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Internal Control: Providing a Foundation for Accountability in Government

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Internal Control: Providing a Foundation for Accountability in Government

An introduction to internal control for managers in governmental organizations

International Organization of Supreme Audit Institutions

Overview

"Internal control is a management tool used to provide reasonable assurance that management objectives are being achieved."

Guidelines for Internal Control Standards,
INTOSAI

Managers are responsible for establishing an effective control environment in their organizations. This is part of their stewardship responsibility over the use of government resources. Indeed, the tone managers set through their actions, policies, and communications can result in a culture of either positive or lax control. Planning, implementing, supervising, and monitoring are fundamental components of internal control. You may go about these activities routinely, without thinking of them as part of a broad control environment that helps to ensure accountability. But they are.
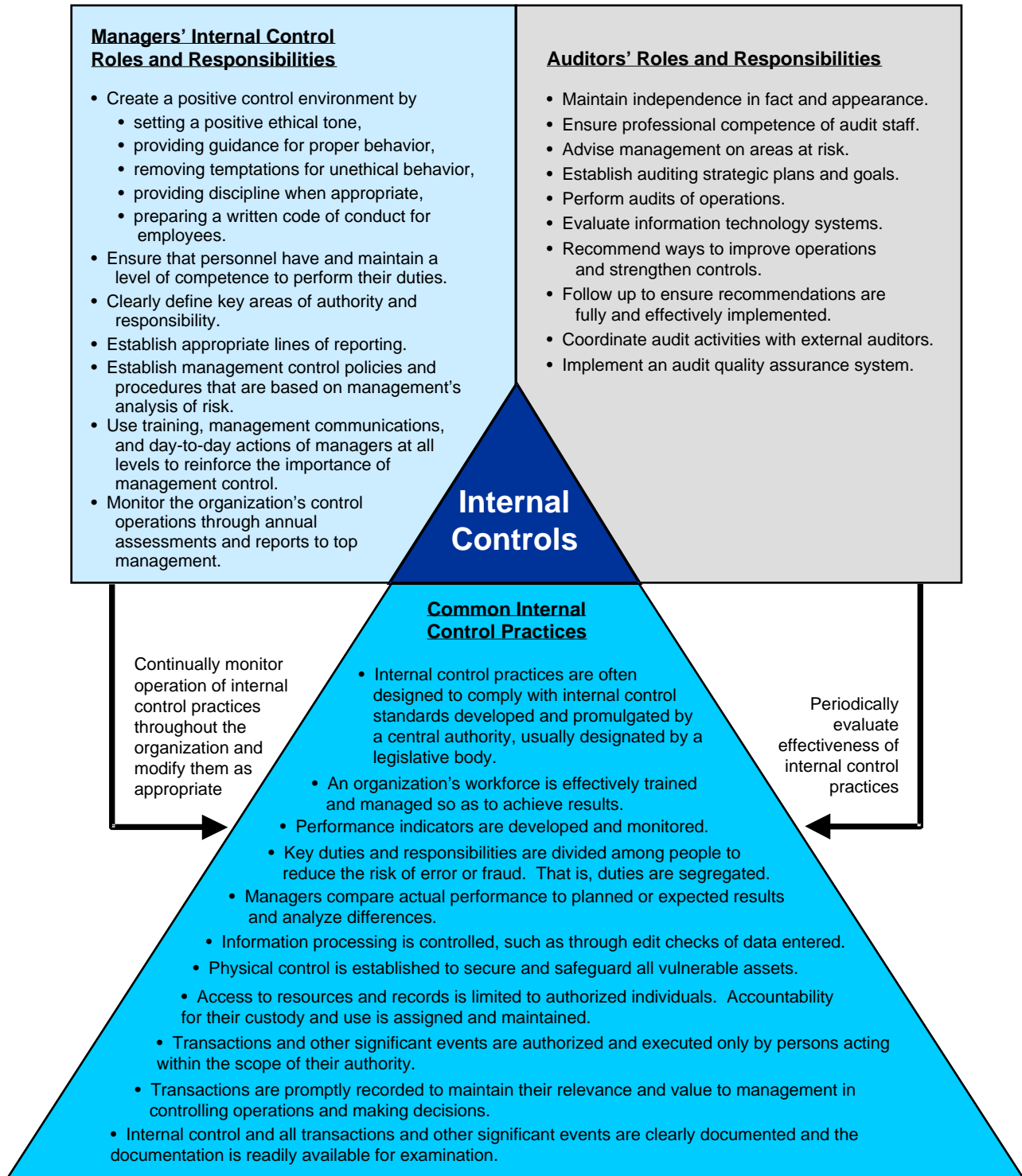
Internal control, or management control, helps to provide reasonable assurance that the organization

- adheres to laws, regulations, and management directives;
- promotes orderly, economical, efficient, and effective operations and achieves planned outcomes;
- safeguards resources against fraud, waste, abuse, and mismanagement;
- provides quality products and services consistent with the organization's mission; and
- develops and maintains reliable financial and management information and fairly discloses that data through timely reporting.

Therefore, it is essential that all managers in an organization understand the importance of establishing and maintaining effective internal control. For this reason, the Internal Control Standards Committee of the International Organization of Supreme Audit Institutions (INTOSAI) has prepared this booklet to

- provide an overall framework for establishing and maintaining effective internal controls,
- describe internal control roles and responsibilities for government managers and auditors,
- describe common internal control practices,
- provide a simple checklist to help you begin thinking about whether your organization has taken appropriate steps to ensure effective internal control, and
- provide a list of references for further information.

Framework for Establishing and Maintaining Effective Internal Control

Managers' Internal Control Roles and Responsibilities

- Create a positive control environment by
  - setting a positive ethical tone,
  - providing guidance for proper behavior,
  - removing temptations for unethical behavior,
  - providing discipline when appropriate,
  - preparing a written code of conduct for employees.
- Ensure that personnel have and maintain a level of competence to perform their duties.
- Clearly define key areas of authority and responsibility.
- Establish appropriate lines of reporting.
- Establish management control policies and procedures that are based on management's analysis of risk.
- Use training, management communications, and day-to-day actions of managers at all levels to reinforce the importance of management control.
- Monitor the organization's control operations through annual assessments and reports to top management.

Auditors' Roles and Responsibilities

- Maintain independence in fact and appearance.
- Ensure professional competence of audit staff.
- Advise management on areas at risk.
- Establish auditing strategic plans and goals.
- Perform audits of operations.
- Evaluate information technology systems.
- Recommend ways to improve operations and strengthen controls.
- Follow up to ensure recommendations are fully and effectively implemented.
- Coordinate audit activities with external auditors.
- Implement an audit quality assurance system.

Internal Controls

Continually monitor operation of internal control practices throughout the organization and modify them as appropriate

Periodically evaluate effectiveness of internal control practices

Common Internal Control Practices

- Internal control practices are often designed to comply with internal control standards developed and promulgated by a central authority, usually designated by a legislative body.
- An organization's workforce is effectively trained and managed so as to achieve results.
- Performance indicators are developed and monitored.
- Key duties and responsibilities are divided among people to reduce the risk of error or fraud. That is, duties are segregated.
- Managers compare actual performance to planned or expected results and analyze differences.
- Information processing is controlled, such as through edit checks of data entered.
- Physical control is established to secure and safeguard all vulnerable assets.
- Access to resources and records is limited to authorized individuals. Accountability for their custody and use is assigned and maintained.
- Transactions and other significant events are authorized and executed only by persons acting within the scope of their authority.
- Transactions are promptly recorded to maintain their relevance and value to management in controlling operations and making decisions.
- Internal control and all transactions and other significant events are clearly documented and the documentation is readily available for examination.

Managers

Managers should realize that a strong internal control structure is fundamental to control of an organization and its purpose, operations, and resources.

Responsibility for providing an adequate and effective internal control structure rests with an organization's management. The head of each governmental organization must ensure that a proper internal control structure is instituted, reviewed, and updated to keep it effective. A positive and supportive attitude on the part of all managers is critical. All managers must be individuals of personal and professional integrity. They are to maintain a level of competence that allows them to understand the importance of developing, implementing, and maintaining effective internal controls.

Management establishes an independent audit function as a key part of the internal control structure. Management should establish objectives for the audit function and place no restrictions on auditors in meeting them. To ensure independence, the head of this audit unit should report directly to the manager heading the agency. Management should also select an experienced, well-qualified person to lead the unit and provide sufficient resources and a competent staff to carry out audit operations. In this regard, managers work constructively with auditors to identify risks and design mitigating controls, and they give auditors responsibility for periodically evaluating internal control operations to identify weaknesses and recommend corrective measures.

Auditors

Management often establishes an audit unit as part of its internal control and self-assessment framework.

Auditors are a part of a governmental organization's internal control framework, but they are not responsible for implementing specific internal control procedures in an audited organization. That is properly management's job.

The auditors' role is to audit an organization's internal control policies, practices, and procedures to assure that controls are adequate to achieve the organization's mission. Although auditors may be part of the organization they audit, it is important and necessary that the auditors' independence be maintained.

For its part, management can demonstrate its support by emphasizing the value of independent and objective auditing. Management should also identify areas for improving performance quality and respond to information developed through audits.

An external audit unit may also play a role in auditing a governmental entity's internal control.

Most governmental entities are also audited by an external audit function. This external auditor is often appointed by, and reports to, the oversight body to which an entity is responsible. This external auditor may examine and suggest improvements to a governmental entity's internal control.

Internal Control

Simply defined, internal control is the process by which an organization governs its activities to effectively and efficiently accomplish its mission.

Internal control should not be looked upon as separate, specialized systems within a governmental organization. Rather, internal control should be recognized as an integral part of each system that management uses to guide its operations.

Establishing effective internal control involves an assessment of the risks the agency faces from both external and internal sources. A precondition to risk assessment is the establishment of clear, consistent entity objectives, which are the goals or purposes to be achieved. Risk assessment is the identification and analysis of relevant risk associated with achieving the objectives. Internal control practices (such as procedures, processes, physical arrangement, organizational structure, and assignment of responsibility and authority) should then be designed and implemented to achieve the goals.

Also, information should be recorded and communicated in writing to management and others within the entity who need it and within a time frame that enables them to carry out their internal control and other responsibilities. Internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved.

Checklist for Managers

In establishing your framework, have you

- ❑ Assessed the risks the organization faces?
- ❑ Identified control objectives to manage the risks?
- ❑ Established control policies and procedures to achieve the control objectives?
- ❑ Created a positive control environment?
- ❑ Maintained and demonstrated personal and professional integrity and ethical values?
- ❑ Maintained and demonstrated a level of skill necessary to help ensure effective and efficient performance?
- ❑ Maintained and demonstrated an understanding of internal controls sufficient to effectively discharge responsibilities?

For implementing internal control, have you

- ❑ Adopted effective internal control throughout the organization?
- ❑ Based the organization's internal control on sound internal control standards?
- ❑ Included in the organization's internal control structure appropriate and cost-effective control practices?
- ❑ Prescribed control practices through management directives, plans, and policies?
- ❑ Established a means of continually monitoring the operation of the organization's internal control practices?

Concerning the audit function, have you

- ❑ Shown an understanding of the difference between internal control and audit?
- ❑ Recognized that an audit function is integral to your organization's internal control?
- ❑ Established an audit function?
- ❑ Ensured the audit organization's independence?
- ❑ Given the audit organization responsibility for evaluating the effectiveness of the audited organization's internal control practices?
- ❑ Established a system to monitor the organization's progress in implementing internal and external auditor recommendations?

References for Further Information

The International Organization of Supreme Audit Institutions has issued the following documents.

_ *Guidelines for Internal Control Standards*
_ *Guidelines for Reporting on the Effectiveness of Internal Controls: SAI Experiences in Implementing and Evaluating Internal Controls*

These publications can be found at (http://www.intosai.org).

Various professional accounting organizations can provide internal control information.

The American Accounting Association
(http://www.aaa-edu.org)

The American Institute of Certified Public Accountants
(http://www.aicpa.org/index.htm)

The Canadian Institute of Chartered Accountants
(http://www.cica.ca)

The Chartered Institute of Public Finance and Accountancy
(http://www.cipfa.org.uk)

The Committee of Sponsoring Organizations of the Treadway Commission (COSO)
(http://www.coso.org)

The Institute of Chartered Accountants in England & Wales
(http://www.icaew.co.uk)

The Institute of Internal Auditors
(http://www.theiia.org)

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