



Accountability and Grants Management: Connecting the Dots



INTERNAL CONTROLS



*U.S. Department of Labor, ETA, Region 4
Discretionary Grantee Training Conference
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The COSO* Definition of Internal Control

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 in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

* Committee of Sponsoring Organizations of the Treadway Commission

Simple Definition

- Internal control is what we do to see that the things we want to have happen **will** happen ...
- And the things we don't want to happen **won't** happen.

Internal Controls Are *Common Sense*



What do you worry about going wrong?

What steps have been taken to assure it doesn't?



How do you know things are under control?

YOU exercise internal control principles in your personal life when you:

- Lock-up valuable belongings
- Keep copies of your tax returns
- Balance your checkbook
- Keep your ATM/debit card PIN number separate from your card
- Compare your monthly credit card statement to the credit card receipts
- Lock your car doors

Objectives of Internal Control

- Internal controls are established to further strengthen:
 - The reliability and integrity of information.
 - Compliance with policies, plans, procedures, laws and regulations.
 - The safeguarding of assets.
 - The economical and efficient use of resources.
 - The accomplishment of established objectives and goals for operations or programs.

Weak Internal Controls

Increase Risk Through...



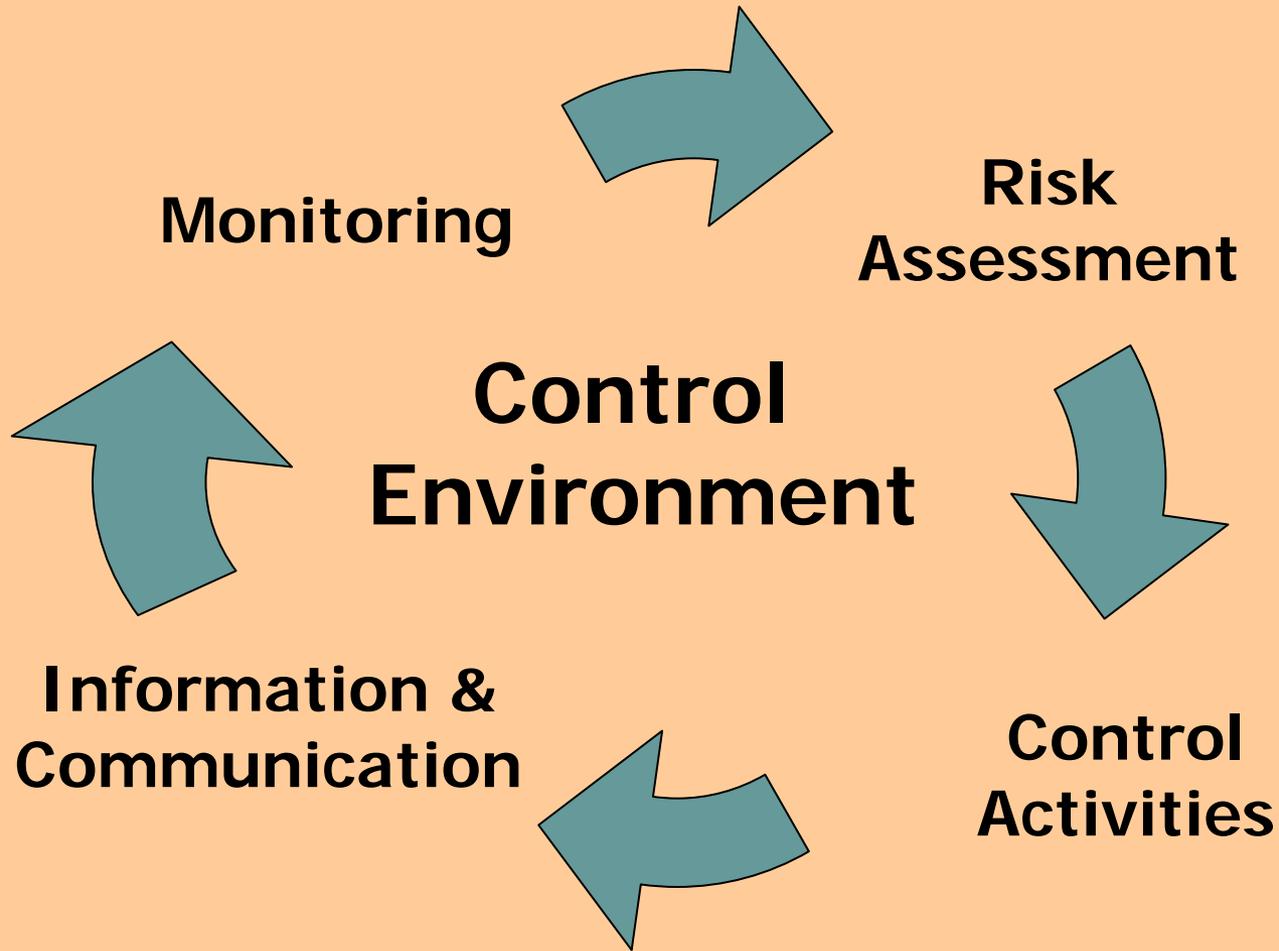
- Business Interruption
system breakdowns or catastrophes, excessive re-work to correct for errors.
- Erroneous Management Decisions
based on erroneous, inadequate or misleading information.
- Fraud, Embezzlement and Theft
by management, employees, customers, vendors, or the public-at-large.



- Statutory Sanctions
penalties arising from failure to comply with regulatory requirements, as well as overt violations.
- Excessive Costs/Deficient Revenues
expenses which could have been avoided, as well as loss of revenues to which the organization is entitled.
- Loss, Misuse or Destruction of Assets
unintentional loss of physical assets such as cash, inventory, and equipment.

Internal Control Framework...

Five Inter-Related Standards:





1. Control Environment

- Foundation for all other standards of internal control.
- Pervasive influence on all the decisions and activities of an organization.
- Effective organizations set a positive “**tone at the top**”.
- Factors include the integrity, ethical values and competence of employees, and, management’s philosophy & operating style.



2. Risk Assessment

- Risks are internal & external events (economic conditions, staffing changes, new systems, regulatory changes, natural disasters, etc.) that threaten the accomplishment of objectives.
- Risk assessment is the process of identifying, evaluating, and deciding how to manage these events... *What is the likelihood of the event occurring? What would be the impact if it were to occur? What can we do to prevent or reduce the risk?*



3. Control Activities

- Tools - policies, procedures, processes -designed and implemented to help ensure that management directives are carried out.
- Help prevent or reduce the risks that can impede the accomplishment of objectives.
- Occur throughout the organization, at all levels, and in all functions.
- Includes approvals, authorizations, verifications, reconciliations, security of assets, reviews of operating performance, and segregation of duties.



4. Communication & Information

- Pertinent information must be captured, identified and communicated on a timely basis.
- Effective information and communication systems enable the organization's people to exchange the information needed to conduct, manage, and control its operations.



5. Monitoring

- Internal control systems must be monitored to assess their effectiveness... *Are they operating as intended?*
- Ongoing monitoring is necessary to react dynamically to changing conditions... *Have controls become outdated, redundant, or obsolete?*
- Monitoring occurs in the course of everyday operations, it includes regular management & supervisory activities and other actions personnel take in performing their duties.

Your Organization Benefits from Strong Internal Controls by:

- Reducing and preventing errors in a cost-effective manner.
- Ensuring priority issues are identified and addressed.
- Protecting employees & resources.
- Providing appropriate checks and balances.
- Having more efficient audits, resulting in shorter timelines, less testing, and fewer demands on staff.

Effective Internal Controls...

- Make sense within each organization's unique operating environment.
- Benefit rather than encumber management.
- Are not stand-alone practices; they are woven into day-to-day responsibilities.
- Are cost-effective.

Important Concepts...

- Internal control is a process; it is a means to an end, not an end itself.
- Internal control is effected by people; it's not merely policy manuals and forms but people at every level of an organization.
- Internal control can be expected to only provide reasonable assurance, not absolute assurance.

Five Key Internal Control Activities...



1. Separation of Duties

- Divide responsibilities between different employees so one individual doesn't control all aspects of a transaction.
- Reduce the opportunity for an employee to commit and conceal errors (intentional or unintentional) or perpetrate fraud.

2. Documentation

Document & preserve evidence to substantiate:

- Critical decisions and significant events...typically involving the use, commitment, or transfer of resources.
- Transactions...enables a transaction to be traced from its inception to completion.
- Policies & Procedures...documents which set forth the fundamental principles and methods that employees rely on to do their jobs.

3. Authorization & Approvals

- Management documents and communicates which activities require approval, and by whom, based on the level of risk to the organization.
- Ensure that transactions are approved and executed only by employees acting within the scope of their authority granted by management.

4. Security of Assets

- Secure and restrict access to equipment, cash, inventory, confidential information, etc. to reduce the risk of loss or unauthorized use.
- Perform periodic physical inventories to verify existence, quantities, location, condition, and utilization.
- Base the level of security on the vulnerability of items being secured, the likelihood of loss, and the potential impact should a loss occur.

5. Reconciliation & Review

- Examine transactions, information, and events to verify accuracy, completeness, appropriateness, and compliance.
- Base level of review on materiality, risk, and overall importance to organization's objectives.
- Ensure frequency is adequate enough to detect and act upon questionable activities in a timely manner.



Internal Control Limitations

- Cost Considerations
- Management Overrides
- Risk of Collusion

Internal Control Myths and Facts

MYTHS:

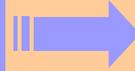
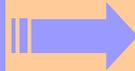
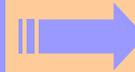
Internal control starts with a strong set of policies and procedures.

Internal control: That's why we have internal auditors!

Internal control is a finance thing.

Internal controls are essentially negative, like a list of "thou-shalt-nots."

Internal controls take time away from our core activities of serving customers.



FACTS:

Internal control starts with a strong control environment.

While internal auditors play a key role in the system of control, management is the primary owner of internal control.

Internal control is integral to every aspect of business.

Internal control makes the right things happen the first time.

Internal controls should be built "into," not "onto" business processes.



QUESTIONS?





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THANKS!

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