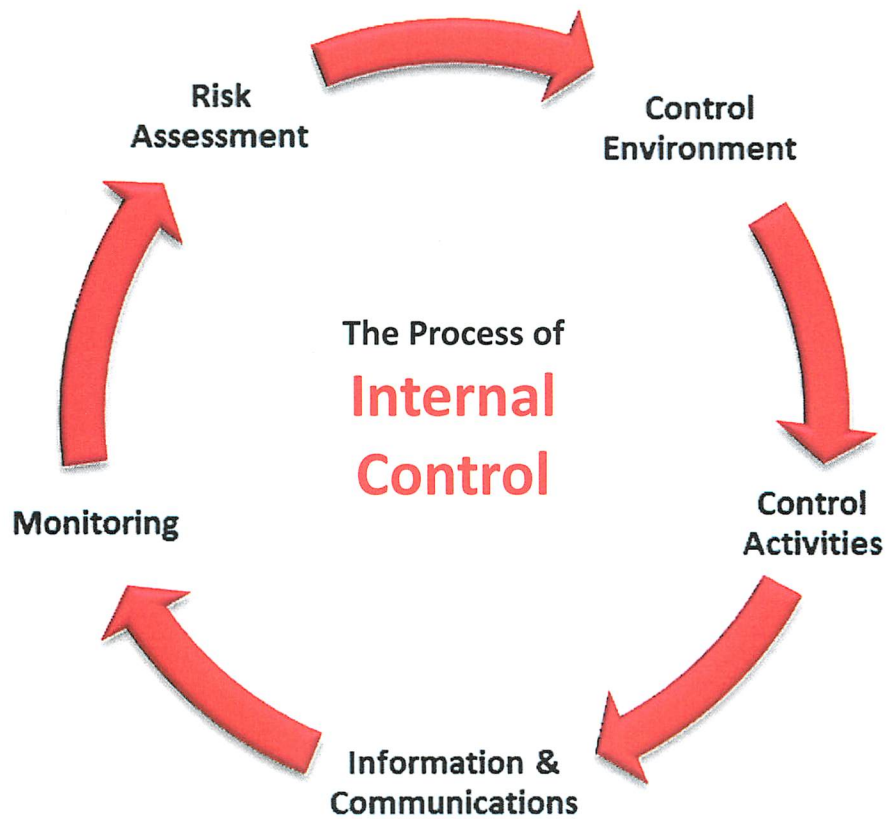




Government of the
District of Columbia
Office of the Inspector General



A brief guide on internal controls for
agency managers and employees

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General
Audit Division**



INTERNAL CONTROLS

The Office of the Inspector General's (OIG) Audit Division is providing the following discussion of internal controls for all District employees.

The goals of this guide are to promote awareness; provide definitions and objectives; and point out responsibilities under applicable federal and District laws.

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What Are Internal Controls?

The International Organization of Supreme Audit Institutions' (INTOSAI) Guidelines for Internal Control Standards for the Public Sector define internal control as an integral process that is effected by an entity's management and personnel and is designed to address risks and provide reasonable assurance that, in pursuit of the entity's mission, the following general objectives are being achieved:

- ◇ executing orderly, ethical, economical, efficient, and effective operations;
- ◇ fulfilling accountability obligations;
- ◇ complying with applicable laws and regulations; and
- ◇ safeguarding resources against loss, misuse, and damage.

Based on this definition, internal control is a dynamic integral process that continuously adapts to the changes an agency is facing. Management and personnel at all levels have to be involved in this process to address risks and provide reasonable assurance of achieving the agency's mission and general objectives.

Agency managers use internal controls every day. For instance, writing procedures to encourage compliance with laws or regulations, locking your office to discourage theft, and reviewing monthly financial reports of accounts to verify transactions

are common internal controls employed to achieve specific objectives.

Why Are Internal Controls Important?

Internal controls provide reasonable assurance that an agency uses its resources, including human resources, to address its established mission, goals and objectives, and takes proper steps to decrease the risks to the agency. It makes good sense for the agency to use internal controls to operate as efficiently and effectively as possible. Such controls help ensure that the agency operates according to its established plans and performance measures.

If agencies utilize internal controls in their daily operating practices and procedures, then agencies can prevent overspending, misuse, waste, and abuse of government resources.

Generally Accepted Government Auditing Standards (GAGAS) indicate that a performance audit with an initial objective of program effectiveness may involve an underlying objective of evaluating internal controls to determine the reasons for a program's lack of effectiveness or how the program's effectiveness can be improved.

What Are the Objectives of Internal Controls?

INTOSAI states that the four purposes of internal control are to:

- ◇ Promote orderly, economical, efficient and effective operations and produce quality products and services consistent with the agency's mission.
- ◇ Safeguard resources against loss due to waste, abuse, mismanagement, errors, and fraud.
- ◇ Ensure adherence to laws, regulations, contract, and management directives.
- ◇ Develop and maintain reliable financial and management data, and to accurately present that data in timely reports.

What Are the Federal And District Laws Governing Internal Controls?

OMB Circular A-123 defines management's responsibility for internal control in federal agencies. The Circular is issued under the authority of the Federal Managers' Financial Integrity Act of 1982 as codified in 31 U.S.C. 3512.

D.C. Code § 1-204.47 requires the Mayor to implement appropriate procedures to ensure that "budget, accounting, and personnel control systems and structures are synchronized for budgeting and control purposes on a continuing basis." D.C. Code § 1-204.48(a)(2) also states that the Mayor is responsible for maintaining systems of accounting and internal control designed to provide:

- (A) Full disclosure of the financial results of the District government's activities;
- (B) Adequate financial information needed by the District government for management purposes;
- (C) Effective control over and accountability for all funds, property, and other assets; [and]
- (D) Reliable accounting results to serve as the basis for preparing and supporting agency budget requests and controlling the execution of the budget

In addition, D.C. Code § 1-204.49 requires the Mayor to, *inter alia*: (a) audit and approve District expenditures; and (b) perform internal audits of the District's accounts, operations, and agency records to determine the effectiveness of accounting systems, internal control, and related administrative practices of District agencies.

Agency heads and officials assist the Mayor in discharging these control-related responsibilities. For instance, 1 DCMR § 1502.1 states that agency heads are responsible for establishing controls over the creation of District government records to ensure that adequate and proper records are made and preserved. Additionally, 1 DCMR § 1503.1 requires agency heads to establish controls over the maintenance and use of records, and ensure that records of continuing historical or other significance can be located and are preserved in good condition for eventual transfer to the Archives.

What Is an Internal Control Structure?

The methods agency managers use – policies, procedures, organizational design, and physical barriers – constitute the internal control structure of the agency. The District’s internal control structure strives to follow the standards outlined in both The Committee of Sponsoring Organizations of the Treadway Commission (COSO)¹ *Internal Control-Integrated Framework* (1992) and the United States Government Accountability Office’s (GAO) *Standards for Internal Control in the Federal Government* (Nov. 1999), as outlined below.

Control Environment – This component addresses the attitude toward internal control and level of awareness in an agency. Much of an agency’s control environment comes from what is known as the “Tone at the Top” message. It relies heavily on the organizational structure and accountability relationships in the agency. The agency’s mission, operational objectives, and strategic statements primarily indicate this message. The control environment is greatly influenced by the extent to which individuals recognize that they will be held accountable.

¹ Organized in 1985, COSO’s mission is “to provide thought leadership through the development of comprehensive frameworks and guidance on enterprise risk management, internal control and fraud deterrence designed to improve organization performance and governance and to reduce the extent of fraud in organizations.” [Http://www.coso.org/aboutus.htm](http://www.coso.org/aboutus.htm) (last visited Nov. 12, 2013).

Control Activities – This component consists of tools used to help prevent or reduce risks that can impede achievement of the agency's goals and objectives. Some examples of these tool categories are:

Directive – Federal, District, and other laws, regulations, policies, guidelines, and procedures.

Preventive – Using risk assessment to determine the level of potential problems before they occur and ensuring there is a plan of action to avoid them.

Detective – These tools involve identifying, initially through audits and reviews, undesired events once they have occurred and alerting management.

Corrective – These tools, which include certification and testing, ensure that focus is maintained on undesirable activities until corrected.

Information and Communication – A component involving reporting procedures and disclosure requirements, which are used to exchange useful information between entities to support decisions and coordinate activities.

Assessing and Managing Risk – This component utilizes vulnerability assessments to determine levels of risk exposure the agency has from a given area. Once the agency evaluates the risk, it determines whether to accept, reduce, or avoid such a risk.

Monitoring – Internal control reviews are used in this component to assess the agency's activities and transactions over time. The value derived from this function is the ability to accurately assess whether controls are effective and functioning as intended.

These components work together to create a comprehensive system for preventing, detecting, and correcting operational problems in District agencies.

How Is an Internal Control Program Implemented?

While every District employee has some responsibility in following policies, procedures, regulations, and laws, and in protecting agency assets, it is recommended that each agency designate an official or a committee to oversee its internal control program. This official or committee assists units and programs throughout the agency in completing a periodic internal control review of procedures or practices designed to detect conscious and/or unintended abuses, lapses, or operational deficiencies.

Some examples of procedures and policies that may be reviewed include:

- ◇ Planning activities
- ◇ Program evaluations
- ◇ Budget cycle
- ◇ Personnel procedures and transactions

- ◇ Information systems
- ◇ Cash activities
- ◇ Contract and grant management
- ◇ Capital programs
- ◇ Compliance programs

Upon completion of an internal control review, the designated official or committee meets with unit managers to discuss the review and any proposed changes in internal controls or procedures. The official also provides internal control training to employees through workshops, films, and other means.

Who Is Responsible for Internal Controls?

Every employee has the responsibility to help ensure that internal controls are effective by following policies and procedures, reporting problems, or suggesting improvements. The greatest amount of responsibility rests with agency heads, managers, and supervisors to ensure appropriate controls are in place for all operations.

The agency head bears ultimate responsibility and should sign an annual certification that the agency is in compliance with internal control standards. Managers help the agency head in discharging this responsibility by ensuring that internal controls are established and functioning to achieve the mission and objectives of their units. To evaluate internal controls, first think about the following general objectives, then identify your unit's specific objectives within these broad categories:

- ◇ **Propriety of Transactions** for all account activity for which the manager is responsible.
- ◇ **Reliability and Integrity of Information** for internal management decisions and agency reports.
- ◇ **Compliance With Agency Policies and Government Regulations**, including but not limited to those related to human resources and financial systems, as well as those of granting agencies and the District and federal governments.
- ◇ **Safeguarding Assets**, including physical objects and agency data.
- ◇ **Economy and Efficiency of Operations** to optimize the use of limited public resources in accomplishing the mission of the unit, agency, and District.

How Are Internal Controls Evaluated?

An audit organization provides an independent evaluation of the adequacy of internal controls and reports the results to agency management and other stakeholders. Auditors examine how the internal controls within an operation work together to form the internal control structure. The auditor gathers information about the mission and process of the agency or unit within the agency, discusses the major objectives with responsible managers, and identifies control points within each process where an error, irregularity, or inefficiency is likely to occur.

The auditor documents existing controls at each significant control point, evaluates the adequacy of the controls to ensure achievement of the objective, and then tests the controls to verify they are working as designed. Further discussions with agency management focus on control risks, manager insights, and potential control enhancements. The greater the risk, the more extensive the control warranted. The auditor's evaluation includes an examination of the internal control elements discussed below.

Personnel – should be competent and trustworthy, with clearly established lines of authority and responsibility documented in written job descriptions and procedures manuals. For example,

- ◇ organizational charts provide a visual presentation of lines of authority.
- ◇ periodic updates of job descriptions ensure that employees are aware of the duties they are expected to perform.
- ◇ maintaining written policies and procedures for manual processing ensures that operations can continue in the event of computer failure or prolonged absence of a key employee.

Authorization Procedures – should include a thorough review of supporting information to verify the propriety and validity of transactions. Approval authority should be commensurate with agency policies and District regulations.

Segregation of Duties – should reduce the likelihood of errors and irregularities. An individual should not have responsibility for more than one of the three transaction components: authorization, custody, and record-keeping. For example,

- ◇ authorization for the assessment of vehicle registration fees or conversion fees should be segregated from the collection of those fees.

Physical Restrictions – are the most important type of protective measure for safeguarding agency assets, processes, and data. For example,

- ◇ safe combinations should be changed periodically and whenever an employee with knowledge of the combination terminates employment.
- ◇ critical forms, such as checkbooks, should be adequately secured.
- ◇ alarm systems may be necessary to adequately protect large amounts of cash, other valuable assets, or sensitive data.

Documentation and Records Retention – should provide reasonable assurance that assets are controlled and transactions are recorded correctly. For example,

- ◇ a standard equipment loan form documents the authorized removal of equipment from an agency and provides assurance that an individual has accepted responsibility for the item.
- ◇ appropriate approval for all new or revised forms having financial implications provides consistency and ensures that adequate transaction information is recorded.

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

- ◇ Account managers, account supervisors, and fiscal officers must verify the propriety of transactions within their accounts.
- ◇ Periodic physical inventories provide assurance that assets physically exist and are available for use.

What Are the Key Internal Controls?

Key controls include the following:

Top-Level Reviews of Actual Performance – Management should track major agency achievements and compare them to established plans, goals, and objectives.

Documentation of Policies and Procedures – Agency policies and operating procedures should be written, communicated, promoted, accessible, and followed to ensure integrity and consistency in processes and transactions.

Management of Human Capital – Effective management of an agency's workforce is essential to achieving results. Only when the right personnel for the job are on board and provided with the right training, tools, structure, incentives, and responsibilities is operational success possible. Management should ensure that skill needs are continually assessed and that the agency is able to employ a workforce that has the requisite skills to achieve established goals.

Training and Supervision – Training should be provided to ensure employees are equipped to fulfill their job responsibilities. Employees should be supervised to ensure they are appropriately directed and held accountable. Employees should be informed of the process for reporting suspected improprieties.

Review and Reconciliation – Routine examination and reconciliation of transaction records to official District records is required to verify the accuracy of the records, the appropriateness of the transactions, and compliance with policies, regulations, and laws.

Physical Control Over Vulnerable Assets – Equipment, inventories, cash, securities, and other property should be physically secured, and periodically counted and compared to the District control records.

Segregation of Duties – As noted above, financial responsibilities should be divided among different employees to ensure that a single person does not perform every aspect of a financial transaction. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets. No one individual should control all key aspects of a transaction or event.

Controls Over Information Processing – Examples of various information processing controls include edit checks of data entered, accounting for transactions in numerical sequences, comparing file totals with control accounts, and controlling access to data, files, and programs.

Proper Execution of Transactions and Events – Transactions and other significant events should be authorized and executed by persons acting within the scope of their authority. This ensures that only valid transactions to exchange, transfer, use, or commit resources and other events are initiated. Authorizations should be clearly communicated to managers and employees. Transactions should be authorized by a delegated official who verifies prior to approving the transaction that:

(1) he or she has approval authority; (2) sufficient funds are available; and (3) the transaction is consistent with administrative policies, regulations, and laws (and benefits the fund sources being charged), allowable (meets the stipulations of the funds), accurate, and reasonable.

Access Restrictions to and Accountability for Assets and Records –

Access to assets and records should be restricted to authorized individuals, and accountability for their custody and use should be assigned and maintained. The recorded accountability for assets (i.e., an official record of personnel to whom access is authorized) should be compared with the existing assets at reasonable intervals so that appropriate action can be timely taken with respect to any differences. This control procedure helps reduce the risk of errors, fraud, misuse, or unauthorized alteration of records related to the use of assets.

Appropriate Documentation of Transactions – All transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. This documentation should be required by management directives, administrative policies, or operating manuals, and may be in paper or electronic form. All documentation and records should be properly managed and maintained.

An agency's internal controls should be flexible to allow agencies to tailor key controls to special needs. The specific controls used by a given agency may be different from those used by others due to a number of factors. These factors include specific threats and risks; differences in objectives; management judgment; size and complexity of the organization; operational environment; sensitivity and value of data; and requirements for system reliability, availability, and performance.

What Can Jeopardize Internal Controls?

While circumstances may compromise the effectiveness of your internal control structure, a few of the most common and serious of these are:

Inadequate Segregation of Duties – Separating responsibility for physical custody of an asset from the related record keeping is a critical control.

Inappropriate Access to Assets – Internal controls should provide safeguards for physical objects, restricted information, critical forms, and update applications. For example, an employee who only needs to view computer information should be restricted to Read and File Scan access instead of Write and Create access. Only authorized individuals should be issued keys for restricted areas.

Inadequate Knowledge of Policies, Procedures, and Regulations – The District government is not a static environment. New regulations, policies, and revisions are a part of our continual evolution. Current regulations and policies are available electronically, and printed copies can be supplied upon request by contacting appropriate agency officials. Managers and employees must stay abreast of these changes and understand their responsibilities.

Form Over Substance – Controls can appear to be well designed, but still lack substance, as is often the case with required approvals. For example, the account manager's signature attests to the accuracy of the payroll processing information, but if the account manager has not ensured that the supporting time records are accurate, the approval process lacks substance.

Control Overrides – Exceptions to established policies are sometimes necessary to accomplish specific tasks, but can pose a significant risk if not effectively monitored and limited. Thorough documentation and approval of all exceptions or control overrides will help management ensure the availability of a clear explanation for unusual transactions or events. A periodic review of these exceptions also helps to identify the need for policy or procedural changes.

Inherent Limitations – There is no such thing as a perfect control system. For instance, staff size limitations may obstruct efforts to properly segregate duties. A limitation in any system is the element of human error, such as situations involving misunderstandings, fatigue, or stress.

How Much Do Internal Controls Cost?

The cost of implementing a specific control should not exceed the expected benefit of the control. For example, the potential loss of a computer printer may justify the cost of a door lock, but not an alarm system. Computer screensavers with passwords are inexpensive, effective methods of protecting sensitive data on a computer.

Sometimes there is no out-of-pocket cost to establish an adequate control. Realignment of duty assignments may be all that is necessary to accomplish the objective. A well-designed internal control structure can enhance operations by improving your agency's overall efficiency and effectiveness as well as reducing the risk of loss or theft.

In analyzing pertinent costs and benefits, managers also should consider possible ramifications for the District and attempt to identify and weigh potential consequences. For instance, it may be difficult to determine the cost of poor public relations and lost goodwill if an ex-employee steals cash because the responsible manager did not change the safe combination or retrieve agency keys upon the employee's separation from government service.

How Can Managers Balance Risks and Controls?

The degree of control employed is a matter of good business judgment. When operating controls are found to contain weaknesses, management may choose among the following alternatives:

- ◇ increase supervision and monitoring;
- ◇ institute additional or compensating controls; and/or
- ◇ accept the risk inherent with the control weakness.

Risk is the probability that an event or action will adversely affect the agency by preventing the achievement of its objectives. The primary categories of risk are errors, omissions, delays, and fraud. In order to achieve goals and objectives, management needs to effectively balance risks and controls. Therefore, control procedures need to be developed so that they decrease risk to a level where management can accept the exposure to that risk. By performing this balancing act, *reasonable assurance* can be obtained. As it relates to financial and compliance goals, being out of balance can cause the following problems:

Excessive Risks	Excessive Controls
Loss of Assets, Grants, or Donors	Increased Bureaucracy
Poor Business Decisions	Reduced Productivity
Noncompliance	Increased Complexity
Increased Regulations	Increased Cycle Time
Public Scandals	Increase of No-Value Activities

In order to achieve a balance between risk and controls, internal controls should be proactive, value-added, cost-effective, and address exposure to risk.

What Can You Do?

You can help strengthen your agency's internal controls by performing these activities:

- ◇ Follow the policies and procedures in place for your job.
- ◇ Always secure your office or workplace when you leave.
- ◇ Use agency resources only in support of agency's goals, objectives, and programs.
- ◇ Keep documents containing confidential or sensitive data in secure files.
- ◇ Shred documents containing confidential or sensitive data when no longer needed.
- ◇ Communicate problems with current procedures or suggestions for improvement to your supervisor.
- ◇ Report any suspicious persons or activities to your supervisor and/or law enforcement agencies.

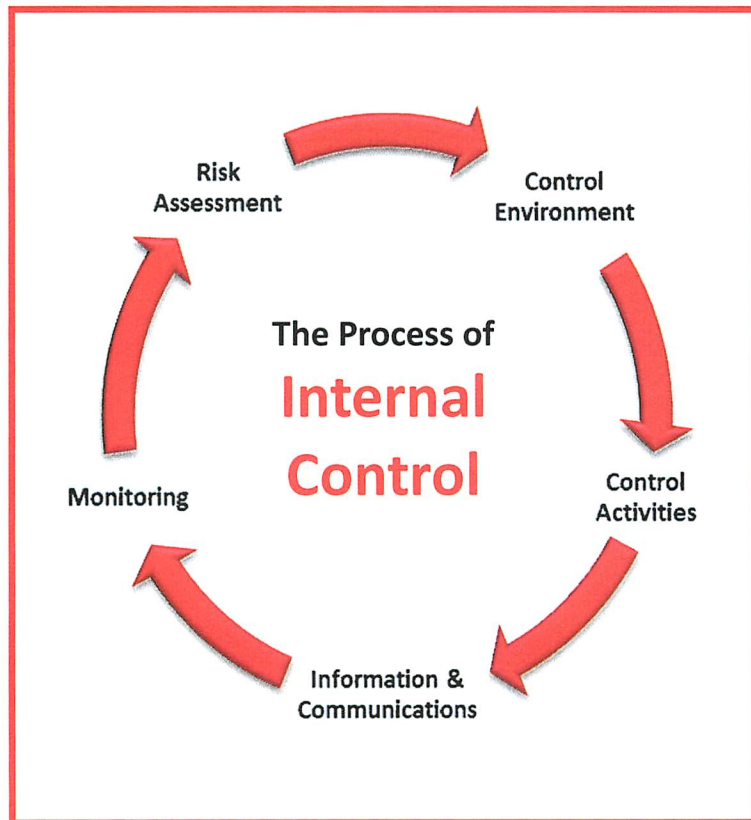
- ◇ Do not share or post your computer passwords.
- ◇ Always secure your computer when you leave for the day.
- ◇ Look for opportunities to reduce waste and improve efficiencies.
- ◇ Facilitate OIG auditor access to records and personnel as requested.

In Closing

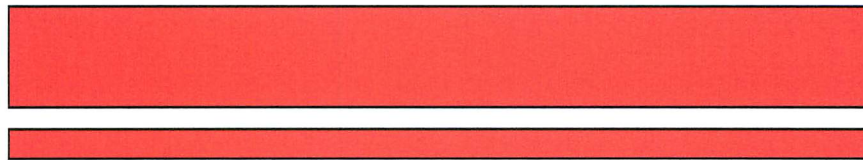
Internal controls should reduce the risks associated with undetected errors or irregularities, but designing and establishing effective internal controls is not a simple task, and cannot be accomplished through a short set of quick fixes. However, we hope that this guide has helped to explain basic internal control concepts and provided ideas for improving your unit's or agency's controls.

Contact Information

If you have any questions regarding this guide, please contact either the Assistant Inspector General for Audits or the Deputy Assistant Inspector General for Audits, District of Columbia Government Office of the Inspector General, at (202) 727-2540.



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