

CCC FINANCE FORUM ON INTERNAL AUDIT

April 23, 2015

ICF/DIAKONIA CENTER

OBJECTIVES OF THE FORUM

- To share and discuss on the **auditor roles, responsibility benefits** of internal audit and different audit functions.
- To explain the necessary **knowledge** and **real experiences** related to internal audits of participant's organization.
- Build up **more networks** and **relationships** among finance practitioners.

EXPECTATIONS

- Participants will have have a better understanding on **the key contents of internal audit** and its **benefits** for sound financial management.
- Participants will have a better understanding on the **process of internal audit activities** from **practitioners** and **experiences**.
- Participants will have **enhanced network** of finance practitioners and professionals.

Group Activity

Challenges at the Workplace where internal audit can address. (10 minutes)

1. Group in 20 and share real work challenges which you think internal audit can address.
2. Write in the flip chart the top 10 or 15 challenges and these will be discussed at the end of this sessions.

Session 4
**INTERNAL AUDIT AND
INTERNAL CONTROLS**

Presentation Outline

- I. Internal Audit and IC
- II. Frameworks of IC
- III. Definition of IC
- IV. Components of IC
- V. Principles to consider for effective IC and achieve Org Objectives
- VI. IC Components under Auditor's Assessment
- VII. Most Common IC Weaknesses observed in NGO

I. Internal Audit and IC

- As the definition of IA - Internal Control is the main component in its examination or review, hence good understanding of Internal Controls is **very important** and **plays a key role** in its proper implementation and that will help in the achievement of the Organization's goals and objectives.
- In order to properly understand Internal Audit, it is important to have a better understanding of the Internal Controls.

II. Framework of IC and its Principles

Frameworks of IC

- INTOSAI Guidelines for Internal Control Standards
- The Institute of Internal Auditors Research Foundation's Systems Auditability and Control (SAC)
- Chartered Institute of England & Wales: Guidance for Directors on the Combined Code :Turnbull Report, 1999
- The Committee of Sponsoring Organizations of the Treadway Commission's Internal Control - Integrated Framework (COSO)

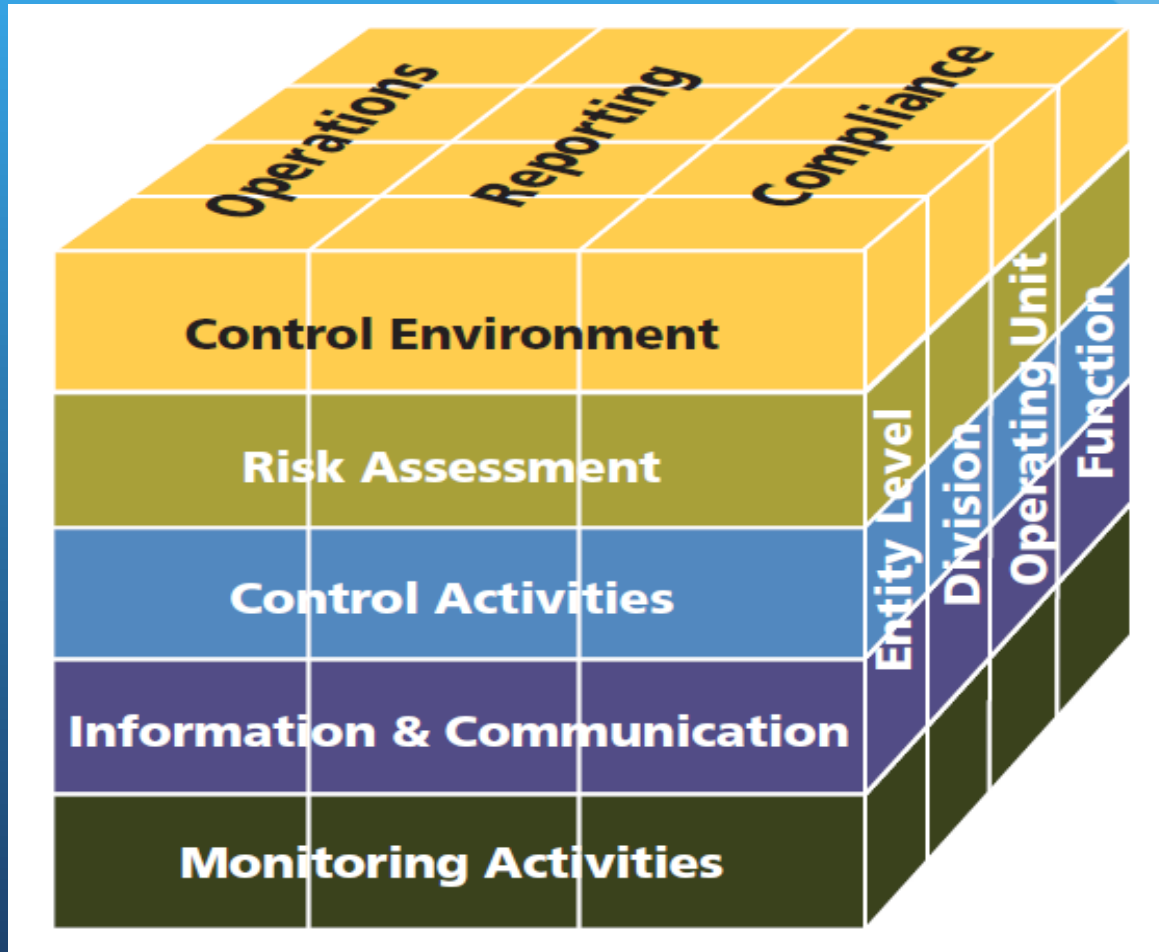
Frameworks of IC

- Canadian Institute of Chartered Accountants: The Framework of Criteria of Control (CoCo)
- The American Institute of Certified Public Accountants Consideration of the Internal Control Structure in a Financial Statement Audit (SAS 55 and 78)
- The Information System Audit and Control Foundation's COBIT (Control Objectives for Information and related Technology).

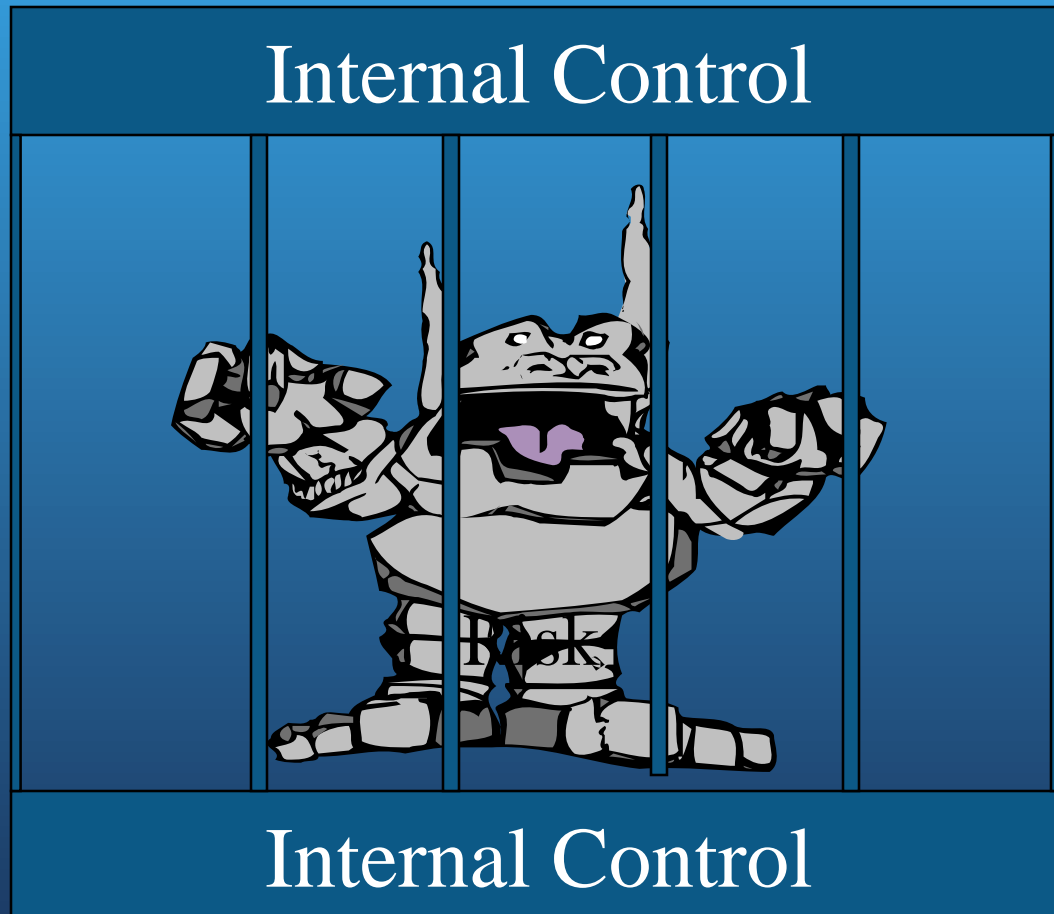
COSO Internal Control Framework

- COSO - Organized in 1985, sponsored by 5 major professional associations headquartered in the US
- American Accounting Association (AAA)
- American Institute of Certified Public Accountants (AICPA)
- Financial Executives International (FEI)
- The Institute of Internal Auditors (IIA)
- Institute of Management Accountants (IMA)

What is COSO IC Framework?



III. Internal Control Definition



A. Internal Control Defined

*Internal control is a **process**, effected by an entity's board of directors, management, and other personnel, designed to provide **reasonable assurance** regarding **the achievement of objectives** relating to **operations, reporting, and compliance**, which include*

- Reliability of financial reporting
- Compliance with applicable laws and regulations
- Effectiveness and efficiency of operations

B. Reasonable Assurance

Code the missing cash to bad debts.



Reasonable assurance involves two considerations:

- ❑ The cost of the entity's internal control should not exceed the expected benefits.
- ❑ Limitations exist in any entity's internal control.

IV. The Components of Internal Control

The internal control framework for most U.S. companies is the Committee of Sponsoring Organizations of the Treadway Commission (COSO) *Internal Control—Integrated Framework*, issued in 1992.

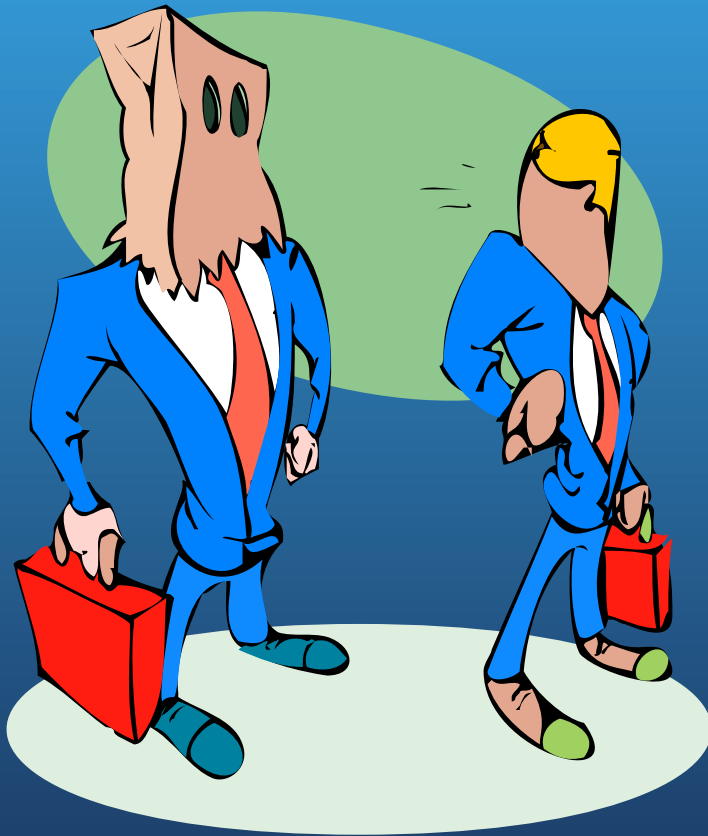
- A. The Control Environment
- B. Risk Assessment
- C. Control Activities
- D. Information and Communication
- E. Monitoring

A. The Control Environment

The control environment is concerned with the actions, policies, and procedures that reflect the overall attitude of the client's top management, directors, and owners of an entity about internal control and its importance.

1. Integrity and ethical values
2. Commitment to competence
3. Board of directors and audit committee
4. Management's philosophy and operating style
5. Organizational structure
6. Assignment of authority and responsibility
7. Human resource policies and practices

1. Integrity and Ethical Values



- ❖ Management actions to remove incentives that prompt a person to behave improperly.
- ❖ Communication of behavioral standards by codes of conduct and example.

2. Commitment to Competence

Management's consideration of the competence levels for specific jobs and how those translate into requisite skills and knowledge.



3. Board of Directors and Audit Committee

❖ Board delegates responsibility for internal control to management and is charged with regular independent assessments of management-established internal control.

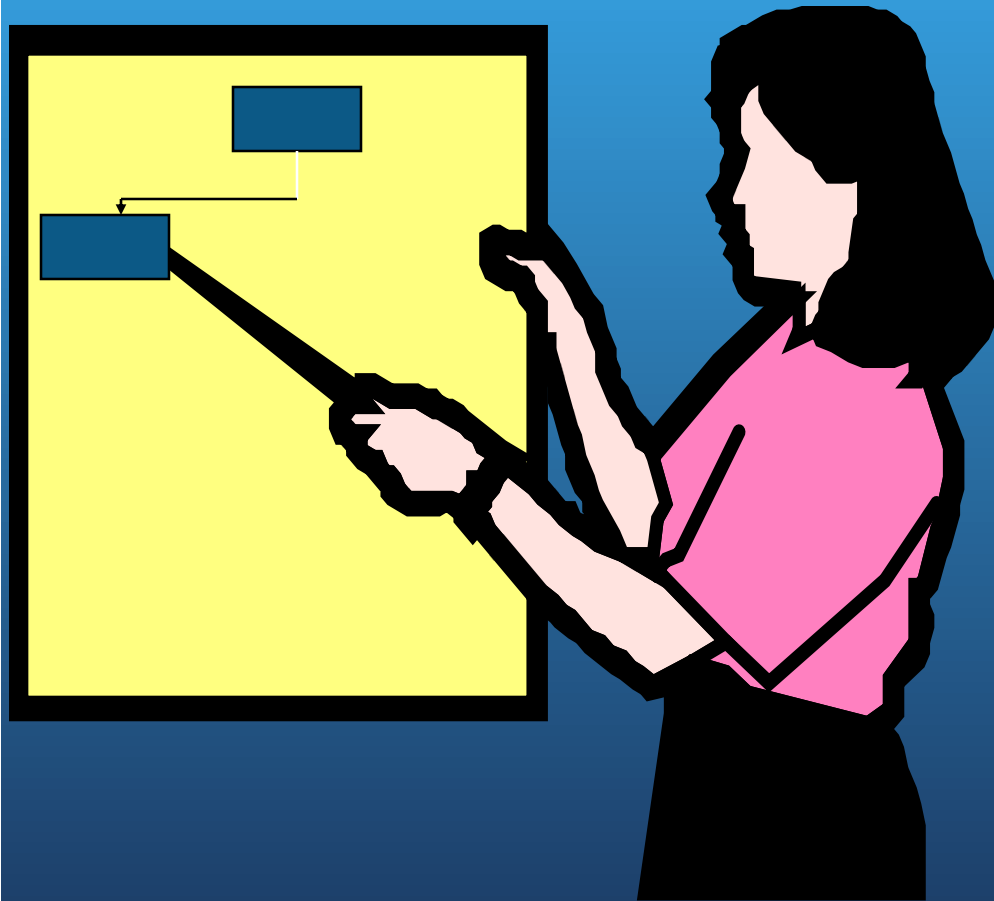


4. Management's Philosophy and Operating Style



Management, through its activities, provides clear signals to employees about the **importance of internal control**. For example, Management regularly asking or requesting for Financial Report, encourage obtaining quotations or bids, obtains proper seller receipts or invoice.

5. Organizational Structure



Understanding the client's organizational structure provides the auditor with an understanding of how the client's business functions and implements controls.

6. Assignment of Authority and Responsibility

Formal methods of communication including:

- ✓ Top management memoranda concerning internal control
- ✓ Organizational operating plans
- ✓ Employee job descriptions



7. Human Resource Policies and Practices



- ❖ If employees are **honest and trustworthy**, other controls can be absent and reliable financial statements will still result.
- ❖ Methods by which persons are **hired, trained, promoted**, and compensated are important elements of internal control.

B. Risk Assessment

Client management's identification and analysis of risks relevant to the preparation of the financial statements in accordance with CIFRS.

1. Client Management's Risk Assessment
2. Auditor Risk Assessment

1. Client Management's Risk Assessment



Client management assesses risk as part of designing and operating internal controls to minimize errors and fraud. Three steps involve:

- i. Identify factors that may increase risk
- ii. Determine significance of risk and likelihood of occurrence
- iii. Develop specific actions to reduce risk to an acceptable level.

2. Auditor Risk Assessment



The auditor obtains knowledge about management's risk assessment process by:

- ❖ Determining how management identifies risks relevant to financial reporting
- ❖ Evaluating their significance and likelihood of occurrence
- ❖ Deciding the actions needed to address the risks.

C. Control Activities

Policies and procedures that client management has established to meet its objectives for financial reporting.

1. Adequate segregation of duties
2. Proper authorization of transactions and activities
3. Adequate documents and records
4. Physical control over assets and records
5. Independent checks on performance

1. Adequate Segregation of Duties



- ❖ Separation of the functions of authorization, recordkeeping, and custody.
- ❖ Separating IT duties from User Departments

2. Proper Authorization of Transactions and Activities

- ❖ General authorization is permissible for routine events for which there are policies to follow.
- ❖ For some transactions specific authorization is needed on a case-by-case basis.



3. Adequate Documents and Records



- ❖ Prenumbered consecutive documents so missing items are noticed
- ❖ Prepared as near to transaction time as possible
- ❖ Obtain the proper receipts and invoices

4. Physical Control Over Assets and Records

- ❖ Deterrents to prevent physical access. (Dual access to Safe)
- ❖ Access controls to prevent getting into computer system.
- ❖ Backup and recovery procedures



5. Independent Checks on Performance



**BIG BROTHER
IS WATCHING
YOU!**

Personnel are likely to forget or intentionally fail to follow procedures, or they may become careless unless someone observes and evaluates their performance.

Types of Control Activities

- Directive - Set up of Policies and Procedures
- Preventive - Segregation of Duties, Training of Policies, Authorization
- Detective - Review and checks, cash counts, reconciliations, review of budget vs actual
- Corrective - Corrections through Journal Entries, changes on IT after change or roles
- Recovery - Back up and recovery of files
- Automated - Security access and password requirement

D. Information and Communication

Methods used to initiate, record, process, and report an entity's transactions and to maintain accountability for related assets.

- ❖ For a small company with active involvement by the owner, a simple computerized accounting system that involves one honest, competent accountant may provide an adequate accounting system.
- ❖ A larger company requires a more complex system that includes carefully defined responsibilities and written procedures.

E. Monitoring

Client management's **ongoing and periodic assessment** of the **quality of internal control** performance to determine whether controls are operating as intended and modified when needed.

- ❖ For many companies, especially larger ones, an internal audit department is essential for effective monitoring.
- ❖ To maintain internal audit independence, it is imperative that they be independent of operating and accounting departments; and that they report to a high level of authority, preferably the audit committee of the board of directors.
 - ❖ External Audit - Management Letter

Summary of Components (CRiCIM)

- **C**ontrol Environment - Board and Management, policies and procedures on internal controls, oversight
- **R**isk Assessment - Org and Auditor assessment of high risk and actions taken to lower the risk
- **C**ontrol Activities - segregation of duties, approval, safeguarding of assets
- **I**nformation and Communication - system of recording, documentation and reporting as internal control.
- **M**onitoring Activities - Internal and external audit

V. IC Components and its Principles

- Control Environment -Tone from the Top, Org commitment to integrity, ethical values, independence and oversight on IC
- Risk Assessment -Org specifies objectives to identify and assess risk and how to manage it to achieve its objectives
- Control Activities - Org selects and develop controls, puts policies into action to achieve its objectives
- Information and Communication - Org obtains, uses quality information to support functioning of IC
- Monitoring Activities - Org selects, develop and performs evaluations to ascertain IC are present and functioning

VI.IC Components under Auditor's Assessment

- Control Environment - Policies and procedures (Fin, Admin, Operations Manual) reviewed approved by BOD, Financial Oversight, Ensures implementation of policies and procedures
- Risk Assessment - regular meetings, interview, where management reviews the operations and identifies risks and recommend for improvement esp on changes in the Org.
- Control Activities - Walkthrough, interview, review of documents on the segregation of duties, safeguarding of assets, checks or supervision, check levels of Authority
- Information and Communication - review the system of recording, documentation and reporting.
- Monitoring Activities - review whether Internal and external audit have been performed.

Group Activity

- Group in 20 members
- Identify at least top 5 or 10 internal control weaknesses in your Organization based from the 5 components of internal controls.
- For each weaknesses, present it in the order being 1 as the weakest internal control and requires immediate attention and on the next column, mark it as (CE) for Control Environment, Risk Assessment (RA), Control Activity (CA), Information and Communication (IC) and Monitoring Activity (MA)

Group Activity

- For Control Activity weaknesses Identify whether it is
 - Directive Control (DiC)
 - Preventive Control (PC)
 - Detective Control (DeC)
 - Corrective Control (CC)
 - Recovery and Automated (RA)
- On the third Column, suggest recommendations in order to improve the internal controls of your Organization
- Present your answers in flip charts

VII. Most Common IC Weaknesses observed with NGOs

- Control Environment - 1. No financial oversight performed for the Organization to ensure IC are in place 2. No proper policies and procedures 3. No JD or unclear JD. 4. Management not requiring Management Financial Report.
- Risk Assessment - 1. Monthly meetings does not involve review of operation and identification of risks unless something happened.
- Control Activities - 1. No proper segregation of duties, no mitigating controls, 2. Proper authorization of transactions, 3. Proper supporting documents, 4. No access security, password, limits of access, 4. Back up and recovery. 5. Access to safe, 6. Checking of transactions, reports, schedules, supervision
- Information and Communication - 1. Financial Report not discussed or checked properly 2. No proper system or recording (Use of excel)
- Monitoring Activities - 1. No internal audit 2. No external audit for the whole Organization.