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

Internal Controls

What is 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
- Objectives can be broadly classified into one or more of the following three classifications:
  - Operations
  - Reporting
  - Compliance
- An objective can fall under one category, can address different needs, and may be a direct responsibility of internal control

What do Internal Controls look like?

- Internal Control
  - Plans, methods, policies, and procedures
  - Continuous built-in component of operations
- Management
  - Responsible for designing an effective internal control system
- Personnel
  - Make the internal control system work
Five Components of Internal Control
• Control Environment
• Risk Assessment
• Control Activities
• Information and Communication
• Monitoring

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

What are Internal Controls going to do for us?

How do we implement internal controls?

- Establish
  - Policies and Procedures
- Communicate
  - To Personnel
- Adjust Internal Controls
  - As needed
- Reviews
  - Periodically and Regularly
- Repeat
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
Controlling the Controls

- Must use every time
- Periodic Monitoring
- Adjust when needed
- Verify Working

Not enough to just set up Internal Controls!

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

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
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 once is too many
- That might when fraud/misuse, errors or misstatements occur

WHO ELSE IS EXCITED
ABOUT INTERNAL CONTROLS

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