

OHIO AUDITOR OF STATE  
KEITH FABER

## Internal Controls

Why are internal controls important and why do we need them?

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## What is Internal Control?

Internal Control  
Process implemented by an entity's oversight body, management, and other personnel that provides *reasonable assurance* that the objectives of an entity will be achieved

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Objectives can be broadly classified into one or more of the following three classifications

Operations      Reporting      Compliance

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An objective can fall under one category, can address different needs, and may be a direct responsibility of internal control

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## What do Internal Controls look like?

Internal Control	<ul style="list-style-type: none"> <li>• Plans, methods, policies, and procedures</li> <li>• Continuous built-in component of operations</li> </ul>
Management	<ul style="list-style-type: none"> <li>• Responsible for designing an effective internal control system</li> </ul>
Personnel	<ul style="list-style-type: none"> <li>• Make the internal control system work</li> </ul>

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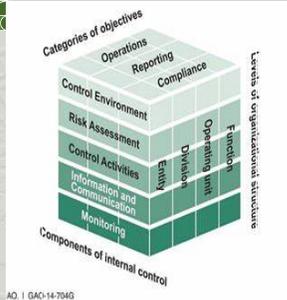
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## Internal Control Components

### Five Components of Internal Control

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



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## What are Internal Controls going to do for us?

### Effective internal control system

- Increases the likelihood that an entity will achieve its objectives
- Reduces the risk of fraud or error

### Cannot provide absolute assurance

- Factors outside the control or influence of management can affect
- Examples: Natural disaster or collusion

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## How do we implement internal controls?



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## Focus of Internal Control

**Integrity of Information**

- Financial or non-financial

**Examples**

- Employee Information
- Vendor Information
- Bank Reconciliation information
- Capital Assets/Inventory Information

**Questions to Ask**

- How accurate is the information used to process the information?
- Who approves the information or changes to the information before and after input into the system?

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## Focus of Internal Control

**Authorization**

- Access to the information should be limited and monitored
- Questions to ask:
  - Who has access to the information?
  - Who has authorization to change or alter the information?
  - Are changes to information approved?

**Segregation of Duties**

- Not one person should be responsible for all functions of any process.
- This includes, but is not limited to
  - Payroll
  - Receipts
  - Expenditures

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## Focus of Internal Control

**Review and responsibility**

- Work should be regularly checked by officials or their designee

**Examples:**

- Payroll
  - Personnel records / payroll roster, Employee pay rates and leave entitlements, Verifying payroll reports agree to the bank statements
- Vendor
  - Vendor Master File, Vendor Payments
- Bank Reconciliations
  - Prepared monthly, Review all information on the bank reconciliation including the underlying information
- Capital Assets
  - Capital assets/inventory listing

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## Controlling the Controls

Must use every time	Verify Working
Not enough to just set up Internal Controls!	
Periodic Monitoring	Adjust when needed

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## Document, Document, Document

Maintain Documentation of Internal Controls being performed

- Assists in the internal review process
- Provides evidence to auditors

Example:

- Control: Invoices are reviewed prior to payment to determine that the goods or services were received and the payment is for the proper amount/proper public purpose
- Control Evidence: Invoice is marked "ok to pay" by the department employee who has knowledge of the expense"

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## Internal Control Deficiencies

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect fraud, errors/noncompliance, and/or financial reporting misstatements on a timely basis.

Take corrective action	Basis for improvement	Over time will get better
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## Things to Remember

Monitor Internal Controls

- Changes to policies and procedures
- Communicated to employees

Not enough to implement internal controls

- If the controls aren't working – change the internal controls

Controls must be followed

- EVERY time not just SOME of the time
- Not following the control process one time is too many-
  - That might when fraud/misuse, errors or misstatements occur

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