

INSPECTOR GENERAL INSTITUTE

TRAINING AND CERTIFICATION FOR INSPECTION
AND OVERSIGHT PROFESSIONALS

Internal Controls

Presented by

Presented by

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What Are Internal Controls?

- Internal Control is a process, effected by people (board, management, etc.) designed to provide reasonable assurance regarding the achievement of objectives in three categories:
 - Effectiveness and efficiency of operations
 - Reliability of financial reporting
 - Compliance with applicable laws/regulations



Control Objectives

Control Objectives

Control Activity



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Control Objectives

Control Objectives	Control Activity
Protect assets in your home.	



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Control Objectives

Control Objectives	Control Activity
Protect assets in your home.	Lock door. Set alarm system.



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Control Objectives

Control Objectives	Control Activity
Protect assets in your home.	Lock door. Set alarm system.
Protect your money.	



Control Objectives

Control Objectives	Control Activity
Protect assets in your home.	Lock door. Set alarm system.
Protect your money.	Keep debit card in safe place and do not write down the PIN number.



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Control Objectives

Control Objectives	Control Activity
Protect assets in your home.	Lock door. Set alarm system.
Protect your money.	Keep debit card in safe place and do not write down the PIN number.
Detect inappropriate access to your funds and bank errors.	



Control Objectives

Control Objectives	Control Activity
Protect assets in your home.	Lock door. Set alarm system.
Protect your money.	Keep debit card in safe place and do not write down the PIN number.
Detect inappropriate access to your funds and bank errors.	Balance your bank statement each month.



Control Objectives

Control Objectives	Control Activity
Protect assets in your home.	Lock door. Set alarm system.
Protect your money.	Keep debit card in safe place and do not write down the PIN number.
Detect inappropriate access to your funds and bank errors.	Balance your bank statement each month.
We only pay bills for goods actually ordered and received.	



Control Objectives

Control Objectives	Control Activity
Protect assets in your home.	Lock door. Set alarm system.
Protect your money.	Keep debit card in safe place and do not write down the PIN number.
Detect inappropriate access to your funds and bank errors.	Balance your bank statement each month.
We only pay bills for goods actually ordered and received.	Perform three-way match of original PO, goods receipt information and invoice prior to payment to vendor.



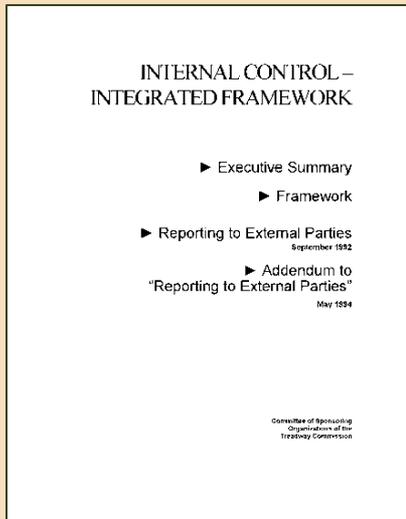
About COSO . . .

Originally formed in 1985, COSO is a joint initiative of five private sector organizations and is dedicated to providing thought leadership through the development of frameworks and guidance on enterprise risk management (ERM), internal control, and fraud deterrence.

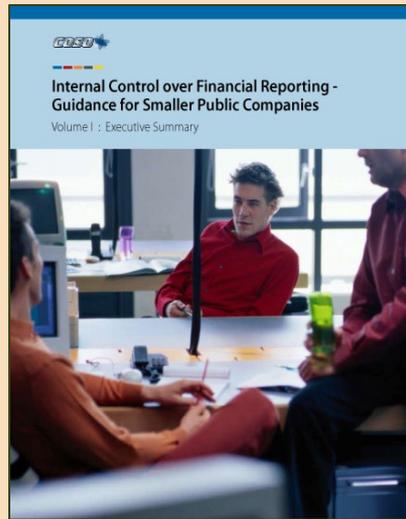
**> 600,000
professionals**



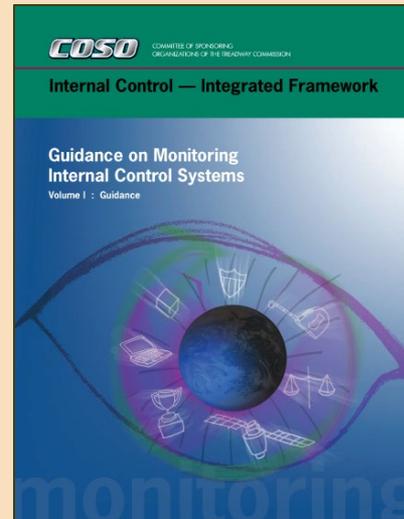
COSO Overview



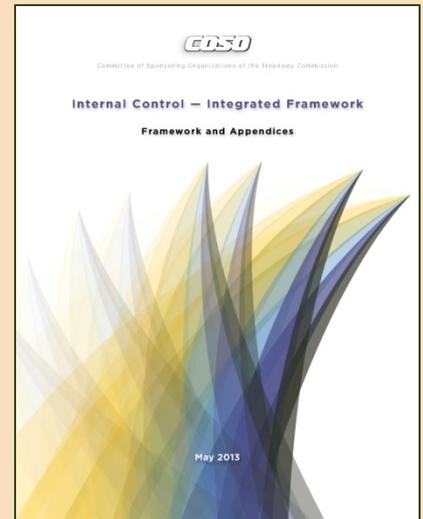
1992



2006



2009



2013



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COSO – Definition of Internal Controls

- Internal control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance.



COSO Report

Committee of Sponsoring Organizations of the Treadway Commission

Objectives

The Framework provides for three categories of objectives, which allow organizations to focus on differing aspects of internal control:

- Operations Objectives—These pertain to **effectiveness and efficiency** of the entity's operations, including operational and financial performance goals, and safeguarding assets against loss.
- Reporting Objectives—These pertain to **internal and external financial and non-financial reporting** and may encompass reliability, timeliness, transparency, or other terms as set forth by regulators, recognized standard setters, or the entity's policies.
- Compliance Objectives—These pertain to **adherence** to laws and regulations to which the entity is subject.



Internal Control Components (COSO)

- 1- Control Environment
- 2- Risk Assessment
- 3- Control Activities
- 4- Communications
- 5- Monitoring

“According to the Generally Accepted Auditing Standards “GAAS”, the auditor is required to understand internal control components.”



Principles of Effective Internal Control

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

17



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Example

Control Environment

1. The organization demonstrates a commitment to integrity and ethical values.

Points of Focus:

- Sets the Tone at the Top
 - Establishes Standards of Conduct
 - Evaluates Adherence to Standards of Conduct
 - Addresses Deviations in a Timely Manner
-
- Points of focus may not be suitable or relevant, and others may be identified
 - Points of focus may facilitate designing, implementing, and conducting internal control
 - There is no requirement to separately assess whether points of focus are in place



How Various Controls Effect Principles

Component

Control Environment

Principle

1. The organization demonstrates a commitment to integrity and ethical values.

Controls embedded in other components may effect this principle

Human Resources review employees' confirmations to assess whether standards of conduct are understood and adhered to by staff across the entity

Control Environment

Management obtains and reviews data and information underlying potential deviations captured in whistleblower hotline to assess quality of information

Information & Communication

Internal Audit separately evaluates Control Environment, considering employee behaviors and whistleblower hotline results and reports thereon

Monitoring Activities

19



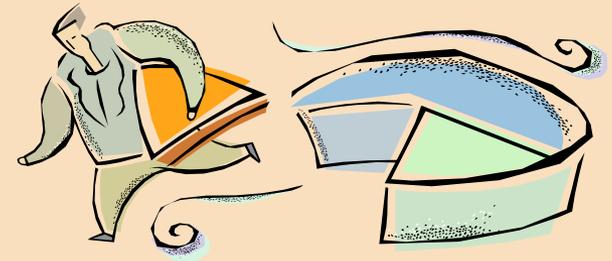
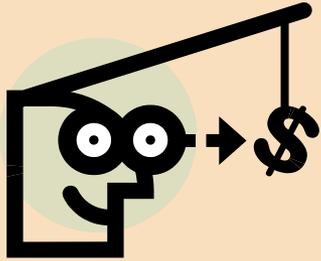
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Why Internal Controls?

Prevent And Detect Fraud, Waste And Abuse

MOTIVE + OPPORTUNITY + JUSTIFICATION



= FRAUD



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Benefits Of Internal Controls

- Ensure internal business is properly transacted.
- Reduce the opportunity for fraud.
- **Protect** elected **officials** and **employees** from personal liability.
- Provide a positive public image by reducing errors, fraud, and mismanagement.



Administrative Controls

Includes but is not limited to the plan of organization and the **procedures and records** that are concerned with the **decision processes** leading to **management's authorization** of transactions. Such authorization is a management function directly associated with the responsibility for achieving the objectives of the organization and in the starting point for establishing accounting control of transactions.



Accounting Controls

Comprises the **plan** of organization and the **procedures and records** that are concerned with the **safeguarding of assets** and the **reliability of financial records** and consequently are designed to produce reasonable assurance that:

- Transactions are executed in accordance with management's general or specific authorization.
- Transactions are recorded as necessary in conformity with Generally Accepted Accounting Principles (GAAP) and to maintain accountability for assets.
- Access to assets is permitted only in accordance with management's authorization.



Standards/Guidance

- COSO Report
Committee of Sponsoring Organizations of the Treadway Commission
- Standards for Internal Control in the Federal Government (2014)
- OMB Circular No. A-123, Dec. 2004 Revision: Management's Responsibility for Internal Control
- Government Auditing Standards (Yellow Book)
- International Standards for the Professional Practice of Internal Auditing (Red Book)



Sarbanes-Oxley Act (2002)

Management's Responsibilities

Section 404 requires management of all **public companies** to issue an internal control report that includes the following:

- A statement that management is responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting.
- An assessment of the effectiveness of the internal control structure and procedures for financial reporting as of the end of the company's fiscal year.



OMB Circular No. A-123

Dec. 2004 Revision: Management's Responsibility for Internal Control

Circular A-123 provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal control. The Circular provides updated internal control standards and *new specific requirements* for conducting management's assessment of the effectiveness of internal control over financial reporting.



OMB Circular No. A-123

Internal Control Components

- Control Environment
 - Risk Assessment
 - Control Activities
- Information and Communications
 - Monitoring



OMB Circular No. A-123

Management 's Responsibilities

Management is responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. Management shall consistently apply the internal control standards to meet each of the internal control objectives and to assess internal control effectiveness.

Annually, management **must** provide assurances on internal control in its Performance and Accountability Report, including a separate assurance on internal control over financial reporting, along with a report on identified material weaknesses and corrective actions.



OMB Circular No. A-123

Action Required

Agencies and individual Federal managers must take systematic and proactive measures to (i) develop and implement appropriate, cost-effective internal control for results-oriented management; (ii) assess the adequacy of internal control in Federal programs and operations; (iii) separately assess and document internal control over financial reporting. (iv) identify needed improvements; (v) take corresponding corrective action; and (vi) report annually on internal control through management assurance statements.



Government Auditing Standards

International Standards for the Professional Practice of Internal Auditing (Practice Advisory 1230-1)

Financial Audits

- Tests of internal control over financial reporting contribute to the evidence supporting the auditors' opinion on the financial statements (GAS 4.20/IIA 2130-1).
- Auditors should state in the reports whether the tests they performed provided sufficient, appropriate evidence to support an opinion on the effectiveness of internal control over financial reporting i.e reasonable assurance about the internal control s effectiveness(GAS 4.20/IIA 2130-1).



Government Auditing Standards

International Standards for the Professional Practice of Internal Auditing (Practice Advisory 1230-1)

Financial Audits

For all financial audits, auditors should report the following deficiencies in internal control (GAS 4.24):

- a- Significant Deficiencies
- b- Material Weaknesses



Government Auditing Standards

Attestation Engagements

In planning examination-level attestation engagements, auditors should obtain a sufficient understanding of internal control that is material to the subject matter in order to plan the engagement and design procedures to achieve the objectives of the attestation engagement.



Government Auditing Standards

International Standards for the Professional Practice of Internal Auditing (Practice Advisory 1230-1)

Performance Audits

- Auditors should obtain an understanding of internal control that is significant within the context of the audit objectives (GAS 6.16/IIA 2130-1).
- Auditors may modify the nature, timing, or extent of the audit procedures based on the auditors' assessment of internal control (GAS 6.17/IIA 2130-1).
- Auditors may obtain an understanding of internal control through inquiries, observations, inspection of documents and records, review of other auditors' reports, or direct tests (GAS 6.18/IIA 2130-1).



1. Control Environment

Organizational Culture

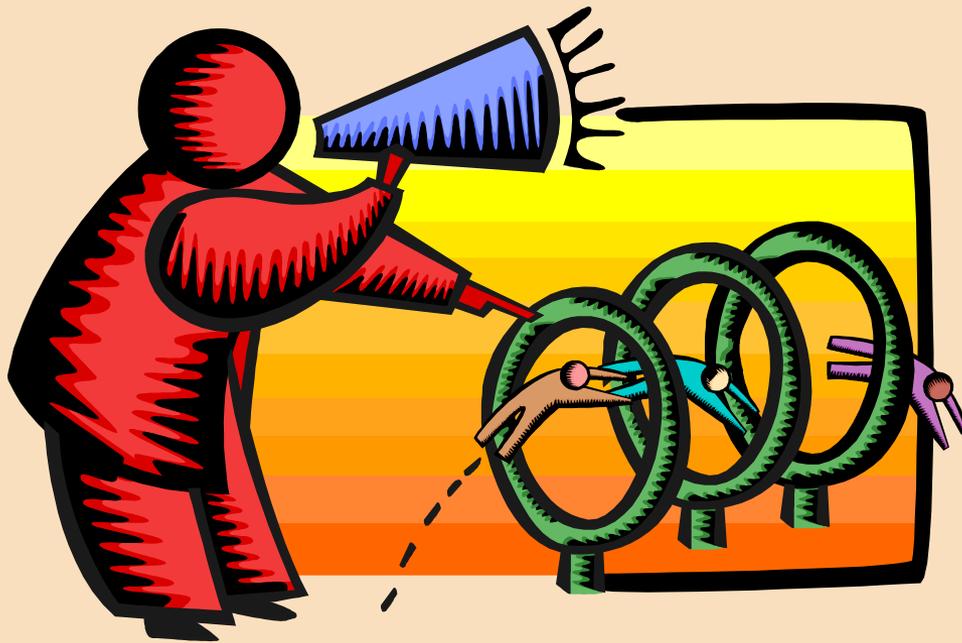
Management Attitude

Management Philosophy

General Atmosphere



The Most Effective Control: Management Attitude



Management must set the tone. Staff won't use internal controls if their management does not take internal controls seriously. *"Code of Conduct"*

Lead by example!



2. Risk Assessment

Changes.. Changes.. Changes..

New Technology

New Client

New Manager

New Employee

New Laws and Regulations

New Standards

New Transactions



3. Control Activities

Segregation of Duties

Safeguarding of Assets

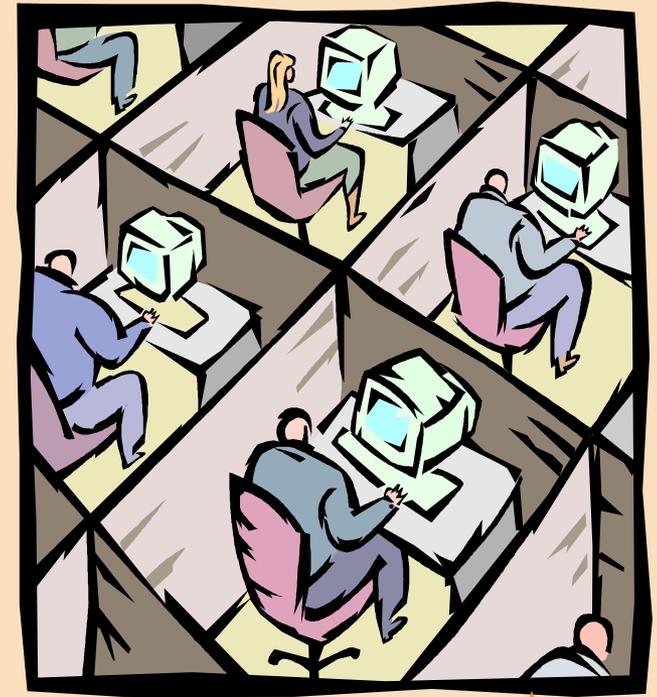
Proper Authorization of Transactions

Proper Documentation



Segregated Duties

- The same person must not receive goods, prepare the pay voucher, and approve pay voucher
- Payroll clerks must not pick up and distribute pay checks
- Employees must be added to payroll only with input from an approved Pay Action Form by Payroll



4. Communications

Effective communication methods for policies
and procedures

Accounting Information System



5. Monitoring

Assess the internal control effectiveness

Update the internal control system continuously



Internal Control Activities

Examples

- Authorization and approval
- Review of operating performances
- Supervision (assigning, reviewing/approving, direction, training)
- Controls over access to resources and records, separation of duties
- Reconciliations
- Verifications
- **Regular reviews of processes and activities**



Types of Control Activities

- Directive
 - Policies and procedures
 - Laws and regulations
 - Training seminars
 - Job descriptions
 - Meetings



Types of Control Activities

■ Preventive

- Segregation of duties (authorization, recordkeeping & custody of the related assets should not be performed by the one same individual)
- Physical control over assets
- Locking office door to discourage theft
- Using passwords to restrict computer access
- Shredding documents with confidential information



Types of Control Activities

■ Detective

- Exception reports which list incorrect or invalid entries or transactions
- Reviews and comparisons
- Reconciliations
- Physical counts of inventories



Components of Internal Control

To be effective, control activities must be

- Appropriate
- Functioning consistently
- Cost effective, comprehensive, reasonable
- Directly related to the control objective



Internal Control Myths & Facts

Myths

- Internal Controls start with a strong set of policies and procedures.
- Internal Controls! That's why we have internal auditors!
- Internal Controls is a “finance thing”
- Internal Controls are essentially negative, like a list of do's and don'ts

Facts

- Internal Controls start with a strong control environment
- While the internal auditors play a key role in the control system, management is the primary owner
- Internal Control is integral to every aspect of operations
- Internal Controls make the right things happen the first time



Questions/ Comments

