



**CDIAC**

**CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION**

# DEVELOPING AND ADMINISTERING INTERNAL CONTROLS FOR BOND ACCOUNTABILITY SEPTEMBER 5, 2019





# Audience Polling

## Detailed Directions in Program

Link: *b.Socrative.com/login/student*

Room Name: *CDIAC*

## Questions

What type of agency do you work for?

How many years of experience do you have administering public debt?

What motivated you to attend this program?



**CDIAC**

**CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION**

# SESSION 1

## RISK ASSESSMENT FOR YOUR AGENCY – WHAT CAN GO WRONG?

# Learning Objectives

By the end of this session attendees will be able to:

- 1) Identify need for and objectives of internal controls.
- 2) Identify the potential risks and the likelihood that the risk will occur.
- 3) Determine the impact should the risk occur.

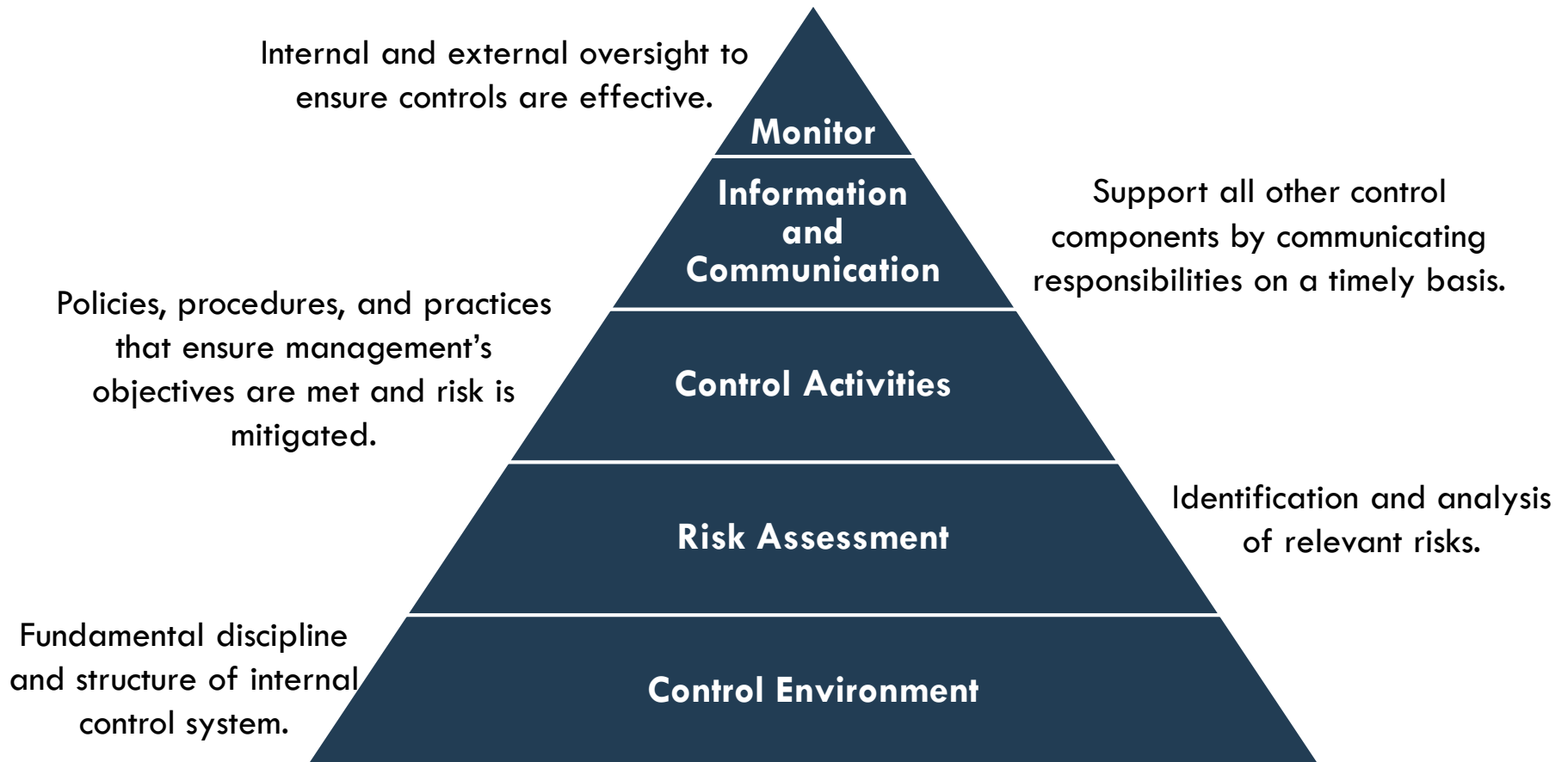
# Internal Controls Defined

**Internal control**, as defined by accounting and auditing, is a process for assuring an organization's objectives in operational effectiveness and efficiency, reliable financial reporting, and compliance with laws, regulations and policies. It encompasses all of the policies and procedures management uses to achieve the following goals:

- Safeguard assets - well designed internal controls protect assets from accidental loss or loss from fraud.
- Ensure the reliability and integrity of financial information - Internal controls ensure that management has accurate, timely and complete information, including accounting records, in order to plan, monitor and report business operations.
- Ensure compliance - Internal controls help to ensure the University is in compliance with the many federal, state and local laws and regulations affecting the operations of our business.
- Promote efficient and effective operations - Internal controls provide an environment in which managers and staff can maximize the efficiency and effectiveness of their operations.
- Accomplishment of goals and objectives - Internal controls system provide a mechanism for management to monitor the achievement of operational goals and objectives

# Internal Controls Framework

Each agency is structured differently, but there is a general framework for analyzing internal controls:



# Recent Consequences of the Lack of Effective Internal Controls

## Misrepresent or omit financial information.

### **New Jersey – 2010**

- First state charged with breaking federal securities laws.
- SEC found they misrepresented and omitted information in bond documents, preliminary official statements, official statements, and continuing disclosures.

## Intentionally fail to disclose material information.

### **San Diego – 2010**

- First time SEC fined municipal officials in a municipal bond fraud case.
- Four officials assessed fines: Former City Manager (\$25K), Comptroller (\$25K), Deputy City Manager (\$25K), Treasurer (\$5k)

## Misuse funds.

### **Harvey, IL – 2014**

- First time SEC filed an emergency court order to keep a municipality's bonds off the market.
- City allegedly siphoned bond funds for general city operations. Additionally, the City allegedly paid and did not disclose \$269,000 of bond proceeds being paid to the comptroller.

# General Considerations

- Variability of bond programs – depending on the purpose of the bond, there can be one or many programs, administering agencies, intended recipients/beneficiaries, funding sources, etc. Accordingly, there is no single set of controls/procedures that will fit every circumstance.
- Ensure adequate separation of duties – particularly risky/challenging for smaller issuers/administering agencies
- Ensure appropriate levels/layers of supervisory/ management review



# Internal Controls - Bond Lifecycle

- Program Start/Planning Phase
- Awarding of Bond Proceeds (e.g. grant awards)
- Disbursement of Bond Proceeds
- Monitoring Activities
- Reporting and Close Out Activities



# Audience Polling

## Detailed Directions in Program

Link: *b.Socrative.com/login/student*

Room Name: CDIAC

## Question

What activity of the bond lifecycle are you the most interested in learning about today?

# Bond Accountability: Risks

**Fund  
Management**

**Legal Use of  
Proceeds**

**Authorizing  
Expenditures**

**Transaction  
Verification**

**Red Flag  
Reporting**

**Standardization  
of Procedures**

**Safeguarding  
Assets**

**Segregation of  
Duties**

# Control Environment

- ▣ Organizational Integrity
- ▣ Maintain Highest Practical Credit Rating
- ▣ Timely Dissemination of Material Financial Information
- ▣ Minimize Transaction Risks
- ▣ Maintain Access to Capital Markets
- ▣ Ensuring Compliance with Legal Requirements

# The Control Activity – Risk Assessment

- Pre-Issuance
  - ▣ Project Identification – Schedule, Sources and Uses of Funds, etc.
  - ▣ Requisitions Control
  - ▣ Tax Due Diligence
  - ▣ Preparation of Financing Schedule
  - ▣ Expenditure/Cash Flow Management
  - ▣ Document Preparation/Review
  - ▣ Fund Establishment

# The Control Activity – Risk Assessment (cont)

- Post-Issuance
  - ▣ Project Management
  - ▣ Fund Monitoring
  - ▣ Requisitions Approval
  - ▣ Expenditure/Payment Approval
  - ▣ Annual certifications pursuant to bond covenants
  - ▣ Annual arbitrage calculation
  - ▣ Debt Service Payments
  - ▣ Reliability of financial data

# Risk Assessment: Possible Risks

- Pre-Issuance
  - ▣ Project Identification Risk Requisitions incorrect
  - ▣ Incorrect Tax Compliance Identified
  - ▣ Incomplete/Incorrect Financing Schedule
  - ▣ Incorrect Funds Established/Incorrect Disbursement Instructions
  - ▣ Restrictive Covenants in Documents not Discovered

# Risk Assessment: Possible Risks

- Post-Issuance
  - ▣ Lack of Segregation of Duties
  - ▣ Missed Debt Service Payment
  - ▣ Incorrect Tax Calculations
  - ▣ Continuing Disclosures not Made
  - ▣ Record Retention
  - ▣ Fraud
  - ▣ Administrative Cost Limits Exceeded
  - ▣ Expenditures Made for Unallowable Purposes



# Risk Assessment: Likelihood Criteria Scoring

Likelihood that the risk event will occur in the next year

Likelihood that the event will occur in the next year	Very Unlikely (0% - 20%)	Unlikely (20% - 50%)	Likely (50% - 80%)	Very Likely (80% - 100%)
	1	2	3	4

# Risk Assessment: Impact Criteria Scoring

Likelihood that the risk event will occur in the next year

Impact on programming if risk event occurs	<b>Very Limited</b>  <b>1</b>  Very limited impact on development programming operations and outcomes. Consequences can be managed under normal operation conditions.	<b>Limited</b>  <b>2</b>  Limited impact on development programming operations and outcomes. Consequences can be managed with limited additional resources and/or managerial effort.	<b>Moderate</b>  <b>3</b>  Moderate impact on development programming operations and outcomes. Consequences can be managed with moderate additional resources and/or managerial effort.	<b>High</b>  <b>4</b>  Significant impact on development programming operations and outcomes. Senior management required to make major adjustments to plans and/or resource allocations.
--	--	---	---	--

# Risk Assessment:

## Factors for Assessing Likelihood

- How the action (control) is performed and the skills of the person performing the action.
- What level of reliance can be placed on IT solutions if the processes are automated?
- Whether or not a action is preventative or detective, i.e. whether it would stop something from happening or merely detect something that has already happened.
- The frequency and timeliness of the action, e.g. daily/weekly/monthly/annually reconciliations.
- The process (reporting mechanism) for flagging errors or control failures.



With so much potential for risk, are there any tools an agency can use to meet their debt management objectives?

*Internal controls help reduce risk and prevent fraud. However, no matter how well-designed the control system, there is always a chance that a determined individual will fraudulently misuse resources. But without an internal control system, management has no reasonable assurance that this is not regularly occurring.*

# QUESTIONS