Internal Controls Simplified
Internal Controls Defined

Action(s) taken by management, the board, and other parties to manage risk and increase the likelihood (provide reasonable assurance) of achieving management’s objectives in the following areas:

- Effectiveness & efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws/regulations
- Safeguarding assets
Types of Internal Controls

- Preventative Controls are designed to keep errors or irregularities from occurring in the first place.
- Detective Controls are designed to detect errors and irregularities which have already occurred and to assure their prompt correction.
- Corrective Controls are designed to correct errors or irregularities that have been detected.
Examples of Internal Controls

Preventive Controls:

- Background Checks
- Locking facilities
- Segregating duties
- Restricting access to cash
- Authorizing Transactions
Examples of Internal Controls

Detective Controls:

• Audits
• Inventories
• Reconciliations

Corrective Controls:

• Actions taken to reverse effects of detective errors
• Correcting Journal Entries
Responsibility for Internal Controls

- Everyone within the District has some role in internal controls, which varies depending on the level of responsibility and the nature of involvement by the individual. The District’s Governing Board, Chancellor, College Presidents, and senior executives establish the presence of integrity, ethics, competence, and a positive control environment.

- Internal Audit Services (IAS) role is to examine the adequacy and effectiveness of the District's internal controls and make recommendations where control improvements are needed.
Limitations of Internal Controls

No matter how well internal controls are designed, they can only provide reasonable assurance that objectives have been achieved. Some limitations inherent in all internal control systems include:

- **Judgment:** The effectiveness of controls are limited by decisions made by human judgment under pressures to conduct business based on the information in hand.

- **Breakdowns:** Even well-designed internal controls can break down. Employees sometimes misunderstand instructions, or simply make mistakes.
Limitations of Internal Controls

- **Management Override:** High level personnel may be able to override prescribed policies and procedures, however this should not be confused with management intervention which represents actions that depart from prescribed procedures for legitimate purposes.

- **Collusion:** Control systems can be circumvented by individuals acting collectively to alter financial data or other information in a manner that cannot be identified by control systems.
Components of Internal Controls

COSO Internal Control Framework

Widely used framework in U.S. and Worldwide.

- Control Environment
- Risk Assessment
- Control Activities
- Monitoring Activities
- Information and Communication
Examples – Controls by COSO Component

Control Environment
- Policies & Procedures
- Governing Board – Board Finance Committee
- Employee Handbook

Monitoring Activities
- Budget vs Actual
- Variance Analysis
- Continuous Monitoring
- Pcard Statements
- IT Monitoring

Risk Assessment
- Formalized Annual Risk Assessment
- Specified Goals / Strategic Plan
- Identification of compliance requirements

Control Activities
- Self Assessments
- Continuous Auditing
- Reconciliations
- Formalized signature authority

Communication
- Relevant / quality information
- Internal communication
- Goals/objectives, responsibility for internal controls
- Communication with external parties