



INTERNAL CONTROLS

Introduction

Internal Controls are to be an integral part of any organization's financial and business policies and procedures. The objectives of internal controls are:

- Protecting resources against waste, fraud, and inefficiency;
- Ensuring accuracy and reliability in accounting and operating data;
- Securing compliance with the policies of the organization;
- Ensuring compliance with applicable laws and regulations;
- Evaluating the level of performance in all organizational units of the organization;
- Providing management with reasonable assurance that leave and payroll transactions are authorized, valid, complete and accurate;
- Safeguarding leave and payroll documents from theft, loss and destruction; and
- Internal controls are simply good business practices.

The benefits of good internal controls are:

- Prevents errors and irregularities from occurring. If errors or irregularities do occur, they will be detected in a timely manner.
- Ensures that issues arising from reporting errors are kept to a minimum and quickly resolved.
- Protects employees:
 - By clearly outlining tasks and responsibilities;
 - By providing checks and balances; and,
 - From being accused of misappropriations, errors or irregularities.

What are Internal Controls?

Internal controls are the practices performed by the Regional Office of Education to provide management with reasonable assurance that assets are safeguarded and transactions are authorized, valid, complete and accurate.

Internal control systems operate at different levels of effectiveness. Determining whether a particular internal control system is effective is a judgment resulting from an assessment of whether the five components – Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring – are present and functioning. Effective controls provide reasonable assurance regarding the accomplishments of established objectives.

Control Environment

The control environment, as established by the Regional Office of Education administration, sets the tone of an institution and influences the control consciousness of its people. Leaders of each department, area or activity establish a local control environment. This is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include:

- Integrity and ethical values;
- The commitment to competence;
- Leadership philosophy and operating style;
- The way management assigns authority and responsibility, and organizes and develops its people;
- Policies and procedures.

Risk Assessment

Every entity faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is the establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. Because economics, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.

Objectives must be established before administrators can identify and take necessary steps to manage risks. Operations objectives relate to effectiveness and efficiency of the operations, including performance and financial goals and safeguarding resources against loss. Financial reporting objectives pertain to the preparation of reliable published financial statements, including prevention of fraudulent financial reporting. Compliance objectives pertain to laws and regulations which establish minimum standards of behavior.

The process of identifying and analyzing risk is an ongoing process and is a critical component of an effective internal control system. Attention must be focused on risks at all levels and necessary actions must be taken to manage. Risks can pertain to internal and external factors. After risks have been identified they must be evaluated.

Managing change requires a constant assessment of risk and the impact on internal controls. Economic, industry and regulatory environments change and entities' activities evolve. Mechanisms are needed to identify and react to changing conditions.

Control Activities

Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities occur throughout the organization, at all levels, and in all functions. They include a range of activities as

diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.

Control activities usually involve two elements: a policy establishing what should be done and procedures to effect the policy. All policies must be implemented thoughtfully, conscientiously and consistently.

Information and Communication

Pertinent information must be identified, captured and communicated in a form and time frame that enables people to carry out their responsibilities. Effective communication must occur in a broad sense, flowing down, across and up the organization. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream.

Monitoring

Internal control systems need to be monitored – a process that assesses the quality of the system's performance over time. Ongoing monitoring occurs in the ordinary course of operations, and includes regular management and supervisory activities, and other actions personnel take in performing their duties that assess the quality of internal control system performance.

The scope and frequency of separate evaluations depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported immediately to top administration and/or county board(s).

Internal control systems change over time. The way controls are applied may evolve. Once effective procedures can become less effective due to the arrival of new personnel, varying effectiveness of training and supervision, time and resources constraints, or additional pressures. Furthermore, circumstances for which the internal control system was originally designed also may change. Because of changing conditions, management needs to determine whether the internal control system continues to be relevant and able to address new risks.

Responsibility

It is the responsibility of management to develop and implement a system of internal controls. However, everyone within the Regional Office of Education has some role in internal controls. The roles vary depending upon the level of responsibility and the nature of involvement by the individual. The Regional Superintendent of Schools and Assistant Regional Superintendent of Schools will establish the presence of integrity, ethics, competence and a positive control environment. The Regional Superintendent of Schools and Assistant Regional Superintendent of Schools (Grant Coordinators and Grant Directors) have oversight responsibility for internal controls within their units. Managers and supervisory personnel are responsible for executing control policies and procedures at the detail level within their specific unit. Each individual

within a unit is to be cognizant of proper internal control procedures associated with their specific job responsibilities and is responsible for complying with internal controls.

Components of the Control Activity

Internal controls rely on the principle of checks and balances in the workplace. The following components focus on the control activity:

Personnel need to be competent and trustworthy, with clearly established lines of authority and responsibility documented in written job descriptions and procedure manuals. Organizational charts provide a visual presentation of lines of authority and periodic updates of job descriptions ensures that employees are aware of the duties they are expected to perform.

Authorization Procedures need to include a thorough review of supporting information to verify the propriety and validity of transactions. Approval authority is to be commensurate with the nature and significance of the transactions and in compliance with Regional Office of Education policy.

Segregation of Duties reduce the likelihood of errors and irregularities. An individual is not to have responsibility for more than one of the three transaction components: authorization, custody, and record keeping. When the work of one employee is checked by another, and when the responsibility for custody for assets is separate from the responsibility for maintaining the records relating to those assets, there is appropriate segregation of duties. This helps detect errors in a timely manner and deter improper activities; and at the same time, it should be devised to prompt operational efficiency and allow for effective communications.

Physical Restrictions are the most important type of protective measures for safeguarding Regional Office of Education assets, processes and data.

Documentation and Record Retention is to provide reasonable assurance that all information and transactions of value are accurately recorded and retained. Records are to be maintained and controlled in accordance with the established retention period and properly disposed of in accordance with established procedures.

Monitoring Operations is essential to verify that controls are operating properly. Reconciliations, confirmations, and exception reports can provide this type of information.

Internal Control Limitations

There is no such thing as a perfect control system. Limitations which may hinder the effectiveness of an otherwise adequate system of controls include:

- Resource constraints
- Inadequate skill, knowledge, or ability
- Degree of motivation by management and employees
- Faulty judgments

- Unintentional errors

Additionally, controls can be circumvented by collusion of two or more people. Keep in mind that management has the ability to override the internal control system.

Staff size limitations may obstruct efforts to properly segregate duties, which requires the implementation of compensating controls to ensure that objectives are achieved. A limitation inherent in any system is the element of human error, misunderstandings, fatigue and stress. Employees are to be encouraged to take earned vacation time in order to improve operations through cross training while enabling employees to overcome or avoid stress and fatigue.

These factors, combined with changing needs and personnel, make it risky to project any evaluation of internal control to future periods. Management must evaluate on an on-going basis to keep controls effective. Management evaluation generally leads to periodic adjustments and corrective action; which also helps assure the continuing effectiveness of the internal control system.

The cost of implementing a specific control should not exceed the expected benefit of the control. Sometimes there are no out of pocket costs to establish an adequate control. A realignment of duty assignments may be all that is necessary to accomplish the objective. In analyzing the pertinent costs and benefits, managers also need to consider the possible ramifications for the Regional Offices of Education at large and attempt to identify and weigh the intangible as well as the tangible consequences.

Internal controls should reduce the risks associated with undetected errors or irregularities, but designing and establishing effective internal controls is not always a simple task and cannot always be accomplished through a short set of quick fixes.

Elements of a Good System

There are 4 elements in a good internal control system:

- Separation of duties
- Authorization
- Documentation
- Reconciliation

Separation of Duties

No person should have control over a transaction from beginning to end. Ideally, no person should be able to record, authorize and reconcile a transaction.

Why?

- To protect employees;
- To prevent and detect intentional and unintentional errors; and,
- To encourage better job performance.

Key Points

- Separation of duties may vary depending on each unit's size and structure.
- Duties may be separated by department or by individuals within a department.
- A simple sharing of duties between individuals may eliminate this weakness.
- Management should increase the review and oversight function when unable to sufficiently separate duties.
- Separation of duties can be circumvented by collusion.

Authorization

Transactions should be authorized and executed by persons acting within the range of their authority.

Why?

- To prevent invalid transactions.

Key Points

- Policies and procedures should clearly identify which individuals have authority to approve different types of transactions.
- Authority comes with accountability and responsibility.
- Individuals should understand what they are approving. Individuals should have first hand knowledge of transactions being approved, or they should review supporting information to verify the propriety and validity of transactions.
- Authorization of adjustments should be timely.
- Authorization for leave, overtime and change of work schedule should be obtained in advance and in writing.
- Authorization should be from at least one level above.
- Employees should not authorize their own transactions.
- Adjustment documents should proceed directly for processing after approval by a supervisor and not return to the employee where it can be falsified. Many frauds occur after approval.
- Supervisors should not sign blank forms.
- The supervisor and employee should initial corrections or adjustments.
- Delegation of authority in writing is required for grants and recommended for other budgets.
- Leave and payroll documents should proceed directly for processing after approval by a supervisor and not returned to the employee where they can be falsified. Many frauds (i.e. unauthorized or excessive overtime hours charged) occur after approval.
- Supervisors should not sign blank timesheets or leave request forms.
- Corrections or adjustments should be initialed by the supervisor and employee.

Documentation

Transactions should be clearly and thoroughly documented and available for review.

Why?

- Documents provide a record of each event or activity.
- Appropriate documentation helps to ensure assets are properly controlled.
- Documents provide evidence of what really happened.
- Appropriate documentation ensures the accuracy and completeness of transactions.

Authorized documents for non payroll transactions may include:

- Journal Vouchers
- Calculation spread sheets (interest, distribution, accruals, etc.)
- Original entry requiring correction

Entries on the Time Sheet Report must be consistent with properly authorized leave and payroll documents. These documents may include:

- Timesheets
- Leave requests (Request For or Report of Absence)
- Attendance Calendar
- Extended leave Approvals from the Regional Superintendent of Schools

Key Points for Non Payroll Transactions

- The documents used to support entries in Accounting Records are Regional Office of Education #40 property, not the personal property of the employees.
- The records must be retained according to your archive schedule.

Key Points for Payroll Transactions

- The Time Sheet Report and documents used to support entries on the Time Sheet Report are Regional Office or Education property, not the personal property of employees.
- Supporting documents are retained for 7 years.
- Use attachments or footnotes to document the reasons for corrections/adjustments to the Time Sheet Report that are not evident.

Reconciliation

Reconciliation is the process of comparing the entries in the general ledger to supporting documentation and resolving any discrepancies or differences. Accounts Payable, Accounts Receivable, Cash, Property depreciation, Interest Income and other. ***For payroll, reconciliation is the process of comparing the entries on the Time Sheet Report to supporting documentation and resolving any discrepancies or differences.***

Why?

- To ensure the accuracy and validity of the entries and accrual balances.
- To ensure the records are accurately recorded.
- To ensure unauthorized changes did not occur.
- To resolve discrepancies in a timely fashion.
- To ensure the employee is entitled to the benefits recorded (annual leave, sick leave, etc.).
- To ensure unauthorized changes do not occur.
- To resolve discrepancies in a timely fashion.

When?

Non Payroll

A supervisory person will perform the reconciliation's regularly, and when:

- Month end closing.
- Outside records are available, monthly bank statements.
- Agree all exceptions recorded in general ledger to source documents.
- Review infrequent transactions.
- Investigate and resolve differences.
- Initial and date the records to document that a review and reconciliation was performed.

Payroll

A supervisory person will perform a reconciliation of the Time Sheet Report at least annually and when an employee:

- Transfers;
- Requests extended leave without pay, or
- Separates from the Regional Office of Education #40

Steps to Include:

- Agree all exceptions (i.e., sick leave, annual leave) recorded on the Time Sheet Report to source documents.
- Agree anything on the Time Sheet Report that affects gross pay (overtime, LWOP, Payroll Adjustments) to the actual pay (check register and certification report).
- Review infrequent transactions such as separation pay calculations.
- Investigate and resolve differences.
- Initial and date the Time Sheet Report to document that a review and reconciliation was performed.

Internal Control Summary

Internal Control Systems Depend On:

- Size of department (number of employees).
- Whether department is centralized or decentralized.
- Complexity of employee schedules.
- Level of management's monitoring and oversight.

Internal Control Elements Include:

- Adequate separation of duties.
- Transactions are authorized and executed by persons acting within the range of their authority.
- Transactions are clearly and thoroughly documented and available for review.
- Reconciliation's are performed regularly.
- A reconciliation of the Time Sheet Report is performed at least annually, and when an employee transfers to another unit, requests extended leave without pay, or separates from the Regional Office of Education #40.

Risk Assessment

The process of assessing risk is an opportunity for management and directors to look at their operations, determine the areas of significant risk, and evaluate what actions can be taken to minimize the risk and enhance the effectiveness and efficiency of the operation, while following applicable laws and regulations. The risk assessment and internal control evaluation can be integrated into the strategic planning process and program review.

All levels of the organization should participate in an annual risk assessment. The process of assessing risk is an opportunity for review of operations, determination of the areas of significant risk, and evaluation of what actions can be taken to minimize the risk and enhance internal controls.

Determination of an effective means of managing the risks, determining the likelihood of occurrence, minimizing the risks, and providing compensating controls is management's responsibility.

Some possible risks to be aware of include:

General

- Noncompliance with federal and state laws and regulations
- Noncompliance with Regional Office of Education #40 policies and procedures
- Personal responsibility for contracts
- Process completed inefficiently or incorrectly
- Misappropriation of funds

Departmental Reports

- Lack of budgetary control
- Unauthorized transactions
- Undetected errors

Cash Receipts

- Lost or stolen cash and checks
- Budget shortfall
- Noncompliance with state regulations
- Tax liabilities and penalties

Payroll

- Fraud
- Overpayments
- Retroactive transactions
- Personal and employer tax liabilities and penalties
- Unreported Leave
- Lawsuits

Personal Computers

- Unauthorized access to computers
- Computer viruses
- Destruction of critical data
- Violation of software license agreements and possible fines
- Loss of educational discounts on software
- Lawsuits

Purchases

- Unauthorized purchases
- Invalid documentation
- Compliance violation
- Budget shortfall

Credit Cards

- Duplicate charges are paid both to the bank and the employee.
- Inappropriate purchases

Fraud and Asset Misappropriation Awareness

Vulnerable Areas

- Payroll
- Petty Cash
- Cash Receipts
- Long Distance Phone Calls
- Travel Vouchers

Consistent Patterns

- “Blind Trust”
- Lack of Separation of Duties
- Progressive
- Simple Methods
- Repeat Offenders
- Seldom takes leave
- No one performs duties when absent
- Works evenings and weekends

Payroll Fraud and Misappropriation Methods

- Overtime abused
- Leave inaccurately reported
- Supervisor knowingly allowed employee to backlog hours to avoid excessive overtime
- Supervisor pre-signed blank timesheets

Prevention of Payroll Irregularities

- Properly approved documents are reconciled to ADP and budget records
- Overtime should be pre-approved in writing with reason and estimated hours documented
- Approved documents should be controlled
- Line through or cross out blank lines on timesheet
- Supervisor approval should be timely
- Process only original documents
- Do not pre-sign blank or incomplete documents
- Do not supervise or control a relative’s employment

Grants

Generally, any institution determined by a Federal granting organization to be out of compliance with any requirements can have their funding revoked and/or be assessed a fine.

- Ensure that expenditures comply with grant documentation
- Budgets are carefully monitored
- Directors approve all activity
- Equipment purchased is recorded and monitored

Other Concerns

- Volunteers should sign an agreement and hours should be reported to payroll for Labor and Industries reporting purposes.
- Surplus property belongs to the Regional Office of Education #40 and has disposal guidelines.
- Child Care in the Workplace is not appropriate.
- Skipping lunches (to adjust arrival or departure time) is not appropriate.
- Supervisor approved flexible work schedules are appropriate.

Supervisor Compliance Check List

Whistleblower Protection

Employees are encouraged to disclose improper action and have their rights protected. An Open Door Policy has been set up to allow employees to report improper actions.

Reporting Improper Action

- Must be within 1 year of occurrence.
- Whistleblower (employee reporting allegation) remains confidential.

Retaliatory Action Defined

- Denied adequate staff or staff changes.
- Refusal to assign meaningful work.
- Unwarranted/unsubstantiated letter of reprimand.
- Demotion, suspension, dismissal.
- Encourage coworkers' hostility.

Key Ethical Concepts

Responsibility for ethical violation rests with the employee or the supervisor who authorized the employee action.

Student employees are subject to restrictions while employed. Regional Office of Education visitors and employee family members (including children) are not authorized to use Regional Office of Education #40 information technology resources.

Substantive Rule

- Employees are obligated to conserve and protect university resources.
- Employees may not use Regional Office of Education #40 resources for private gain.

Use of Email

- Personal outside business use of email is not permitted.
- Occasional and limited personal (non-business) use is acceptable, if it does not interfere with the performance of duties.

Use of the Internet

- Refer to acceptable use policy in the Regional Office of Education #40 Policy Manual.

Phone Calls/Fax/Voice Mail/Cell Phones/Copy Machines

- Personal business use of phones and copy machines is not permitted.

Consumable Supplies

- Personal business use of paper, envelopes, tablets, and other office, shop, maintenance, custodial, and motor vehicle supplies is not permitted.

Managing an Audit

These are suggestions when interacting with auditors, to expedite the audit process while minimizing disruptions to day-to-day departmental operations. It is important to both the auditors and the departments to have accurate and objective audit results.

- Designate an audit liaison person.
- Clarify the audit object and scope (areas to be tested and period covered by the audit).
- Determine auditor needs (records, workspace, and resources).
- Consider giving the auditor a general tour of your facilities.

Access to Records by Auditor

- Ensure original documents do not leave department premises without prior approval.
- If a request is ambiguous, ask the auditor for the purpose of reviewing the document. Be prepared to recommend alternate documents that would achieve the auditor's purpose.
- Unless absolutely necessary, do not allow full access to your file drawers, storerooms, etc. Auditors are expected to obtain permission and state their objective for accessing these areas.
- Have documents available upon their arrival. Maintain a list of records provided to the auditor.
- Review records you are providing to anticipate questions. If records will hurt the Regional Office of Education's interest, notify department management of the issue.

Responding to Audit Findings

- Keep informed of issues throughout the audit.
- Ensure an exit interview is held. Use it to verify facts and respond to the audit. Ask a representative from the Regional Superintendent's Office to attend if there are questioned or disputed findings.
- Ask for time to review findings, and then re-verify calculations and source data.
- Concede valid findings, but do not speculate on whether they apply to other areas within the Regional Office of Education #40
 - Discuss with the auditor the dispositions of audit issues, i.e. verbal comment, exit item, management summary or report item.
 - If necessary, appeal the auditor's conclusion with their supervisors. This action should be coordinated with the Regional Superintendent of Schools.

“Must Do” Management Actions

‘Hard’ Controls (Mandatory Internal Control and Checks and Balances)

1. Use only original signatures to approve documents.
2. Departmental Reports
 - a. Review and document the reconciliations of the monthly department financial statements to the appropriate supporting documents to assure all items are authorized Regional Office of Education #40 purchases/charges.
 - b. Budget the best annual estimate of the department’s earnings and expenditures.
 - c. Compare actual results to the budget and follow up significant variances.
3. Payroll
 - a. Reconcile labor distribution reports to timesheets/exception reports (including reconciling leave accrual amounts to leave slips).
 - b. Collect from Staff & Administration a signed Attendance Calendar for each pay period.
 - c. Collect from nonexempt and exempt staff a signed Attendance Calendar for each pay period.
 - d. Collect from hourly classified and student employees a signed positive timesheet for each pay period.
 - e. Have supervisors with direct knowledge of the actual time worked sign Attendance Calendars and positive timesheets.
 - f. Review the monthly departmental labor distribution report and reconciliation.
 - g. Budget the best annual estimate of the department’s labor expenses.
4. Separate incompatible duties (e.g. pro-card holder/approval authority, cash receipts handling/accounts receivable posting, payroll preparation/verification, etc.) among different department staff members.
5. Identify active/inactive grant accounts and assure/implement a process through which requisitions, expenditures, and document retention is approved by the Regional Superintendent and periodically reviewed by the upper administration and that this process is in accordance with Regional Office of Education #40 and funding source requirements (capital equipment approval, contract approval, etc.). Ensure that inactive project grants are closed according to Regional Office of Education #40 procedures.
6. Cash Receipts
 - a. Deposit weekly or daily (if needed) any cash/checks received in your department as authorized in the policy and procedures manual.
 - b. Issue a pre-numbered receipt for all cash transactions.
 - c. Use a cash receipts form for all checks and cash and submit them to the bank for deposit
 - d. Safeguard cash and checks against theft or loss.
7. Purchases
 - a. Review in detail the supporting documentation for any action that you authorize, approve, review, or sign.
 - b. Establish a mechanism for ensuring that all departmental purchases are appropriate.
 - c. All contracts and credit applications require Regional Superintendent’s approval.
 - d. **Always submit receipts as proof of payment.**
8. List and account for each equipment asset and its location valued at more than \$1,000.

9. Reconcile external bank accounts and credit card transactions (if applicable) at least monthly.
 - a. Establish procedures to ensure that cardholders comply with the reimbursable business expense policy.

‘Soft’ Controls (Internal Controls to Strengthen Oversight and Encourage Compliance)

1. Complete an Annual Risk Assessment and/or Internal Control Review.
2. Be familiar with the Policies and Procedures Manual.
3. Implement a workable, current version of a departmental procedure/policy manual, and update/develop the manual at least annually. Document written procedures for processes that are important to the operations of the department.
4. Avoid circumventing any established internal controls over department operations.
5. Identify a group of peer managers (Grant Managers and other Regional Offices of Education) as a pool of resources and establish a two-way line of communication among those individuals.
6. Review operational processes on a continuous basis for duplication of effort.
7. Identify strengths/weaknesses within your employee pool and re-organize duties accordingly to develop a stronger team. Encourage employees to participate in professional development activities.
8. Be alert to fraud risks and ‘red flags’ for fraud occurring in your unit’s operations.
9. On a regular basis compare/analyze the actual revenue and expenditures to the amount of budgeted revenue/expenditures (i.e. financial analysis).
10. Provide relevant financial reports/status updates to Regional Superintendent on a regular basis.
11. Document all reconciliation’s, verifications, approvals, etc. to assure a defined audit trail of all transactions exit.