

Understanding Internal Controls



Federal Highway Administration
New Mexico Division

Agenda and Objectives

-  Defining and discussing the importance of internal controls
-  Identify control objectives and techniques
-  Define the five standards and understand their intention
-  Identifying how the standards are used

“Internal Controls – organization, policies, and procedures – are tools to help program and financial managers achieve results and safeguard the integrity of their programs.” OMB Definition

What are Internal Controls



“How can I effectively, efficiently, and economically carry out my responsibilities for the proper stewardship of the public resources for which I am accountable?”

The Road Map

Effective Internal Control Program

Types of Controls



Directive



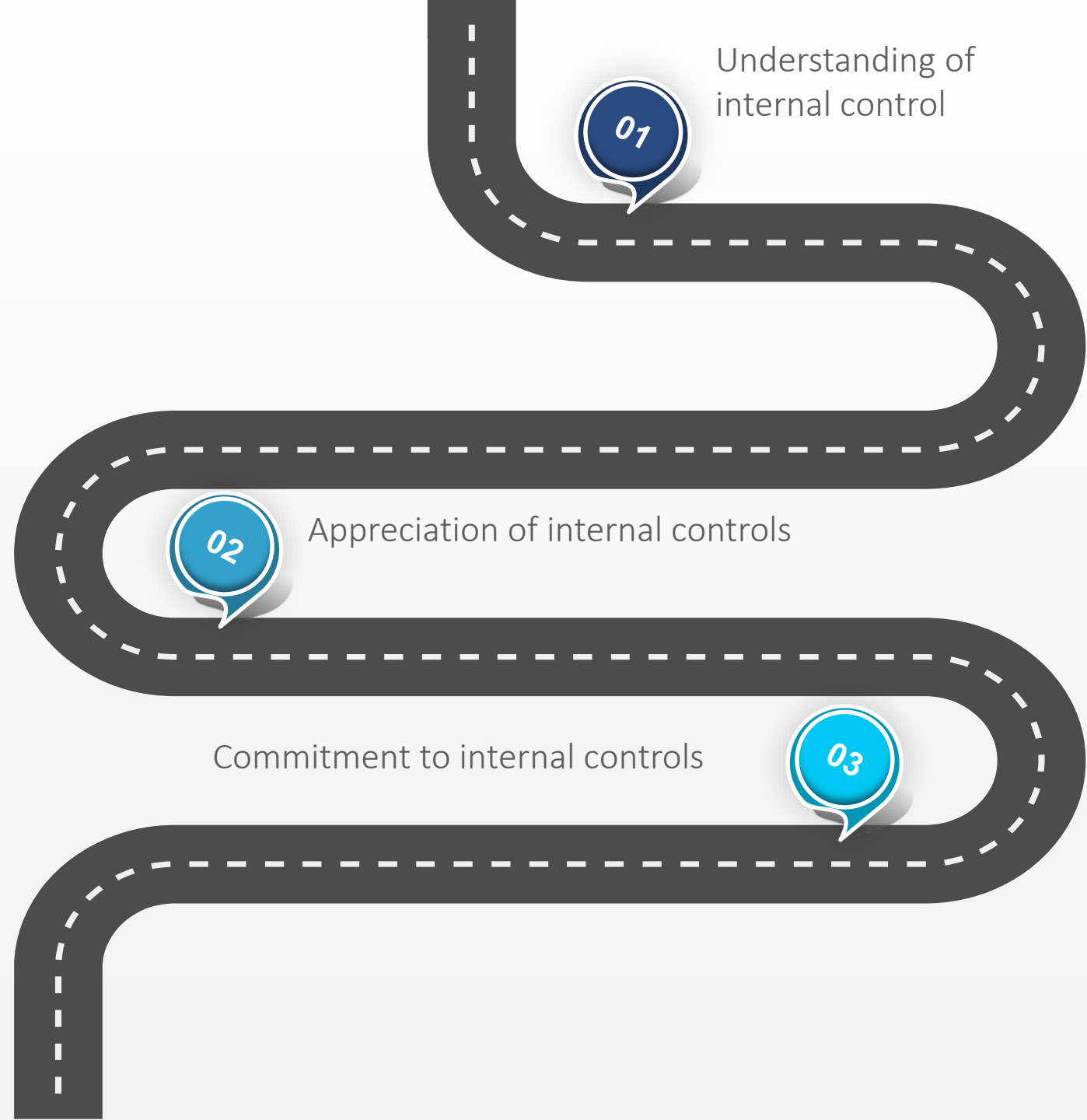
Preventive



Detective



Corrective



Accountability

01 Use of resources is consistent with agency mission

02 Programs and resources are protected from waste, fraud, and mismanagement

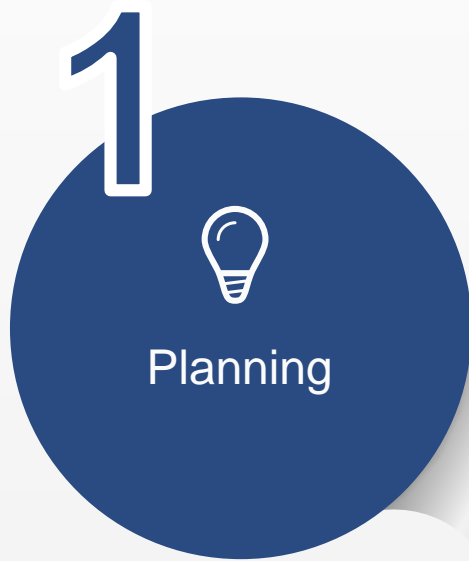
03 Laws and regulations are followed

04 Reliable/timely information is obtained, maintained, reports, and used for decision making



Three Objective of Internal Controls

Effective and efficiency of operations



Compliance with applicable laws and regulations

Reliability of financial reporting

GAO Definition

Internal Controls – organization, policies, and procedures – are tools to help program and financial managers achieve results and safeguard the integrity of their programs.

Effectiveness and efficiency of operations

Reasonable assurance that objectives will be achieved



Reliability of financial reporting

Compliance with applicable laws and regulations

Why Internal Controls are Important

Public

Public demands for accountability in the use of taxpayer dollars.



Everyone is interested

Congress, OMB, GAO, OIGs, agency management, the media.

Resources

Internal controls are the normal, common sense approach to the management and protection of various types of resources



Effectiveness

Internal controls are the means to accomplish a mission within available resources

Importance of Internal Controls in an Organization



Fundamental Components of Internal Control



Control Objectives

Statements about what is supposed to happen. Found in Laws, government-wide and agency regulations, agency goals and performance measures, policy statements and in operations manuals.



Control Techniques

Specific steps, activities, or procedures that are performed to implement the control objectives. They tell how internal controls objectives are to be carried out.

Control Objectives

Plans and Policies

What Management wants to happen (or not to happen).

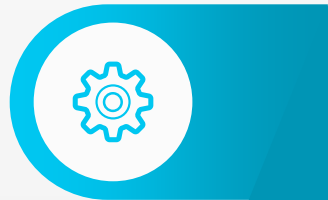


Control Objectives Should Be

Written, complete, appropriate,
measurable, and logical



Tailor-made for the
program/function/activity –
not “canned”



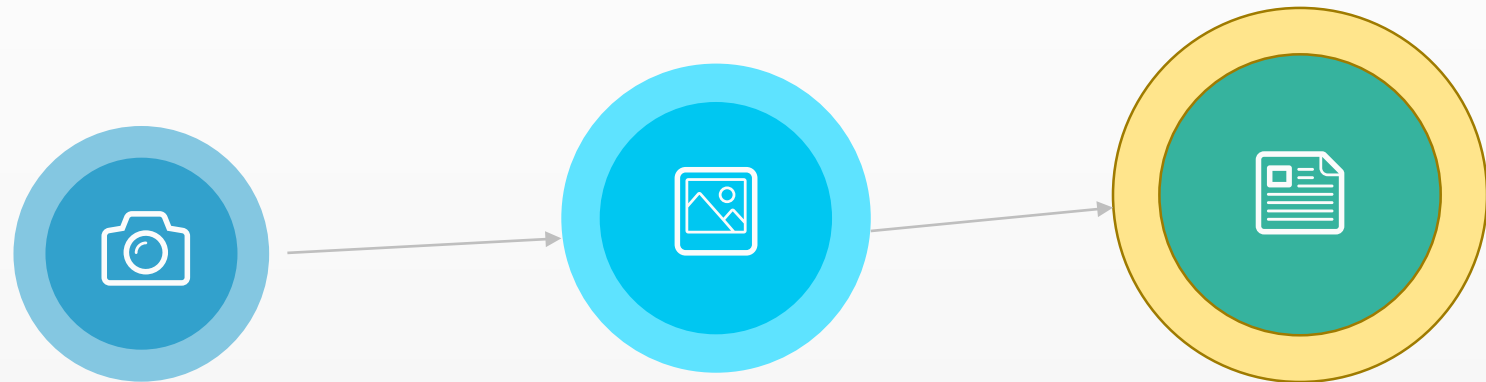
Supporting the achievement
of the mission and the
overall goals of the internal
control mandates



Specifically designed for each
situation management wants
to “manage”



Control Objectives Helps Us To



Identify control techniques or mechanisms

Evaluate the control system

Provide documented response criteria for addressing risk

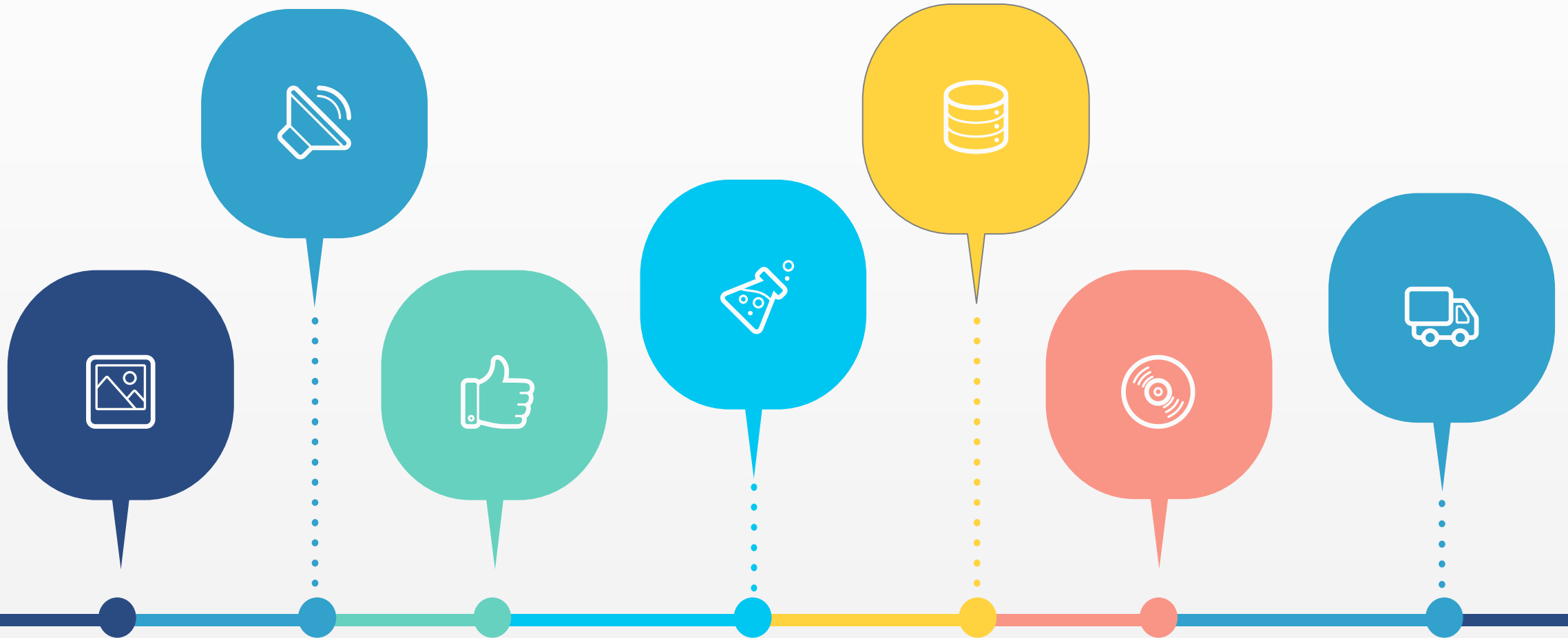
Establishing an Effective Control Objective

Identifying what you want to happen



Identify what you don't want to happen

Control Techniques



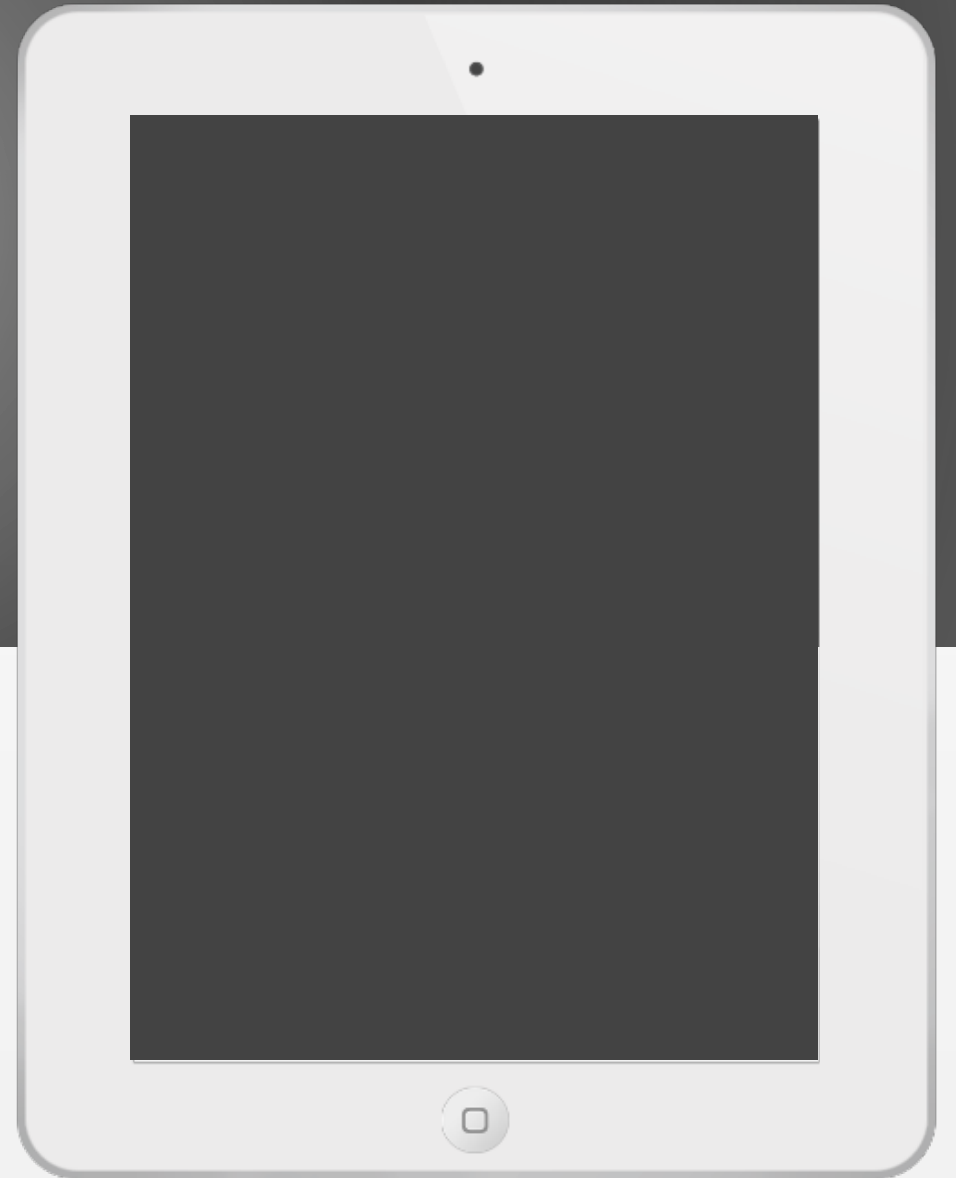
Control Techniques helps us achieve our Control Objectives

Identifying and Developing Internal Control Techniques

- *Major work is based on well-designed procedures,*
- *Provide consistency of treatment of similar transactions.*
- *Ensuring accuracy, provide directions, and increase productivity*



Examples of Control Techniques



Questions to ask when developing control techniques

What needs to happen in this process?

How should they do this process?

What essential steps are needed to carry out the process?

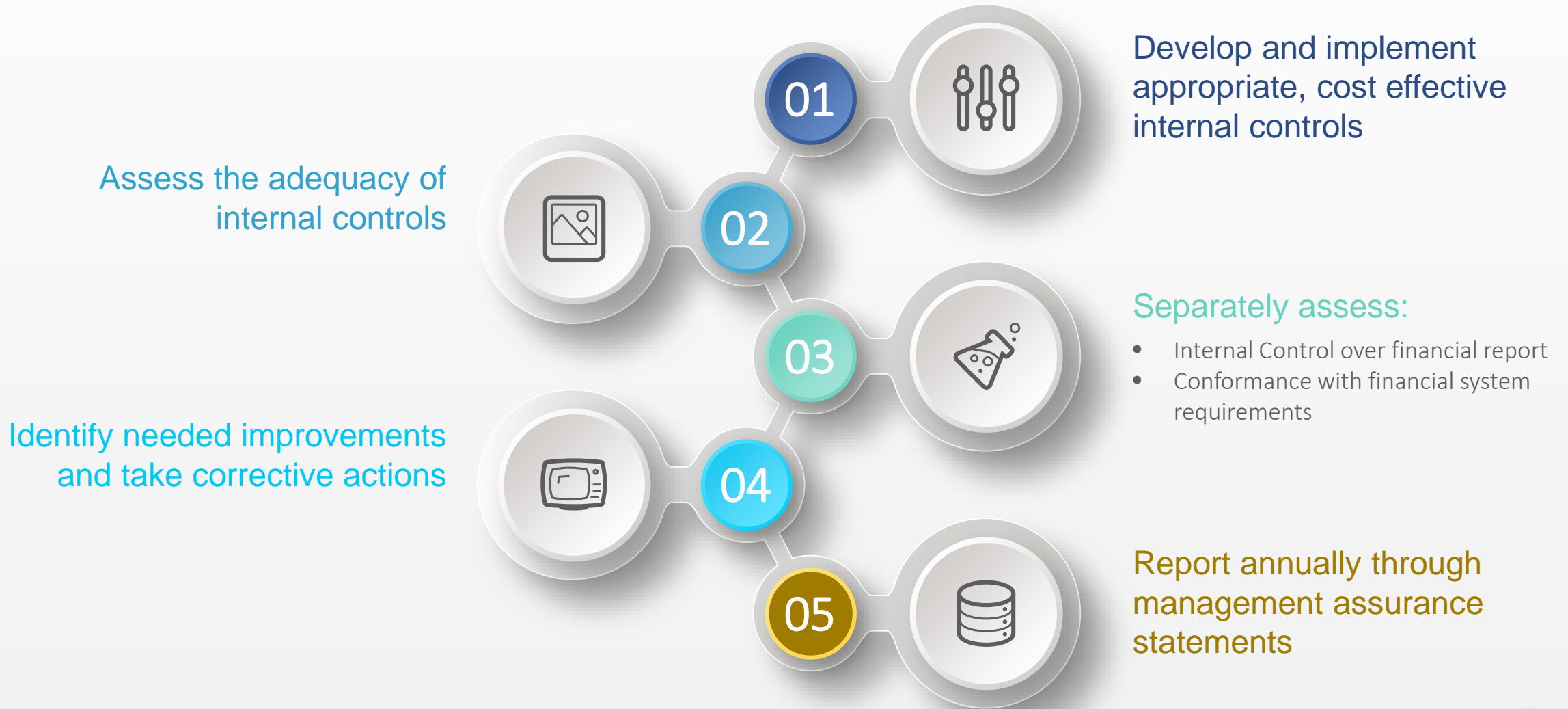
When do they do this process?

Who performs this process and what do they need to know and do?

What are the inputs and outputs of this process?



What Controls Mean to Managers



What Reasonable Assurance Recognizes



Human mistakes, judgement errors, and acts of collusion to circumvent controls can negatively affect meeting agency objectives



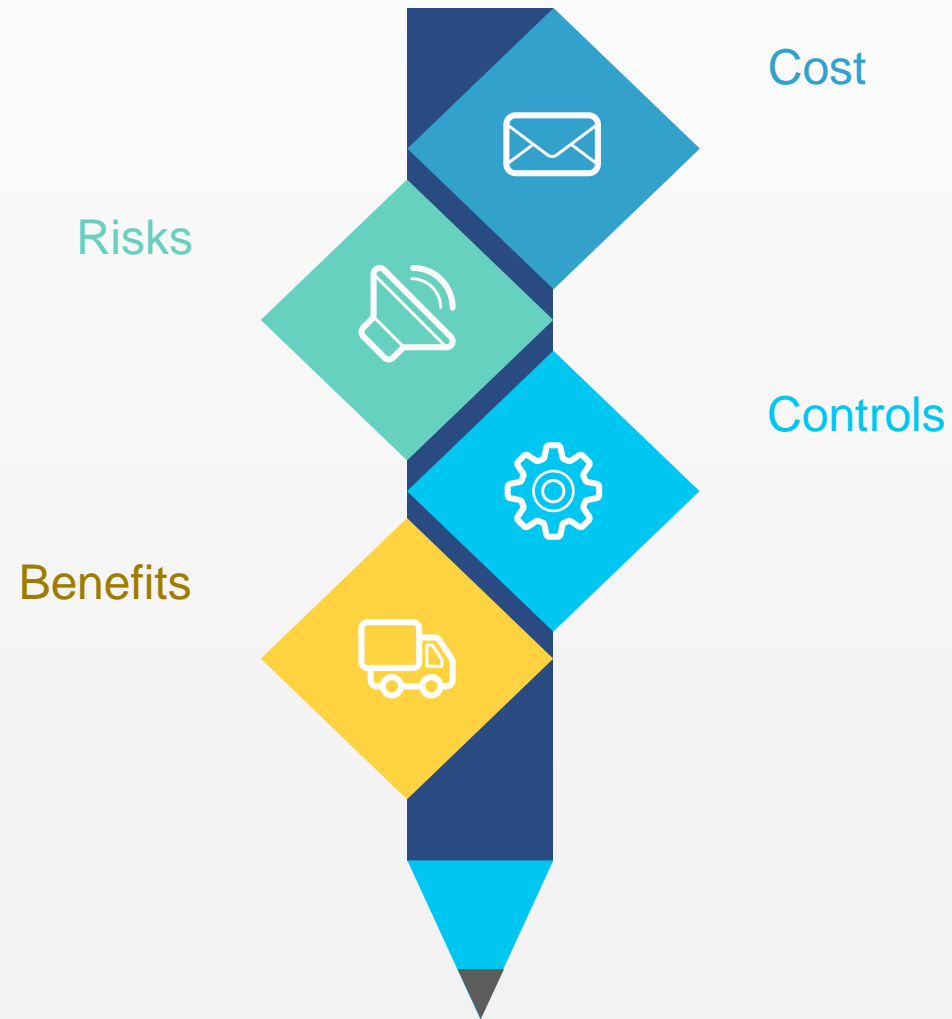
There are lifecycle costs and benefits of controls



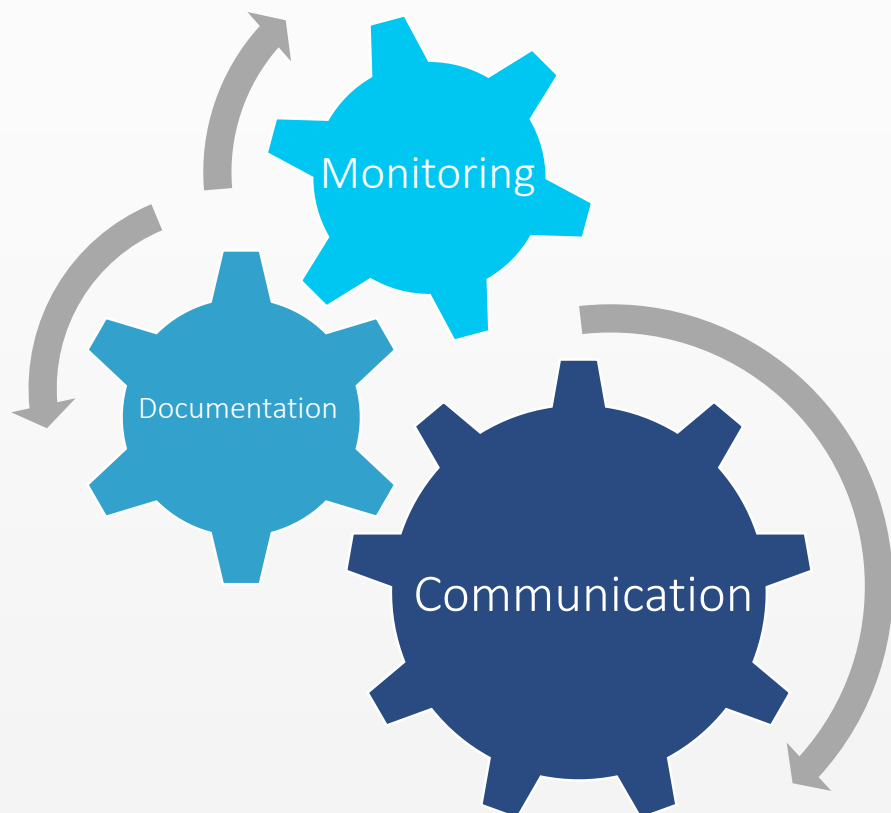
The cost of a control should not exceed the benefits likely to be derived



Balancing Our Control Programs



Manager Responsibilities



- Clearly defining and communicating organizational mission and goals
- Assessing risks
- Deciding where controls are needed
- Designing and developing written descriptions of controls
- Communicating these controls to all personnel
- Placing controls in operations
- Continuously monitoring and improving the effectiveness of internal controls
- Periodically testing (evaluating) controls
- Eliminating duplicate or excess controls and improving weak controls
- Reporting on whether controls are in place and working effectively
- Taking timely and effective action to correct deficiencies
- Tracking progress on correcting deficiencies to ensure timely and effective results
- Identifying consequences when controls fail

Problems Arise

Auditors Secret



Lack of control objective or control techniques



An inadequate control objective or control technique



Failure to follow internal controls



Internal Control Deficiencies

Lack of Education about Internal Control

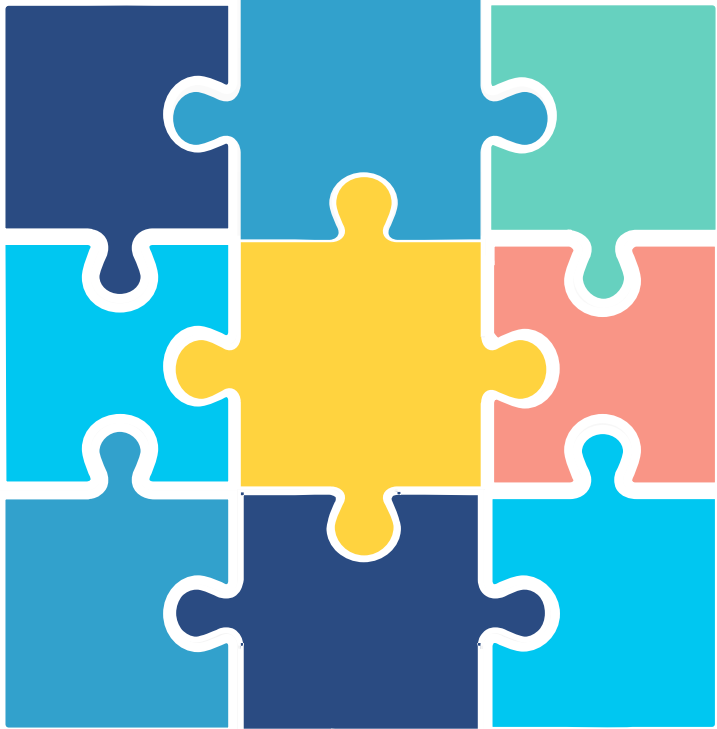
A bean counter, financial or auditing function



Accounting and budgeting related only



Too administrative and not operational



Not critical to mission accomplishments



Not important to program managers



A paperwork exercise

Internal Control

Integrated Framework

GAO Standards

Provide criteria for assessing the design, implementation, and operating effectiveness of internal control in the federal government entities to determine if an internal control system is effective



Apply to all of an entity's objective – all aspects of operations, reporting, and compliance



Should be built by management as an integral part of an entity's operations, especially through policies and procedures



Are presented through a hierarchical structure of:



- Five Components
- Seventeen principles related to the components
- Attributes related to the principles

The Five Standards of Internal Control

Control Activities

Monitoring

Information

Communication

Risk Assessment

Control Environment



Control Environment

Control Activities

Monitoring

Information

Communication

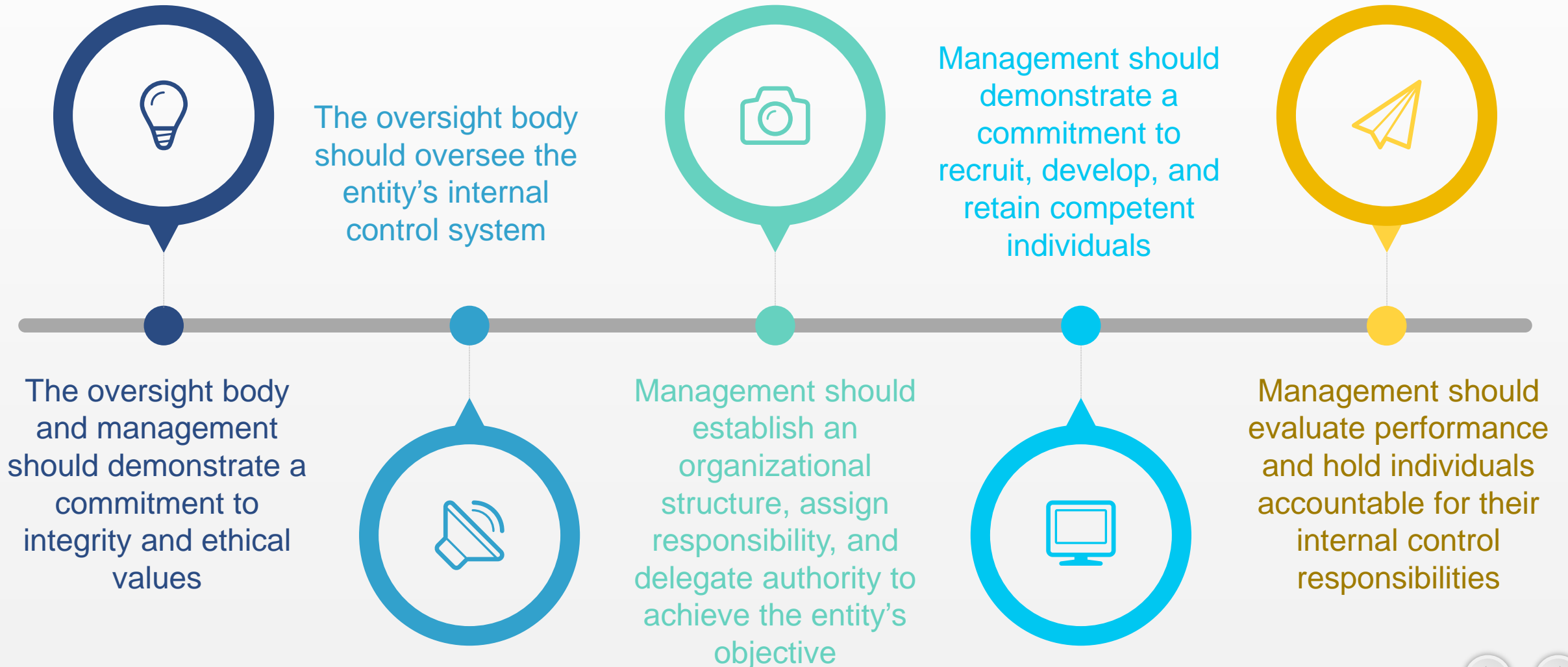
Risk Assessment

Control Environment



The Control Environment is the foundation for an internal control system

Control Environment Principles



Control Environment Principles

Exercise Oversight Responsibility:
Oversight structure
Oversight for the internal control system
Input for remediation of deficiencies

Demonstrate commitment to competence:
Expectation of competence
Recruitment, development, and retention of individuals
Succession and contingency plans and preparation

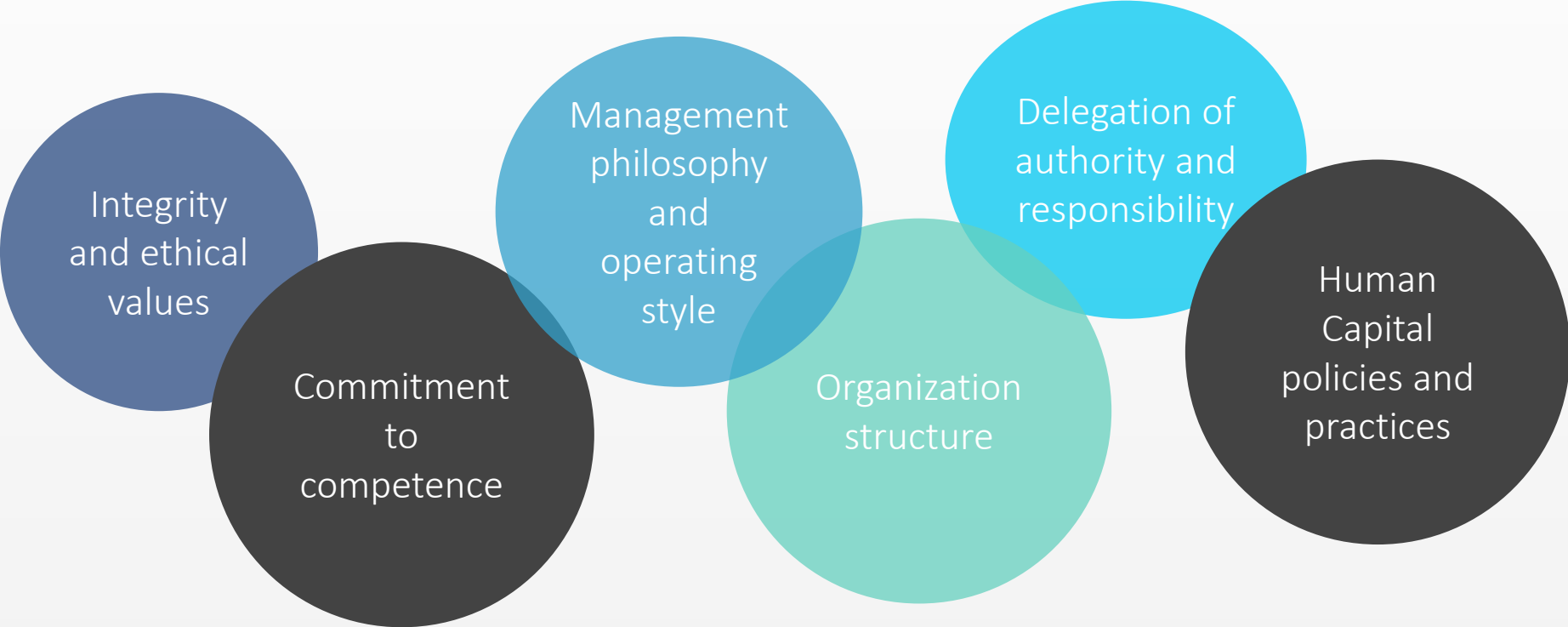


Demonstrate commitment to integrity and ethical values:
Tone at the top
Standards of Conduct
Adherence to standards of conduct

Establish structure, responsibility and authority:
Organization structure
Assignment of responsibility and delegation of authority
Documentation of the internal control system

Enforce Accountability:
Enforcement of accountability
Consideration of excessive pressures

Factors that can affect Control environment



Risk Assessment

Control Activities

Monitoring

Information

Communication

Risk Assessment

Control Environment



Risk Assessment Principles



Risk Assessment Principles



Control Activities

Control Activities



Control Activities Principles

Top-level reviews of actual performance



Control of information processing



Physical control over vulnerable assets



Segregation of duties



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Management should design control activities to achieve objectives and respond to risks

11

Management should design the entity's information system and related control activities to achieve objectives and respond to risks

12

Management should implement control activities through policies



Control Activities Specific to Information Systems

General control applies to all information System:



Mainframe



Desktop/laptop computer



Network



End-user environment



Information and Communication

Control Activities

Monitoring

Information

Communication

Risk Assessment

Control Environment

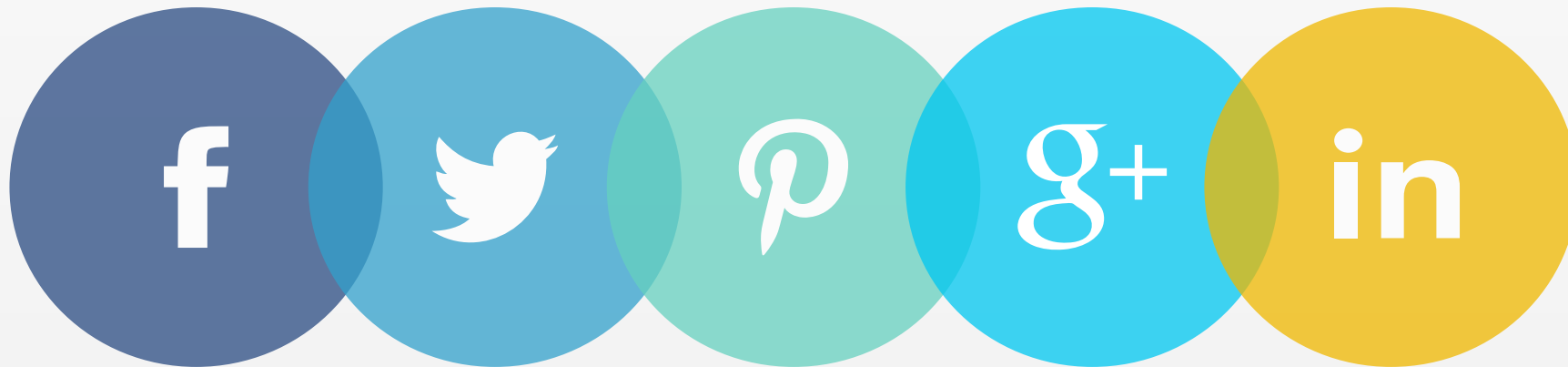


Information and Communication Principles

13 Use Quality Information

14 Communicate Internally

15 Communicate Externally



Monitoring

Control Activities

Monitoring

Information

Communication

Risk Assessment

Control Environment



Monitoring Principles



Establish a baseline



Internal control system monitoring



Evaluation of results



Reporting / Evaluation of issues



Corrective Actions

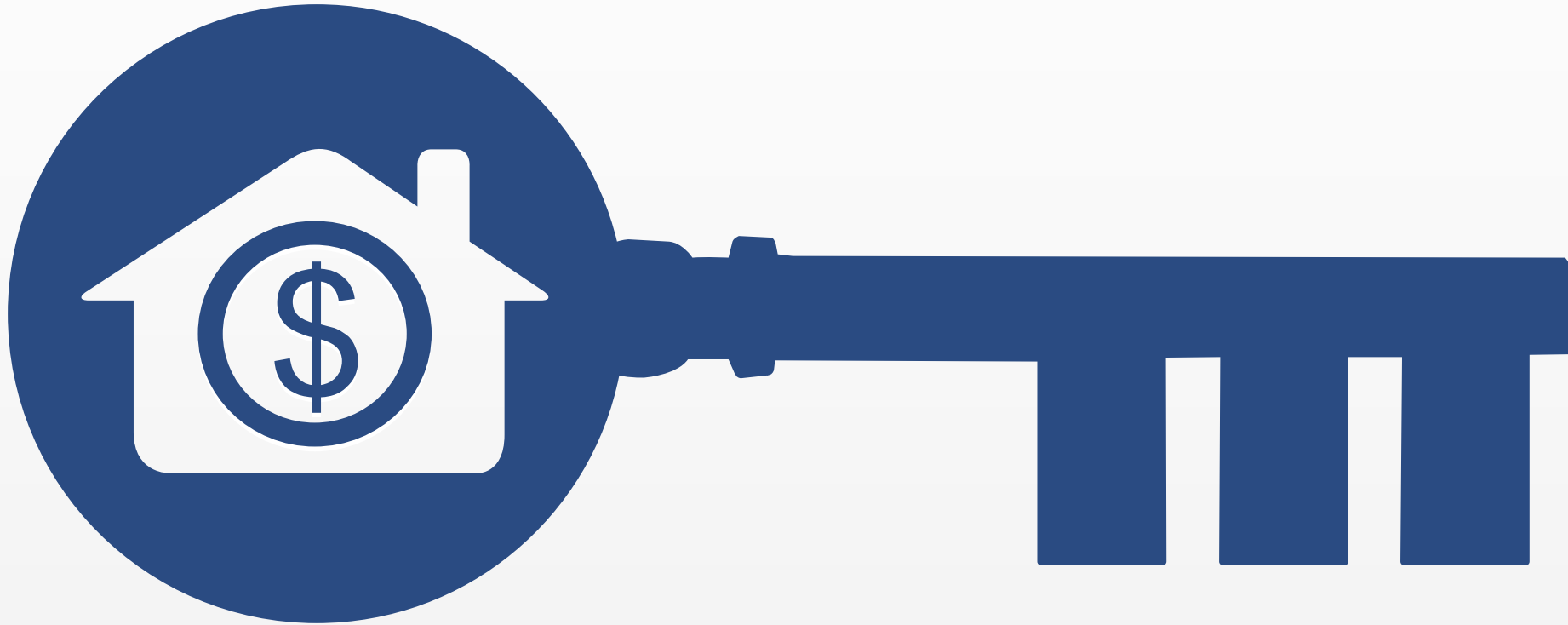
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Perform Monitoring Activities

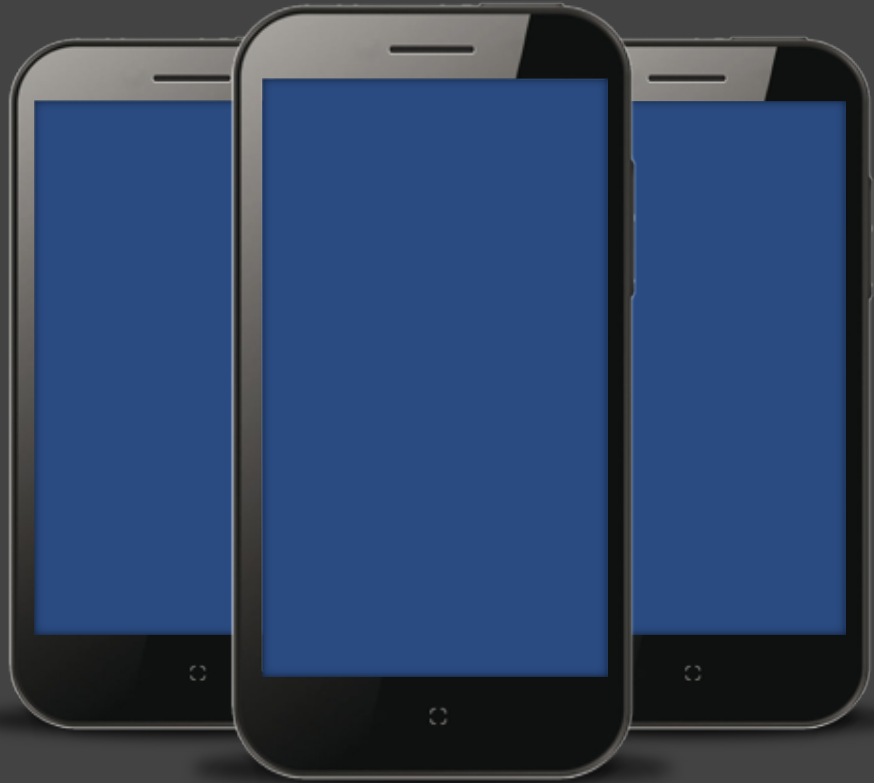
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Evaluate Issues and Remediate Deficiencies

Internal Control Management and Evaluation Tool



<http://gao.gov/products/GAO-01-1008G>



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