



Internal Controls

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Internal Controls Presentation Outline

- Definitions
- Why have internal controls?
- Risks of Weak Internal Controls
- Components of internal control
- Limitations of Internal Control
- Understanding Control Design
- What internal controls can/can't do

Internal Control

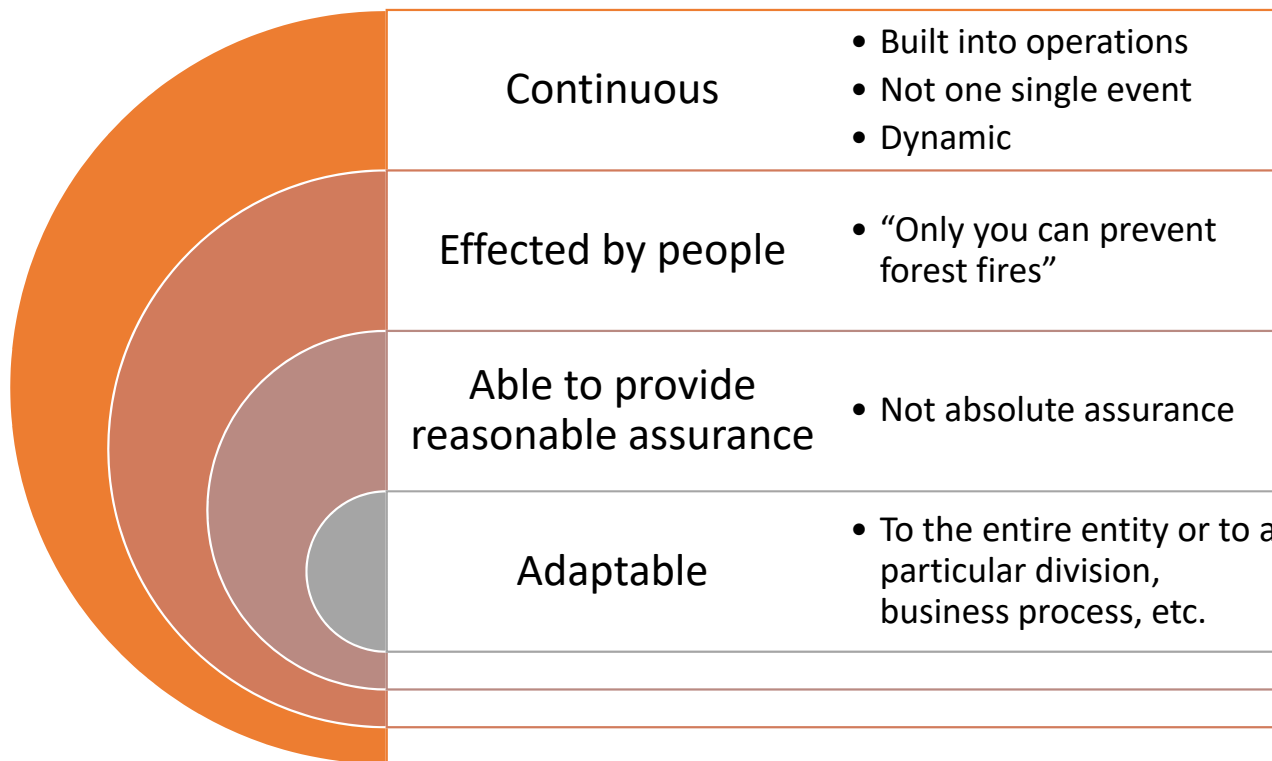
INTERNAL CONTROL is a *process*, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to:



Management has a fundamental responsibility to develop and maintain effective internal control.

Internal Control

INTERNAL CONTROLS are;



Connect



Why have internal controls?

Internal controls help ensure that we consistently do the right things, the right way in order to achieve the right objectives.

Internal control CARES!

COMPLIANCE with laws and policies

ACCOMPLISH objectives

RELEVANT and reliable data

EFFICIENT and economic use of resources

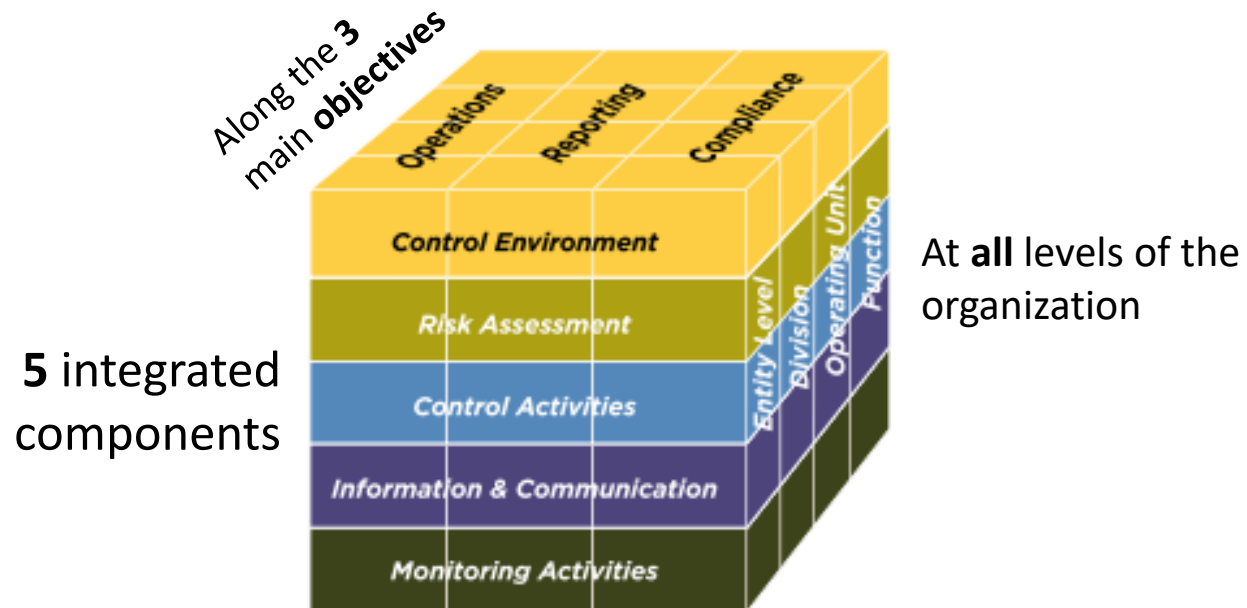
SAFEGUARD assets

Risks of Weak Internal Controls

- Financial misstatements
- Business loss
- Loss of funds or materials
- Incorrect or untimely management information
- Fraud or collusion
- Tarnished reputation with the public
- Program Sustainability compromised
- Missed goals



Framework



5 Integrated Components



1. Control Environment

- The set of standards, processes, and structures that provide the basis for carrying out internal control
- Comprises integrity and ethical values of the organization as well as: Management's philosophy and operating style, Organizational structure, How management assigns authority and responsibility (both along functional and administrative reporting lines), the competence of the entity's people, Personnel development (including training and support)

- The Board and Senior Management - **and you!**
 - Establish **tone at the top**
 - Establish expected standards of conduct and reinforce expectations
- Parameters enable the Board to carry out its governance oversight responsibilities

5 Integrated Components

The **Control Environment** should ensure controls are in place, covering areas such as:

- Hiring practices
- Training programs
- Whistleblower policies
- Code of **Ethics**
- Clear lines of responsibility and authority
- Etc.



As part of our regular business processes, we should continually monitor and update the Control Environment for dynamic changes

5 Integrated Components

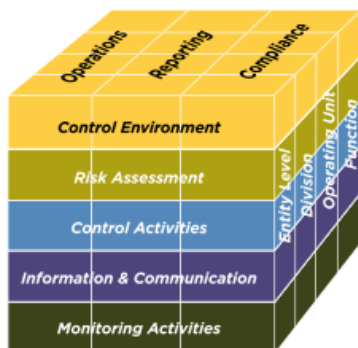
The **Control Environment** should be documented:

- **Process documentation/ controls**
 - Determine extent of existing documentation; leverage this
 - Create new if no documentation exists
 - Update for changes in operations

Types of documentation that can be used:

- Process Narratives
- Organizational charts
- Flowcharts
- Questionnaires
- Memorandums
- Checklists

5 Integrated Components



2. Risk Assessment

- Involves a dynamic and iterative process for identifying and assessing risks
 - Risk: the possibility that an event will occur and adversely affect the achievement of objectives.
-
- The Board and Senior Management (and you!)
 - Establish **objectives** linked at different levels of the entity
 - Must take holistic approach – look at the full organization
 - Apply internal control to achieve multiple objectives
 - Prevent domino effects, e.g., weakness in financial reporting that jeopardizes operations
 - Establish risk tolerances
 - Increasingly important when resources are constrained

Managing risks

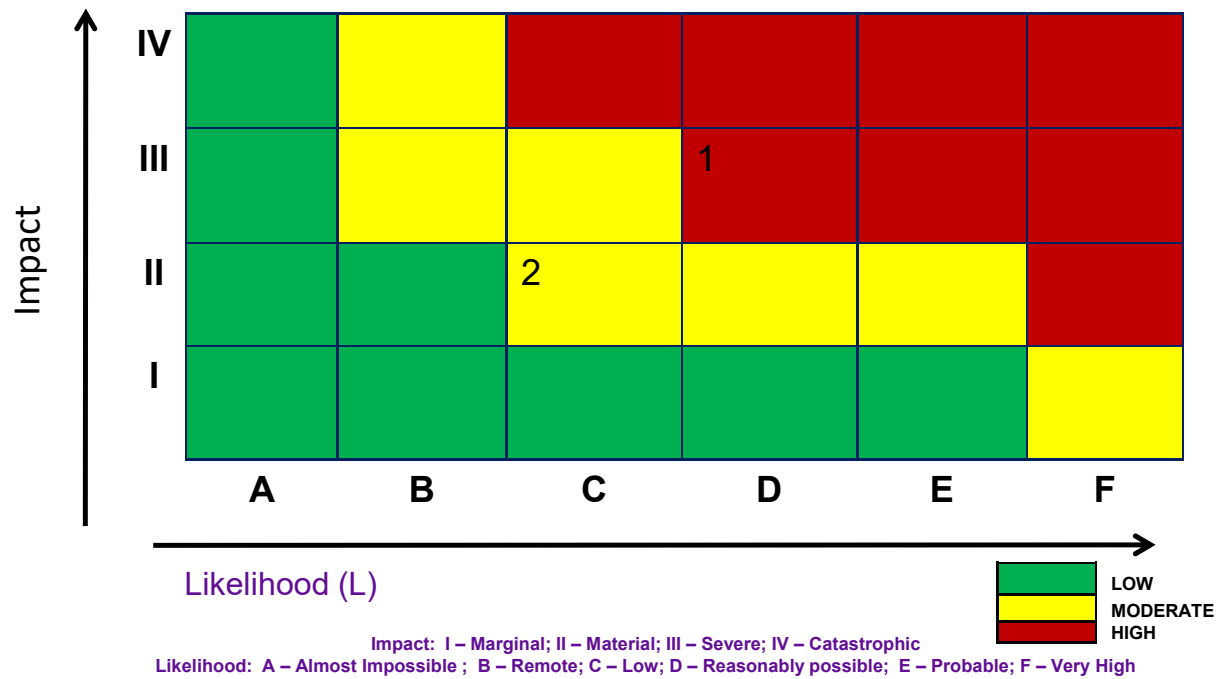
Internal control is to a large extent about managing risks. Risks to The institution can be categorized under five headings:

1. **Strategic** - including Political risk, talent and succession planning risk, and risk from dependencies on other organizations
2. **Financial** - including risk of audit findings and other things that would undermine reporting integrity
3. **Compliance** - including Fraud and non-compliance with fair employment practices
4. **Operational** - including the risk that Programs fail to meet their objectives, natural disasters, and lack of technology availability
5. **Reputational** - including tarnished public image

5 Integrated Components

Risk Mapping

Consider the organization's risk tolerance and risk appetite related to the risk response



5 Integrated Components

Risk Strategies

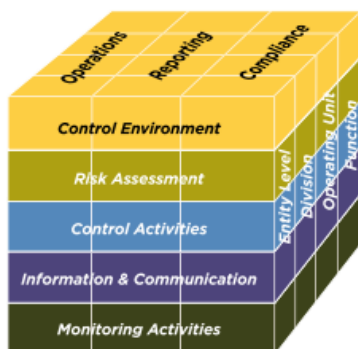


How does an Institution manage risks?

- Plans
- Policies
- Procedures
- Standard operating practices
- Guidelines

These, along with the positive attitudes and efforts of employees, help minimize risks to The institution.

5 Integrated Components



3. Control Activities

- The actions established through policies and procedures that help ensure management's directives to mitigate risks are carried out.
- Performed at all levels within the entity

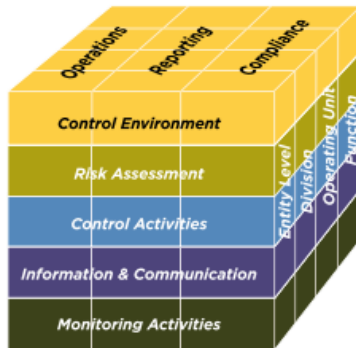
Types:

- Preventive and detective and corrective
- Compensating
- Manual and automated

Examples:

- Approvals & Authorizations
- Embedded verifications
- Reconciliations
- Independent Reviews
- Asset security
- Segregation of duties

5 Integrated Components



4. Information and Communication

- Information is necessary to carry out internal control responsibilities to support achievement of objectives
- Communication: the continual, iterative process of providing, sharing, and obtaining necessary information
- Internal and external
- Information should be timely, accessible, and allow for successful control actions



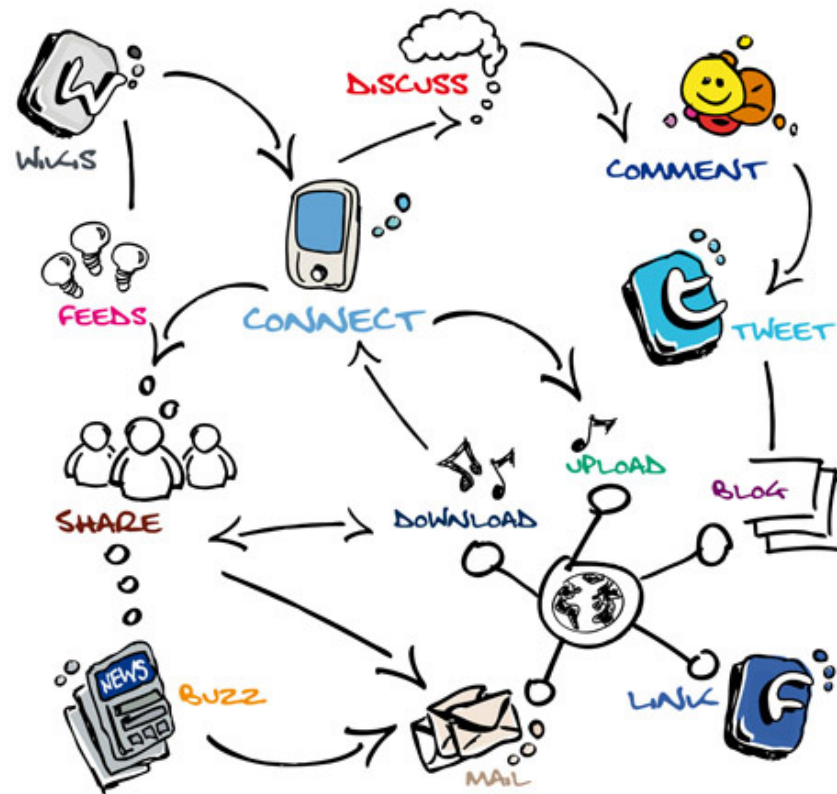
Key: To **communicate** the **right information** to the **right people** at the **right time**

5 Integrated Components

Information & Communication

Things to communicate:

- Initiatives
- Goals
- Changes
- Opportunities
- Feedback
- Questions
- Answers
- Policies
- Procedures
- Standards
- Expectations



5 Integrated Components

5. Monitoring Activities

- Evaluations used to ascertain whether components of internal control are **present** and **functioning**
- *Ongoing* evaluations:
 - Built into business processes
 - Provide timely information
- *Separate* evaluations:
 - Conducted periodically
 - Vary in scope and frequency
 - Dependent on assessment of risks, effectiveness of ongoing evaluations, other management considerations



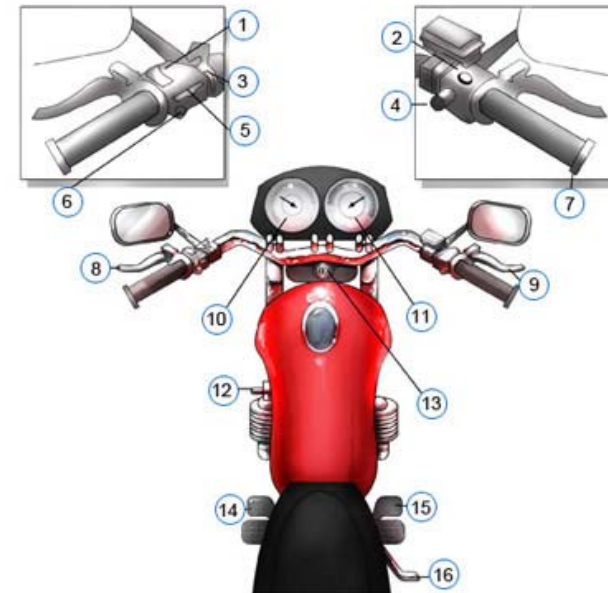
Findings are evaluated against relevant criteria

Deficiencies are communicated to the Board and Sr. Management

5 Integrated Components

Testing Control Processes

- **Identify**
 - transactions to be tested
 - key controls
 - applicable standards to test the transaction (i.e., criteria to judge compliance effectiveness)
- **Determine**
 - appropriate type of testing
 - extent of testing
- **Create** test plan
- **Conduct** tests for effectiveness
- **Document** testing and results
- **Assess** test results
- **Communicate** findings, recommendations



Limitations of Internal Control

Even an effective system of internal control can experience a failure.

Limitations may result from:

- Suitability of established objectives
- Reality that human judgment in decision making can be faulty and subject to bias
- Breakdowns that can occur because of human failures such as simple errors
- Ability of management to override internal control
- Ability of management, other personnel, and/or third parties to circumvent controls through collusion
- External events beyond the University's control

Again, internal control provides *reasonable*, not absolute, assurance of achieving objectives.

Common Basic Internal Control Principles



Establish Responsibility

- Assign each task to only one person



Segregate Duties

- Don't make one employee responsible for all parts of a process



Restrict Access

- Don't provide access to systems, information, assets, etc. unless needed to complete assigned responsibilities



Document Procedures and Transactions

- Prepare documents to show that activities have occurred



Independently verify

- Check others' work

Understanding Control Design

Good Controls are:

- Focused
- Integrated
- Accurate
- Simple
- Accepted
- Cost Effective



What internal controls can/can't do

Internal controls can be designed to:

- Remove the risk
- Control the risk
- Accept the risk and create contingency plans for worst-case scenarios where feasible

Different controls have different levels of influence.

The strength of the control must be balanced with the need for operating efficiency.

Whose job is it?

Everyone's!

- Internal controls can only be fully effective when everyone plays their part
 - Those closest to the work are often best able to identify what controls are needed and assess how well the controls actually work
 - Those with a higher level view can assess the overall significance of risks in each area and determine how strong the controls need to be

Resources

External sites:

- PwC summary on why the COSO Update deserves your attention:
http://www.pwc.com/en_US/us/10minutes/assets/pwc-10minutes-update-coso-committee-sponsoring-organizations-treadway-commission.pdf
- COSO website: <http://coso.org/>
- COSO Executive Summary on updated Internal Control Integrated Framework:
http://coso.org/documents/990025P_Executive_Summary_final_may20_e.pdf

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