INTERNAL CONTROLS

2023 Annual Clerks Conference

Indiana State Board of Accounts

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WHAT ARE INTERNAL CONTROLS?

Why do we need them?

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INTERNAL CONTROL - DEFINITION

Internal control is the process by which management structures an organization to provide assurance that an entity operates effectively and efficiently, has reliable financial reporting system and complies with applicable laws and regulations.

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INTERNAL CONTROL - PURPOSE

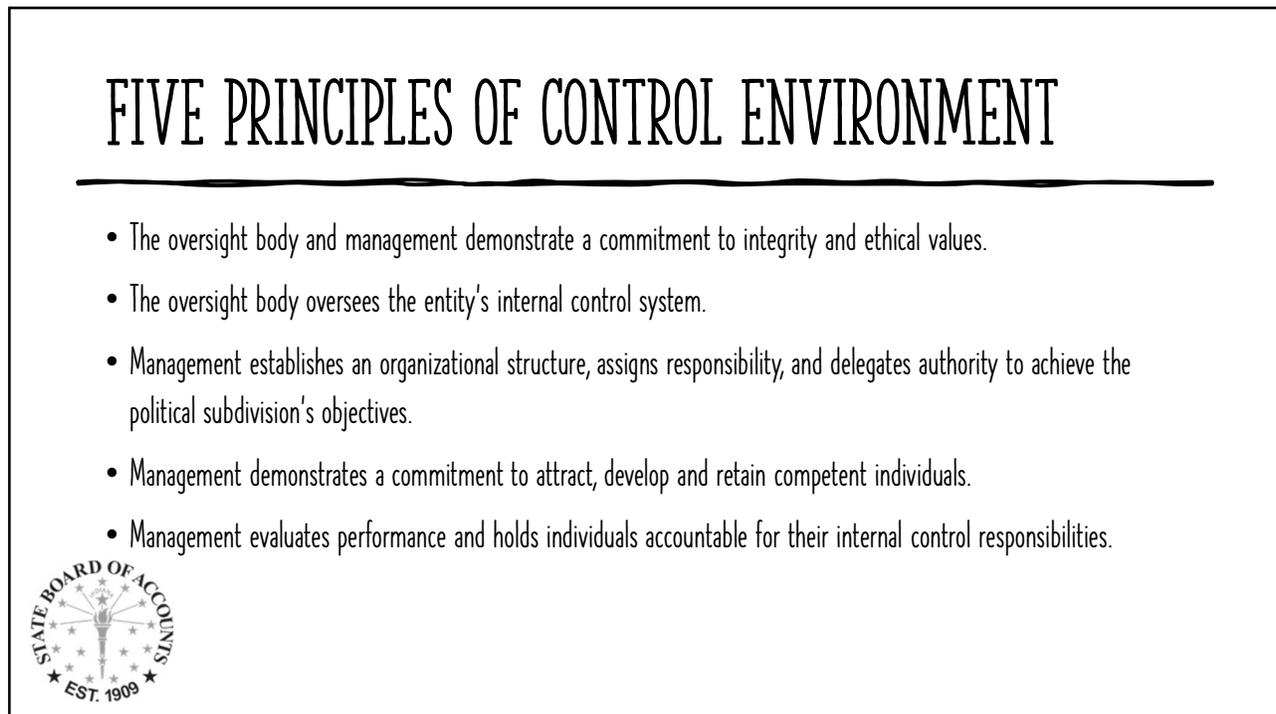To combat fraud and mistakes by preventing opportunity, detecting fraud, errors, and omissions.

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FIVE COMPONENTS

🖥	Control Environment
⚠	Risk Assessment
📋	Control Activities
✉	Information and Communication
✓	Monitoring Activities

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FIVE PRINCIPLES OF CONTROL ENVIRONMENT

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

- The oversight body oversees the entity's internal control system.

- Management establishes an organizational structure, assigns responsibility, and delegates authority to achieve the political subdivision's objectives.

- Management demonstrates a commitment to attract, develop and retain competent individuals.

- Management evaluates performance and holds individuals accountable for their internal control responsibilities.

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THREE PRINCIPLES OF CONTROL ACTIVITIES

- Management designs control activities to achieve objectives and respond to risks.

- Management designs the political subdivision's information system and related control activities to achieve objectives and respond to risks.

- Management implements control activities through policies.

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THREE PRINCIPLES OF INFORMATION AND COMMUNICATION

- Management uses quality information to achieve the political subdivision's objectives.

- Management internally communicates the necessary quality information to achieve the political subdivision's objectives.

- Management externally communicates the necessary quality information to achieve the entity's objectives.

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WHAT IS RISK?

What is risk assessment?

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RISK - DEFINITION

The possibility that an event will occur and adversely affect the achievement of objectives.

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RISK ASSESSMENT – DEFINITION

The process used to identify and assess internal and external risks to the achievement of objectives, and then establish risk tolerances.

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MANAGEMENT DEFINES OBJECTIVES CLEARLY TO ENABLE THE IDENTIFICATION OF RISKS AND DEFINES RISK TOLERANCES.

- Objectives defined in clear terms will include information such as:
  - who is to achieve the objective,
  - how the objective will be achieved, and
  - when the objective will be achieved.

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MANAGEMENT IDENTIFIES, ANALYZES, AND RESPONDS TO RISK RELATED TO ACHIEVING THE DEFINED OBJECTIVES.

Management analyzes identified risk to estimate the effect of the risk on achieving the defined objectives at the entity level and transaction level. For example,

- How likely is the risk to occur?
- How will it impact the objective?
- Is the risk based on complex or unusual transactions?
- Is the risk based on fraud?

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MANAGEMENT CONSIDERS THE POTENTIAL FOR FRAUD WHEN IDENTIFYING, ANALYZING, AND RESPONDING TO RISKS.

- The types of fraud which could impact the achievement of objectives include fraudulent financial reporting, misappropriation of assets, and corruption.
- As a part of this analysis, fraud risk factors are identified: pressure, opportunity, and rationalization.

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MANAGEMENT IDENTIFIES, ANALYZES, AND RESPONDS TO SIGNIFICANT CHANGES THAT COULD IMPACT THE INTERNAL CONTROL SYSTEM.

- Internal control is a process, and part of that process is the responsibility for management to be <u>continually aware of changes,</u> both external and internal, that could affect the achievement of the political subdivision's objectives.

- Those changes should be analyzed for both their immediate effect and for any future impact.

- Management would then determine any modifications needed in the internal control process to adapt to these changes.

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SUMMARY OF RISK ASSESSMENT

Set your goals

Identify risks that could prevent you from reaching the goals

Risk analysis

Formulate a plan to address those risks

Determine your risk tolerance

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WHAT IS MONITORING?

Why is it important?

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MONITORING - DEFINITION

activities currently in place to evaluate the effectiveness of mitigation/management activities for each sub-risk.

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MANAGEMENT ESTABLISHES AND OPERATES MONITORING ACTIVITIES TO MONITOR THE INTERNAL CONTROL SYSTEM AND EVALUATE THE RESULTS.

- A baseline of the current state of the internal control system is compared against the original design of the internal control system. The baseline consists of issues and deficiencies identified in the internal control system.

- The results of the monitoring process are evaluated and documented. Potential changes to the internal control system are identified.

- Control and monitoring activities may be the same, but it is the intent of the activity that distinguishes which component the activity is supporting.

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MANAGEMENT REMEDIATES IDENTIFIED INTERNAL CONTROL DEFICIENCIES ON A TIMELY BASIS.

- Management establishes a mechanism for personnel to report internal control issues identified while performing their responsibilities. These issues are documented and evaluated on a timely basis.

- Management remediates identified issues. Corrective actions include resolution of audit findings.

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SUMMARY OF MONITORING

Assess the quality of performance over time	Ensure that audit findings and results are promptly resolved
Ensure that the results of internal reviews are promptly resolved	Should be ongoing monitoring and separate evaluations

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QUESTIONS?

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