



Office of Operations 2009 Fall Conference



Navigating Uncertain Times

Introduction to Internal Controls



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Objectives

- What are Internal Controls?
- Why are they important?
- What is **your** role?



Agenda

Internal Controls Background

- Control Environment
 - Group Exercise
- Risk Assessment and Control Activities
 - Group Exercise
- Information/Communication and Monitoring
 - Group Exercise
- Case Study
 - Group Discussion



NYS Governmental Accountability, Audit & Internal Control Act of 1987

Management should:

- Establish and maintain guidelines for a system of internal controls.
- Establish and maintain an internal control system and review process.
- Make a clear and concise statement of managerial policies and standards available to all employees.



NYS Governmental Accountability, Audit & Internal Control Act of 1987

Agencies must:

- Designate an Internal Control Officer.
- Provide internal control education and training.
- Periodically evaluate the need for an internal audit function.



Budget Bulletin 350

Annual Compliance Certificate

- Includes an Internal Control Summary of internal control activities undertaken in the previous year.
 - Must be submitted to Division of the Budget by March 31.
- * Those unable to certify must submit an action plan.



Committee of Sponsoring Organizations of the Treadway Commission (COSO)

- A voluntary private sector organization dedicated to improving the quality of financial reporting through business ethics, effective internal controls, and corporate governance.
- Developed our current integrated framework in 1992.



Building Blocks



Internal Control

The integration of the activities, plans, attitudes, policies, and efforts of the people of an organization working together to provide reasonable assurance that the organization will achieve its mission.



Basic Premises

Internal Controls:

- Impact every aspect of an organization: all of its people, processes and physical structures.
- Are a basic element built into an organization – not a feature that is added on.
- Are dependent upon people and will succeed or fail depending on the attention people give it.



Basic Premises

Internal Controls:

- Incorporate the qualities of management – good and bad.
- Are effective when all of the people and the surrounding environment work together.
- Provide a level of comfort to an organization. Controls do not guarantee success.
- Help an organization achieve its mission.



Why Internal Controls?

Internal Controls help agencies:

- Ensure efficient and effective operations.
- Comply with laws and directives.
- Provide reliable data and timely reports.
- Safeguard resources.



Who Has a Role in Internal Controls?

- Everyone in an organization has responsibility for ensuring that the internal control system is effective.
- The greatest amount of responsibility rests with the managers.
- Top executives have the ultimate responsibility.



Case Study

Case Study – Initial Review

- Agency XYZ and ABC Linen



Basic Components

- Control Environment
- Risk Assessment
- Control Activities
- Information and Communication
- Monitoring



Internal Controls Pyramid



Control Environment



Control Environment

Influences all of the decisions and activities of an organization, and the control consciousness of its people.

The Tone at the Top

Is the foundation for all the other components.



Control Environment

The atmosphere created by the people of an organization.

How would you describe yours?



Management's Responsibilities

Develop an operating style and philosophy:

- Practice ethics and integrity
- Commit to excellence
- Foster positive employee morale
- Have a supportive attitude
- Set the tone
- Provide direction and vision
- Hire and keep competent staff



Exercise 1

Control Environment

Purchasing Office

1. What is the control environment of the Purchasing Office?
2. What impact does the control environment have?

Accounts Payable Office

1. What is the control environment of the Accounts Payable Office?
2. What impact does the control environment have?



Risk Assessment



Definition of Risk Assessment

Risk

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

Assessment

To evaluate; to examine carefully; to determine or set the value of something.



Process

1. What are the objectives?
2. What could go wrong (the Risk)?
3. What's the likelihood of it occurring?
4. What's the impact if it happens?
5. Prioritize and respond accordingly.



Risk Assessment

Assess each risk in terms of:

- The likelihood of the negative event.
- The significance or impact of the event.



Risk Assessment

Likelihood

The probability that an unfavorable event would occur if there were:

- No internal controls.
- Existing internal controls.

Impact

A measure of the magnitude of the effect on an organization if the unfavorable event were to occur.



Ask the questions ...

- What obstacles could stand in the way of achieving your objective?
- What can go wrong?
- What is the worst thing that *could* happen?
- What is the worst thing that *has* happened?



Ask the questions ...

- Are there new processes? Changed ones?
- New goals or legislation?
- Staffing changes?
- What keeps you awake at night?

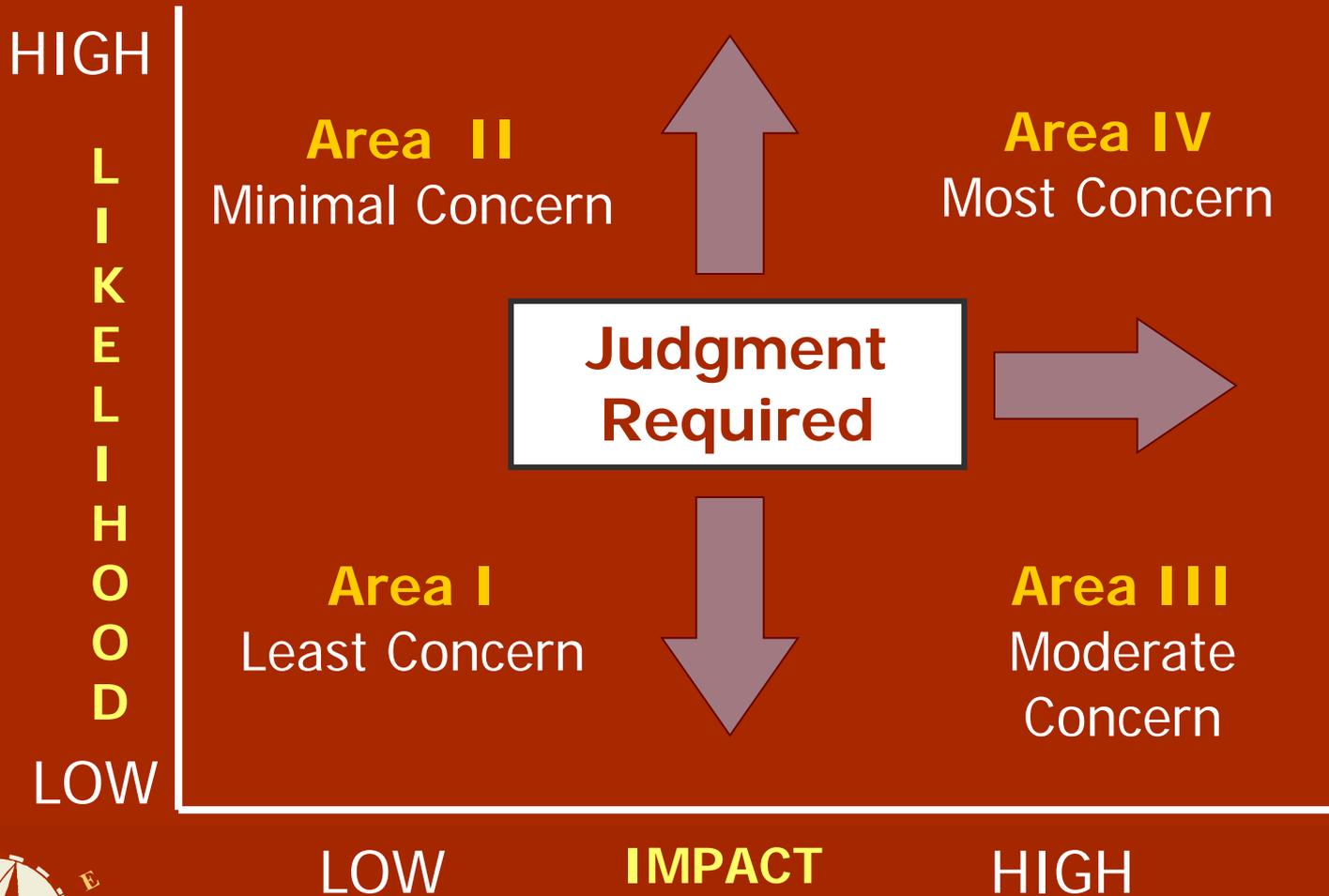


What do you need?

- A thorough understanding of the process.
- A systematic approach.
- Historical knowledge.
- An active imagination.



Evaluating Risk



Helpful Hints

- Change is the one constant.
- A risk assessment is never “done.”
- Communication and education can make all the difference.
- The greatest risk is turning a blind eye to the possibility of risk.
- Knowledge is power!



Managing Risk

Three options:

- Avoid the risk
- Accept it
- Prevent it



Managing Risk

Avoid the risk.

- Whatever the risky activity is...
- **Don't do it!**
- No additional controls are required.



Managing Risk

Accept the risk.

- Continue the way you're going.
- **Maintain the Status Quo.**
- Make no changes and add no new controls.



Managing Risk

Prevent or reduce the risk.

- Actively work to control the risk.
- **Change how you operate!**
- Establish whatever controls are necessary to manage the risk.



Management's Responsibilities

- Monitor for changes.
- Have a plan!
- Define what's acceptable.
- Communicate the importance of risk.



Control Activities



Control Activities

The tools – both manual and automated – that help prevent or reduce the risks that can stop an organization from meeting its objectives and goals.



Control Activities

Controls can be...

Directive: Guiding an organization toward a desired outcome.

Preventive: Deterring the occurrence of an undesirable event.

Detective: Identifying undesirable events and alerting management.

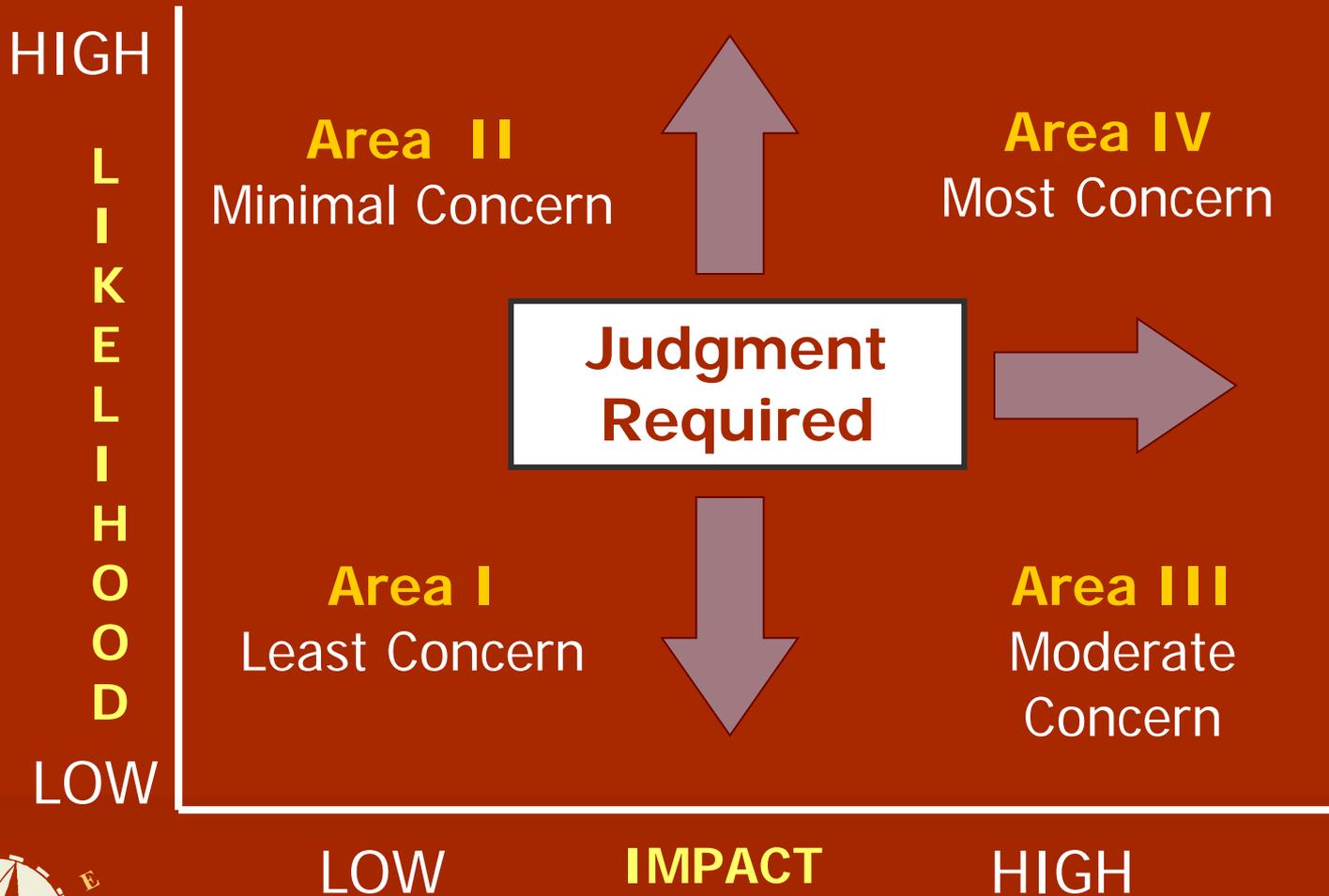


Commonly Used Control Activities

- Documentation
- Approval and authorization
- Verification
- Supervision
- Separation of duties
- Safeguarding assets



Risk and Controls



Control Activities

Cost vs. Benefit



The cost of the controls should not be greater than the cost of the potential loss.



Management's Responsibilities

Ensure controls are:

- Cost effective.
- Adequate to manage risk.
- Included in system design.
- Monitored and periodically evaluated.



Exercise 2

Risk Assessment and Control Activities Scenario

- What are your observations about the agency's risk assessment process? How can it be improved?
- What are your observations about the control activities they did or did not institute? What would you do differently?



Information and Communication



Information and Communication



The exchange of information between and among people and organizations.



Information and Communication

Information should be:

- Timely: Available when the user needs it.
- Useful: Sufficiently detailed.
- Tailored to the user.



Information and Communication

Lines of Communication:

- **Down** from management
- **Up** from the staff
- **Across** units and departments

Are the lines of communication open?



Management's Responsibilities

Promote channels that communicate:

- All necessary information.
- Employees' responsibilities.
- Problems and suggestions.
- An agency's mission, vision, and values.
- A commitment to internal controls.



Monitoring



Monitoring

The ongoing review of an organization's daily activities and transactions to determine whether controls are effective in ensuring that operations work as intended.



Monitoring

Monitoring

Daily or routine procedures like supervision, transaction review and problem resolution.

Evaluation

Periodic assessments of the organization's performance over time.



Things to Consider

- Are we complying with our system of internal controls?
- Are we doing things the way we should to accomplish our mission?



Management's Responsibilities

Focus attention on:

- Control environment
- Effectiveness of control activities
- Goal achievement
- Risks and opportunities
- Communication



Exercise 3

Information/communication and monitoring scenario:

1. What are the control weaknesses in information/communication?
2. What are the control weaknesses in monitoring?

All

1. What is the potential impact of this scenario?
2. What could be done differently?



Questions



Case Study – Review

Breakout Group Discussion

- Identify at least five control weaknesses and their related components. Be sure to include at least one weakness for each component.
- For each weakness, what control could have been put in place to prevent the scheme?

Group Discussion

- Share Results with the Class



Thank You!

