



Internal Controls and the Internal Auditor

**Presented By:
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Interrelated Components

■ Control Environment

■ Risk Assessment

■ Control Activities

■ Information and Communication

■ Monitoring

What is an Internal Control?

- **Internal control is broadly defined as 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:**
 - **Protect District assets.**
 - **Effectiveness and efficiency of operations.**
 - **Reliability of financial reporting.**
 - **Compliance with applicable laws and regulations.**

Limitations of Internal Control

1. Management Override

- **Management may override the structure to commit fraud or misstate the financial statements.**

2. Human Errors

- **Human errors may arise from misunderstanding of instructions, mistakes of judgment, and personal carelessness, distractions, or fatigue.**

3. Collusion

- **Collusion may circumvent the separation of duties.**

4. Changing Conditions

- **Conditions may change, weakening a system that was adequate at a point in time.**

5. Combination of duties

- **One employee is performing conflicting job duties (lack of segregation of duties).**

Control Characteristics

- When identifying controls within processes – consider the characteristics of those controls

Preventative

- Controls that minimize the possibility of an error or deliberate misstatement

- Examples: building access cards, segregation of duties, no price change without supervisor's access code

Detective

- Controls that detect misstatements and allow them to be corrected

- Examples: reconciliations, edit reports, security violation reports

Activities vs. Controls

| ACTIVITY | CONTROL |
|---|---|
| Purchase orders are prepared and 'locked' (from edits) | Match invoice to purchase order (preventative, Management review) |
| Proof of Delivery note is prepared on receipt of fixed asset | Proof of delivery note is matched to invoice (Detective, Management review) |
| Payroll system produces an edit report of all employee changes | All changes are reviewed for proper authorization (Detective, Authorization) |

Tests of Internal Controls & Investigations

- Random change fund counts
- Review of bank reconciliations
- Observation of physical inventories
- Review of cash handling procedures
- Tests of compliance with applicable laws and/or regulations (i.e. sub-recipient monitoring)
- Tests of procedures of purchasing, accounts payable, auxiliary operations and foundations

Controls over Cash

■ Segregation of Duties

■ Physical Control Over Cash

■ Accurate and Timely Recording

■ Proper Execution of Transactions

■ Appropriate Documentation

■ Controls Over Information

Processing

■ Management Review

Balancing Risk & Control

■ Primary Categories of Risk –

■ Errors

■ Omissions

■ Delay

■ Fraud

| 3rd Quarter 2001 | 3rd Quarter 2000 | 2nd Quarter 2001 | 2nd Quarter 2000 | Nine Months 2001 | Nine Months 2000 |
|--|------------------|------------------|------------------|------------------|------------------|
| Revenues \$43,641 | \$59,338 | \$50,789 | \$152,499 | \$183,706* | |
| Expenses 43,018 | 55,467 | 47,979 | 144,918 | 166,224* | |
| After-Tax Profit/Loss | 623 | 1,321 | 1,121 | 1,881 | |
| After-Tax Annualized Return on Capital | 1.1% | 7.3% | 5.0% | 4.5% | 11.4% |
| Assets** | 2,680,452 | 2,342,225 | 2,562,618 | 2,680,452* | 2,342,225 |
| Capital & Subordinations | 150,319* | 139,721 | 146,179 | 150,319* | 139,721 |
| Commission Revenues | 6,062 | 7,415 | 6,668 | 20,215 | 25,868* |
| Number of Firms Reporting | 261 | 273 | 258 | 272 | 284 |

■ Motivation

■ Opportunity

■ Personal Characteristics

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| Number of Profitable Firms | 158 | 210 | 171 | 178 | 242 |
| Aggregate Pre-Tax Earnings of Profitable Firms | 2,807 | 4,300 | 3,482 | 10,970 | 18,470 |
| Number of Unprofitable Firms | 103 | 63 | 87 | 94 | 42 |
| Aggregate Pre-Tax Earnings of Profitable Firms | (2,183) | (428) | (663) | (3,388) | (989) |
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AICPA Internal Control Checklist

■ Ethical Environment

■ Risk Assessment and Control Activities

■ Audit Committee Effectiveness

■ Internal Auditing Function Effectiveness

What Can You Do at Your District?

- Set the tone at the top
- Have written policies and procedures
- Have adequate segregation of duties
- Review transactions for authorization
- Provide channel for employees to communicate suspected improprieties
- Cross-train staff
- Ensure that staff take vacation time
- Perform operational/performance audits
- Hire an Internal Auditor

Internal Audit Function

Typical tasks performed by Internal Auditors:

■ Facilitate External Audit

■ Tests of Internal Controls & Investigations

■ Special Projects

■ Provide Training

■ Use of Resources

Facilitate External Audits

- Negotiate contract
- Setup planning meetings with key personnel
- Coordinate timing of fieldwork
- Ensure completion of all tasks
- Review financial reports
- Verify billings against contract
- Resolve audit findings

Special Projects

- **General Obligation Bond**
- **Software Conversions**
- **Student Housing**
- **Regulatory Audits; interpretation of regulatory changes**
- **Document Retention/Imaging**
- **Independent Contractor Process/ Reporting**
- **Requirements of System Office (i.e. Noncredit Course Self Assessment)**

Training

Ethics

■ Sarbanes/Oxley Act of 2002

■ 1099 Reporting

■ Internal Controls – Why They are Important

Training

■ Ethics

■ Sarbanes/Oxley Act of 2002

■ 1099 Reporting

■ Internal Controls – Why They are Important

Use of Resources

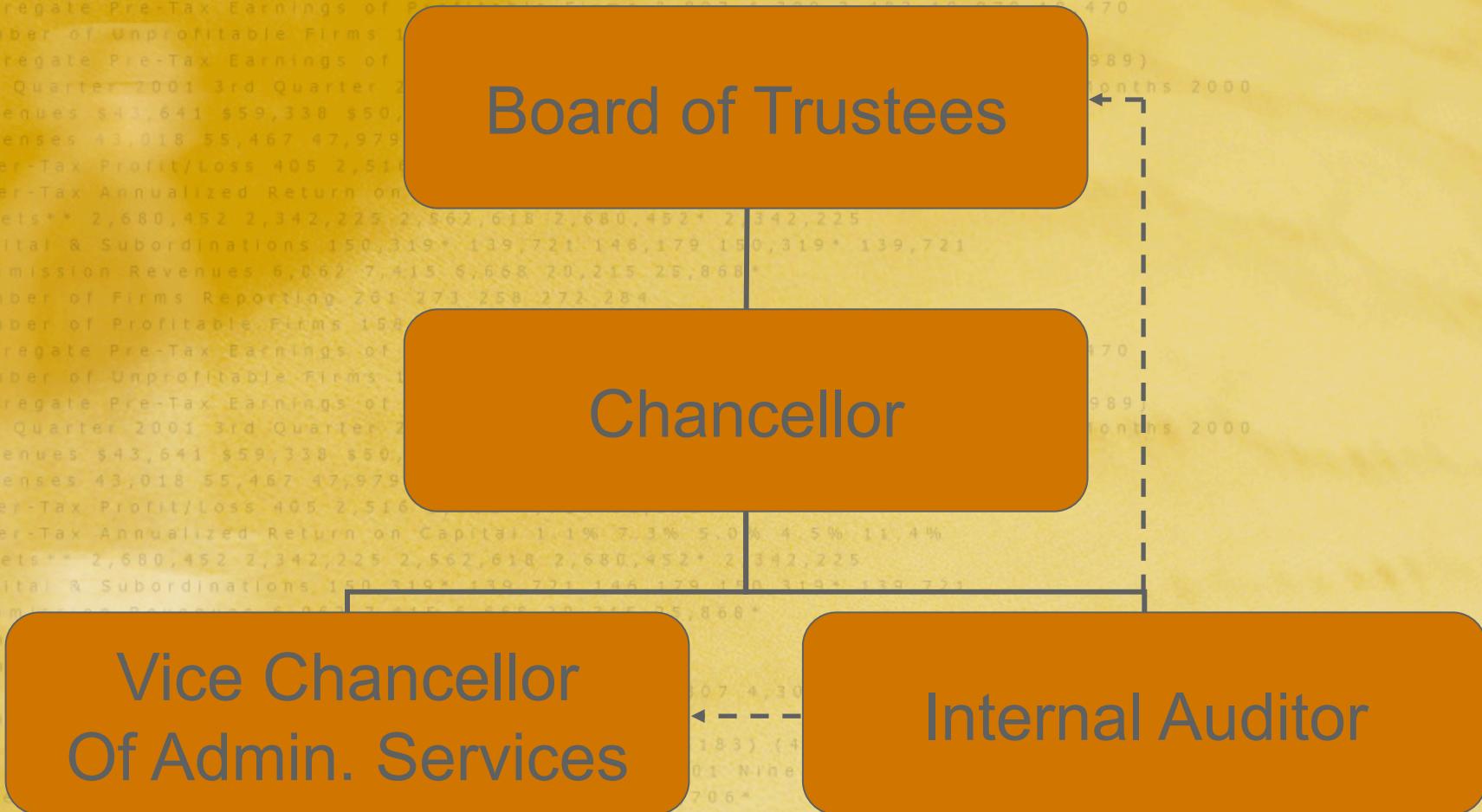
- **Education Code/State Constitution**
- **Community College Internal Auditors (CCIA)**
- **Institute of Internal Auditors (IIA)**
- **IRS and FTB Rules and Regulations**
- **Internal Policies & Procedures**
- **Conferences**
- **Department of Education**
- **System Office**

Board Policy for Internal Audit

It should include the following, at a minimum:

- **Access to all records, properties & personnel**
- **No direct responsibilities/authority over any process reviewed**
- **Cannot develop & install procedures which they audit**
- **Provide written memorandum to management subsequent to completion of audit**
- **Code of Ethics**

Reporting Requirements



Is It Worth It?

Salary. . . .

\$75,000

Benefits. . . .

\$25,000

**Having a scapegoat
when things go
wrong. . . .**

Priceless!!!

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Questions?

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