could have implemented effective internal control that would have prevented, or at least quickly detected, this fraud

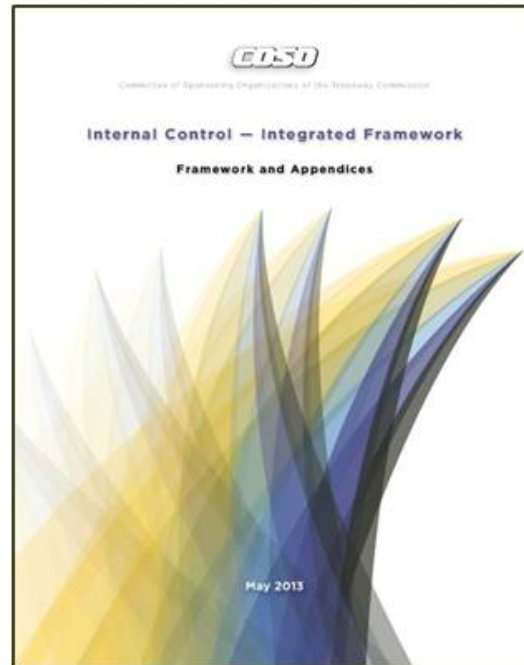
*Winter 2014 edition

Standards for Internal Control

- GAO has issued standards for internal control in the government
- Effective beginning FY 2016 and for the FMFIA reports covering that year
- www.gao.gov/greenbook



COSO Internal Control—Integrated Framework



Available at www.ic.coso.org

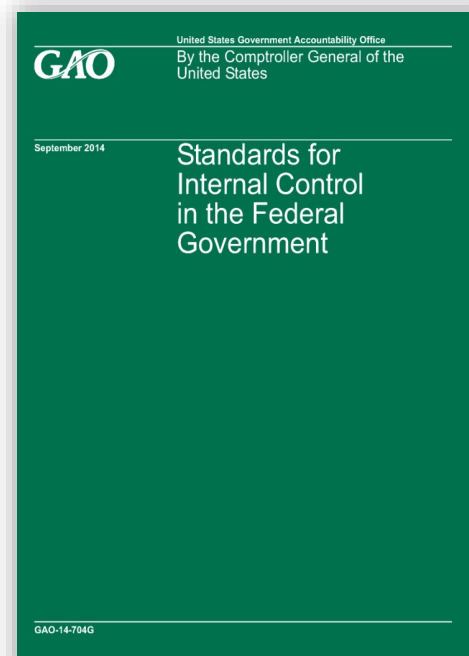
Standards for Internal Control

- Can be used by management to understand requirements and by auditors to understand criteria
- Cited in OMB's Uniform Administrative Requirements § 200.303 Internal Control Requirements as standards/guidance for establishing and maintaining effective internal control over a federal award
- Five components of internal control, 17 principals, 48 attributes
 - All components and principles are requirements for establishing an effective internal control system

Revised Green Book

Overview

Standards



Revised Green Book: Overview

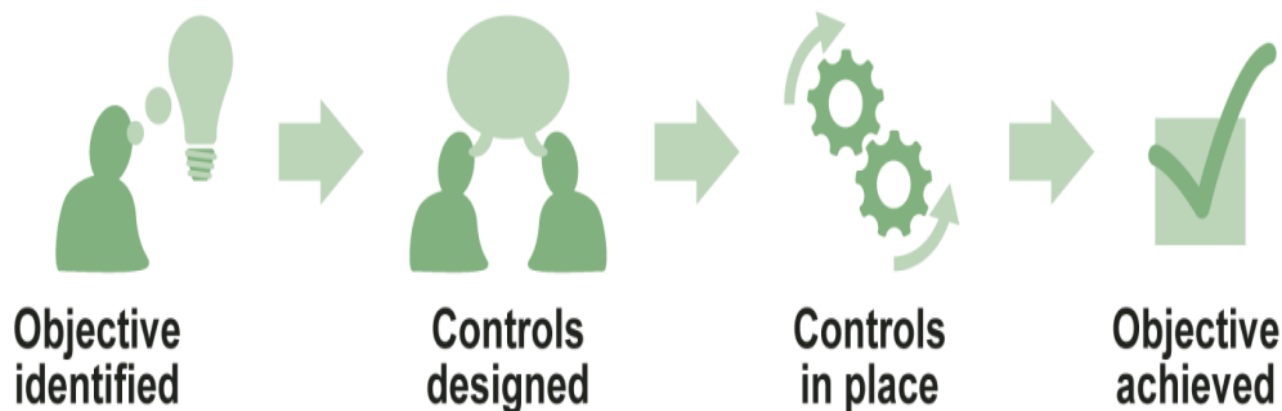
- Explains fundamental concepts of internal control
- Addresses how components, principles, and attributes relate to an entity's objectives
- Discusses management evaluation of internal control
- Discusses additional considerations

Overview

Standards

Fundamental Concepts

Internal control is a process to help entities achieve objectives



Source: GAO. | GAO-14-704G

Component, Principle, Attribute

Component

Control Environment

Principle

The oversight body
and management should
demonstrate a commitment
to integrity and ethical values

Attributes

Set the Tone
at the Top

Establish
standards
of conduct

Evaluate
adherence to
standards of conduct

Overview: Components and Principles

- In general, all components and principles are required for an effective internal control system
- Entity should implement relevant principles
- If a principle is not relevant, document the rationale of how, in the absence of that principle, the associated component could be designed, implemented, and operated effectively
- OV2.05: The 17 principles support the effective design, implementation, and operation of the associated components and represent requirements necessary to establish an effective internal control system.

Overview: Attributes

- Attributes are considerations that can contribute to the design, implementation, and operating effectiveness of principles
- OV2.07 excerpt: The Green Book contains additional information in the form of attributes. . . Attributes provide further explanation of the principle and documentation requirements and may explain more precisely what a requirement means and what it is intended to cover, or include examples of procedures that may be appropriate for an entity.

Overview: Management Evaluation

- An effective internal control system requires that each of the five components are:
 - Effectively designed, implemented, and operating
 - Operating together in an integrated manner
- Management evaluates the effect of deficiencies on the internal control system
- A component is not effective if related principles are not effective

Overview: Additional Considerations

- The impact of service organizations on an entity's internal control system
- Discussion of documentation requirements in the Green Book
- Applicability to state, local, and quasi-governmental entities as well as not-for-profits
- Cost/Benefit and Large/Small Entity Considerations

Documentation requirements (Appendix I)

- OV2.06: If management determines a principle is not relevant, management supports that determination with documentation that includes the rationale of how, in the absence of that principle, the associated component could be designed, implemented, and operated effectively
- Control Environment
 - 3.09: Management develops and maintains documentation of its internal control system
- Control Activities
 - 12.02: Management documents in policies the internal control responsibilities of the organization.

Documentation requirements (Appendix I)

- Monitoring
 - 16.09: Management evaluates and documents the results of ongoing monitoring and separate evaluations to identify internal control issues.
 - 17.05: Management evaluates and documents internal control issues and determines appropriate corrective actions for internal control deficiencies on a timely basis.
 - 17.06: Management completes and documents corrective actions to remediate internal control deficiencies on a timely basis.

Revised Green Book: Standards

- Explains principles for each component
 - Control Environment
 - Risk Assessment
 - Control Activities
 - Information and Communication
 - Monitoring
- Includes further discussion of considerations for principles in the form of attributes

Overview

Standards

Revised Green Book: Components and Principles

Control Environment

1. Demonstrate Commitment to Integrity and Ethical Values
2. Exercise Oversight Responsibility
3. Establish Structure, Responsibility, and Authority
4. Demonstrate Commitment to Competence
5. Enforce Accountability

Risk Assessment

6. Define Objectives and Risk Tolerances
7. Identify, Analyze, and Respond to Risk
8. Assess Fraud Risk
9. Analyze and Respond to Change

Control Activities

10. Design Control Activities
11. Design Activities for the Information System
12. Implement Control Activities

Information & Communication

13. Use Quality Information
14. Communicate Internally
15. Communicate Externally

Monitoring

16. Perform Monitoring Activities
17. Remediate Deficiencies

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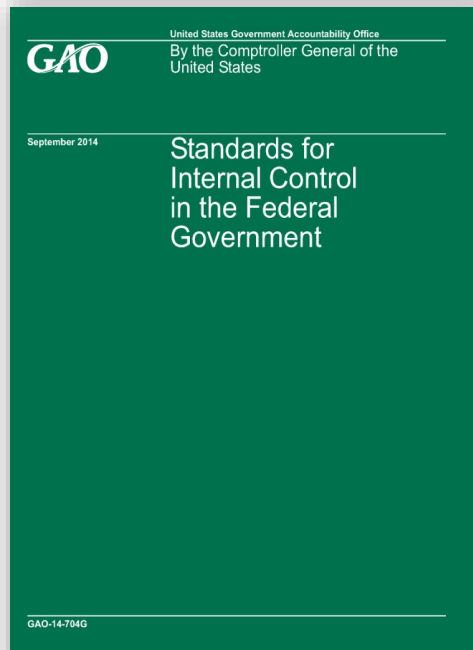
Monitoring

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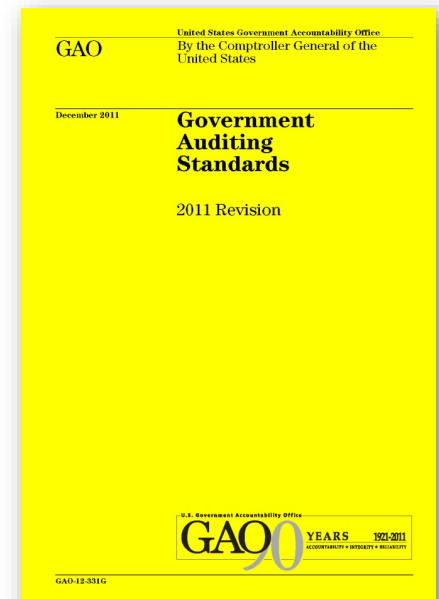
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Relationship between the Green Book and Yellow Book



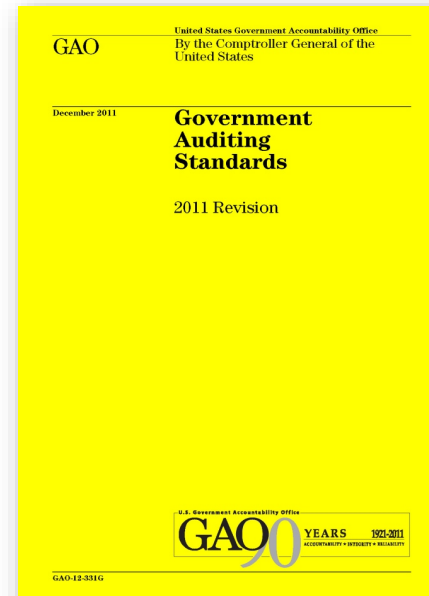
- Can be used by management to understand requirements
- Can be used by auditors to understand criteria



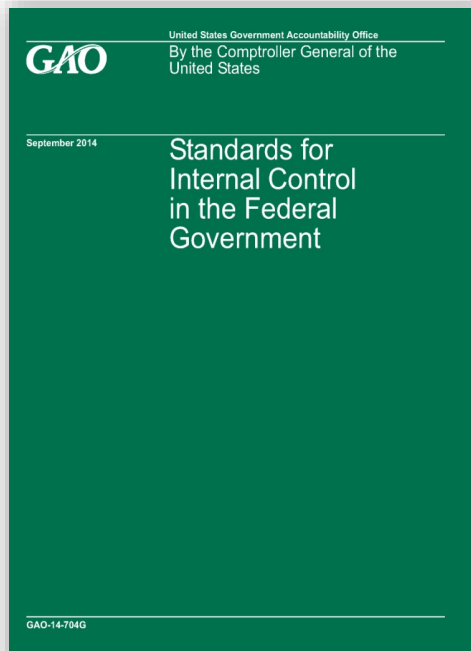
The Yellow Book: Framework for Audits

Findings are composed of:

- Condition (What is)
- **Criteria (What should be)**
- Cause
- Effect (Result)
- Recommendation (as applicable)



Linkage Between Criteria (Yellow Book) and Internal Control (Green Book)

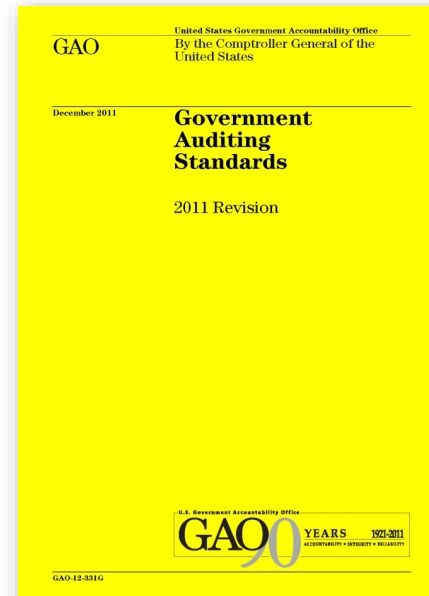


- Green Book provides criteria for the design, implementation, and operating effectiveness of an effective internal control system

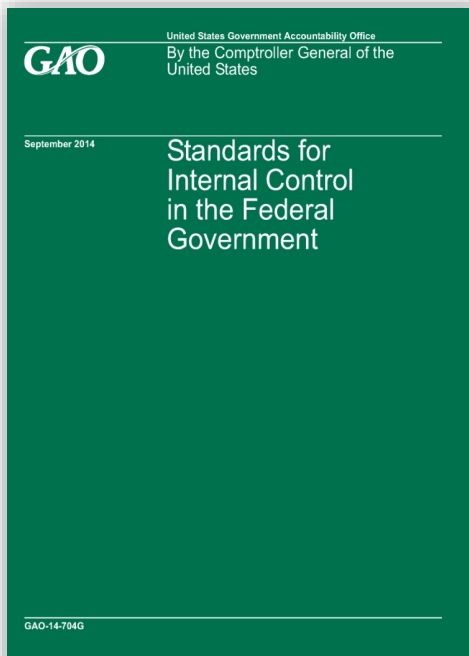
The Yellow Book: Framework for Audits

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- Condition (What is)
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- **Cause**
- Effect (Result)
- Recommendation (as applicable)



Linkage Between Findings (Yellow Book) and Internal Control (Green Book)



- Findings may have causes that relate to internal control deficiencies

Case Study

Dixon, IL

Control Environment

GAO Green Book Principles

Principle 2. The oversight body should oversee the entity's internal control system.

Principle 3. Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives.

Dixon deficiencies in its system of internal control

- ☐ Dixon's City Council and Mayor did not oversee the design, implementation, and operation of the city's internal control system or provide direction on the remediation of any deficiencies.
 - ☐ Few internal controls in place.
 - ☐ Crundwell was allowed to make decisions and perform Treasurer duties with virtually no oversight.
-
- ☐ The assignment of responsibility and delegation of authority did not promote achievement of the city's objectives.
 - ☐ No consideration of the overall responsibilities assigned to Crundwell.
 - ☐ Excessive level of authority assigned to Crundwell.

Control Environment (cont.)

GAO Green Book Principles

Principle 4. Management should demonstrate a commitment to recruit, develop, and retain competent individuals.

Principle 5. Management should evaluate performance and hold individuals accountable for their internal control responsibilities.

Dixon deficiencies in its system of internal control

- ☐ No succession or contingency plans for the Treasurer role.
 - ☐ No identification and training of a succession candidate or at a minimum, an alternate individual.
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- ☐ No accountability for performing assigned internal control responsibilities.
 - ☐ No consideration of internal control responsibilities in determining overall performance objectives or in evaluating performance.

Risk Assessment

GAO Green Book Principles

Principle 6. Management should define objectives clearly to enable the identification of risks and define risk tolerances.

Principle 7. Management should identify, analyze, and respond to risks related to achieving the defined objectives.

Dixon deficiencies in its system of internal control

- ☐ Dixon did not define objectives.
- ☐ Consequently Dixon was unable to identify risks to achieving its objectives or determine risk tolerances.

- ☐ Dixon did not perform a risk assessment to identify risks.
- ☐ Consequently it was unable to identify internal controls to mitigate these risks.

Risk Assessment (cont.)

GAO Green Book Principles

Principle 8 – Management should consider the potential for fraud when identifying, analyzing and responding to risks.

Principle 9 – Management should identify, analyze, and respond to significant changes that could impact the internal control system.

Dixon deficiencies in its system of internal control

- ☐ Dixon did not consider the potential for fraud of taxpayer dollars.
- ☐ Dixon did not consider the fraud risk factor of opportunity: lack of internal controls and ultimate trust in Crudwell provided an opportunity to commit fraud.
- ☐ Dixon did not consider changing conditions that could affect the city and its environment (e.g., reduced state funding resulting in the need for city budget cuts).
- ☐ Dixon did not analyze the effect of changes on the internal control system and determine whether existing controls are effective for meeting objectives or addressing risks under the changed conditions.

Control Activities

GAO Green Book Principles

Principle 10 – Management should design control activities to achieve objectives and respond to risks.

Dixon deficiencies in its system of internal control

- ☐ No comparison of actual performance to expected results and analysis of significant differences.
- ☐ Lack of effective management of the city's workforce.
- ☐ No physical control over vulnerable assets or limits of access to resources and records – e.g., control log of check stock, accountability of issued checks)
- ☐ No segregation of duties - authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets
 - ☐ Disbursements by check should require the approval and signature of an individual other than the individual recording the transaction and the individual reconciling the bank account.
 - ☐ Opening a new bank account should require the approval and signature from someone outside of the transaction processing role.
 - ☐ Invoice approvals should require verification of receipt of goods/services
- ☐ No mandatory vacation and/or rotation of duties

Control Activities (cont.)

GAO Green Book Principles

Principle 12 – Management should implement control activities through policies.

Dixon deficiencies in its system of internal control

- ☐ No policies documenting the internal control responsibilities.
- ☐ No periodic review of policies, procedures, and related control activities for continued relevance and effectiveness.

Information and Communication

GAO Green Book Principles

Principle 13 – Management should use quality information to achieve the entity's objectives.

Principle 14 – Management should internally communicate the necessary quality information to achieve the entity's objectives.

Principle 15 – Management should externally communicate the necessary quality information to achieve the entity's objectives.

Dixon deficiencies in its system of internal control

- ☐ Management or City Council did not identify information that could have been used to inform users as to the achievement of objectives and related risks.
 - ☐ Certain data (e.g., bank statements) was obtained from internal sources that in hindsight were not reliable.
 - ☐ Data received was not processed into quality information that could be evaluated to make informed decisions.
-
- ☐ Management and the oversight body did not receive quality information that flows up the reporting lines from internal personnel.
 - ☐ Dixon did not have a separate line of communication for internal personnel to report sensitive and/or confidential matters, such as a whistleblower or ethics hotline.
-
- ☐ Management and the oversight body did not receive quality information that flows up the reporting lines from external personnel.
 - ☐ Dixon did not have a separate line of communication for external personnel to report sensitive and/or confidential matters, such as a whistleblower or ethics hotline.

Monitoring

GAO Green Book Principles

Principle 16 – Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.

Principle 17 – Management should remediate identified internal control deficiencies on a timely basis.

Dixon deficiencies in its system of internal control

- ☐ Dixon did not perform any monitoring of its system of internal control.
 - ☐ Consequently Dixon would not have understood if an internal control was not operating effectively or if there was a control gap (i.e., no internal control).
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- ☐ Since there was no monitoring activities, issues were not evaluated or remediated through corrective actions.

Speaker Contact Information

Melinda J. DeCorte
CPA, CFE, CGFM, PMP

Direct: (703) 725-8559
melindadecorte@gmail.com



From undergraduate students to government executives and industry experts, . . . we are all . . . **AGA!**