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Do's and Don'ts of Internal Control

Fran Copeland, CFO, Alabama Department of Public Safety

What are internal controls?

Internal controls are the processes we use to safeguard our assets, promote operational efficiency, ensure the reliability and integrity of information, accomplish goals and objectives, and ensure compliance with policies, laws, regulations, etc.

Who is responsible for internal controls?

Management is ultimately responsible for internal controls.

Are there different types of controls?

Preventive controls prohibit or stop something from going wrong, while detective controls identify unwanted actions that have already occurred.

Risks that may affect our performance

Internal risks include such things as personnel turnover, lack of experience or training, theft, fraud, abuse, etc.

External risks that can affect the agency include catastrophes such as hurricanes, floods, snow or tornadoes, recessions, technology, etc.

Options for handling risks

We can accept the risk – if it occurs, we can handle it.

We can insure the risk – pay someone else to assume the risk. If it happens, we're covered.

We can control the risk – and this is where internal controls come in by having established ways to reduce the probability that a risk will occur.

What should we do?

We should split up responsibilities so that no one person can fully control an activity.

We should provide supervision which includes instructing others, overseeing work as it is done, reviewing work already done, approving actions, etc.

We should only allow authorized transactions to be made. Signatures are common authorization controls. Your signature means you've looked at it, approved it and said it's OK. READ everything before signing.

We should regularly inspect physical assets on hand and match them to what's on the books.

We should monitor our internal control system to insure that it is in place and working as designed.

We should use and keep secret passwords to reduce unauthorized computer access. Backup procedures reduce losing data.

We should have locks, alarms, cameras, and security personnel where called for to prevent and detect theft of important assets.

What else can we do?

We can set up an anonymous fraud hotline. According to the Association of Certified Fraud Examiners (ACFE), those organizations with a hotline suffered a median loss of \$100,000, whereas organizations without hotlines had a median loss of \$200,000.

We can have an internal audit unit. According to the ACFE, those with internal audit units and regularly performed surprise audits had similar reductions as with a fraud hotline.

What internal control cannot do

An internal control system cannot turn a poor performer into a good one. Internal control cannot provide absolute assurance about the achievement of objectives. It can only provide reasonable assurance since there are limitations inherent in all internal control systems. Breakdowns in internal control can occur due to a simple error or mistake. Faulty judgments can be made at any level of management. Controls may be circumvented by collusion or management override. Internal control systems depend on available resources. There has to be a cost-benefit analysis in the design of the system.

What are some don'ts in internal control?

Don't let complacency lull you into a sense of security. When things go well for a period of time, we get lax in our complying with internal control procedures, such as monitoring, reviewing, reconciling, verifying, etc. We assume that things will continue to go well. They may not.

Don't let trust interfere with your responsibility to monitor and review. Just because someone has been with you forever doesn't prevent that person from committing fraud. We're always shocked when someone is arrested for fraud. "Why, she's been here twenty years and I would have trusted her with my life." Those we trust have more opportunity to commit fraud than others. Think about it.