Introduction To Reporting On Internal Controls

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To: Audit Committee

What is a Control?

- A control is any action taken by management, the board, and other parties to manage risk and increase the likelihood that established mission, objectives and goals will be achieved.

- A control serves as a defense in safeguarding assets and in preventing and detecting errors, fraud, non compliance with provisions of laws, regulations, contracts, or grant agreements.

- It helps program managers achieve desired results through effective stewardship of public resources

The Control Process

- Control processes - are the policies, procedures, and activities that are part of a control framework

- Risk management - is a process to identify, assess, manage, and control potential events or situations to provide reasonable assurance regarding the achievement of the organization's mission, goals and objectives.

Who Relies on Controls?

- Management
  - They set the "tone at the top" that affects integrity and ethics and other factors of a positive control environment

  - Management designs and implements internal control procedures

  - Monitor the effectiveness of the internal control system

Who Relies on Controls

- Council and Public need to know whether:
  - Management use their authority and manage government resources properly and in compliance with laws and regulations

  - Government programs are achieving their objectives and desired outcomes

  - Government services are provided effectively, efficiently, economically, ethically and equitably

Who Relies on Controls?

- Auditors
  - External and Internal auditors assess whether the controls are properly designed, implemented and working effectively, and make recommendations on how to improve internal control
  - Weaknesses in control relate directly to the amount of audit verification the Auditors must do.
  - The amount of verification directly affects the cost of audits

Understanding Internal Controls

- Auditors obtain an understanding of internal controls through:
  - Inquiries
  - Observations
  - Inspection of documents and records
  - Review of other auditor's reports
  - Direct testing

Types of Controls

- Two types of controls:
  - Preventative
    - Designed to discourage errors or prevent irregularities from occurring. They are proactive controls that help prevent a loss. *Examples: Separation of duties, proper authorization, adequate documentation, and physical control over assets.*
  - Detective
    - Designed to find errors or irregularities after they have occurred. *Examples: Reviews, analyses, variance analyses, reconciliations, physical inventories, and audits.*

Who is responsible for controls?

- Everyone plays a part in the internal control system.

- Ultimately, it is management's responsibility to ensure that controls are in place. Each area of operation, must ensure that internal controls are established, properly documented, and maintained.

Who is responsible for controls?

- Every employee has some responsibility for making this internal control system function. Therefore, all employees need to be aware of the concept and purpose of internal controls.

- Auditor General's role is to assist management in their oversight and operating responsibilities through independent audits and consultations designed to evaluate and promote the systems of internal control.

Deficiency in Controls

- The audit can reveal a deficiency in either the

  - Design of the control – *Example: Invoices do not require management approval before payment*

  - Operation of the control – *Example: Process requires management approval before payment, yet payments are being processed without management approval*

Why can controls break down?

- No matter how well internal controls are designed, they can only provide **reasonable assurance** that objectives have been achieved.

Why can controls break down?

- Some limitations inherent in internal control system:

  - **Judgment** - The effectiveness of controls will be limited by decisions made with human judgment under pressures to conduct business based on the information at hand.

  - **Breakdowns** - Even well designed internal controls can break down. Employees sometimes misunderstand instructions or simply make mistakes.

  - **Management override** - High level personnel may be able to override prescribed policies and procedures for personal gain or advantage.

  - **Collusion** - Individuals acting collectively can alter financial data or other management information in a manner that cannot be identified by control systems.

Conducting the Audit – A Review of The Control Framework

- Audit is conducted based on the audit plan

- Auditor obtains sufficient and relevant information and audit evidence to support audit findings and recommendations

- Management is kept informed of the progress of the audit based on their preferences expressed during the planning meetings

Audit Closing Meeting

- Audit closing meeting is done at the completion of fieldwork

- Audit closing meeting is held with client management and may include the department's General Manager, Director and/or Manager

- The audit findings are provided to management prior to the Audit closing meeting.

Audit Closing Meeting

- All findings and recommendations are discussed with management (even if they have been discussed previously)

- Discuss with management what Audit is looking for in a management response and timeline for responses

Audit Findings and Recommendations

- Findings and recommendations are recorded in the Audit Findings template and used as a discussion tool at the closing meeting.

- Any changes or amendments as discussed during the closing meeting are recorded

- Template serves as the framework for the creation of the draft audit report

Audit Report

- Audit report is drafted and sent to management for review

- Ask that management provide written responses to audit recommendations within 2 weeks (10 working days)

- Review with management what audit is looking for in a response
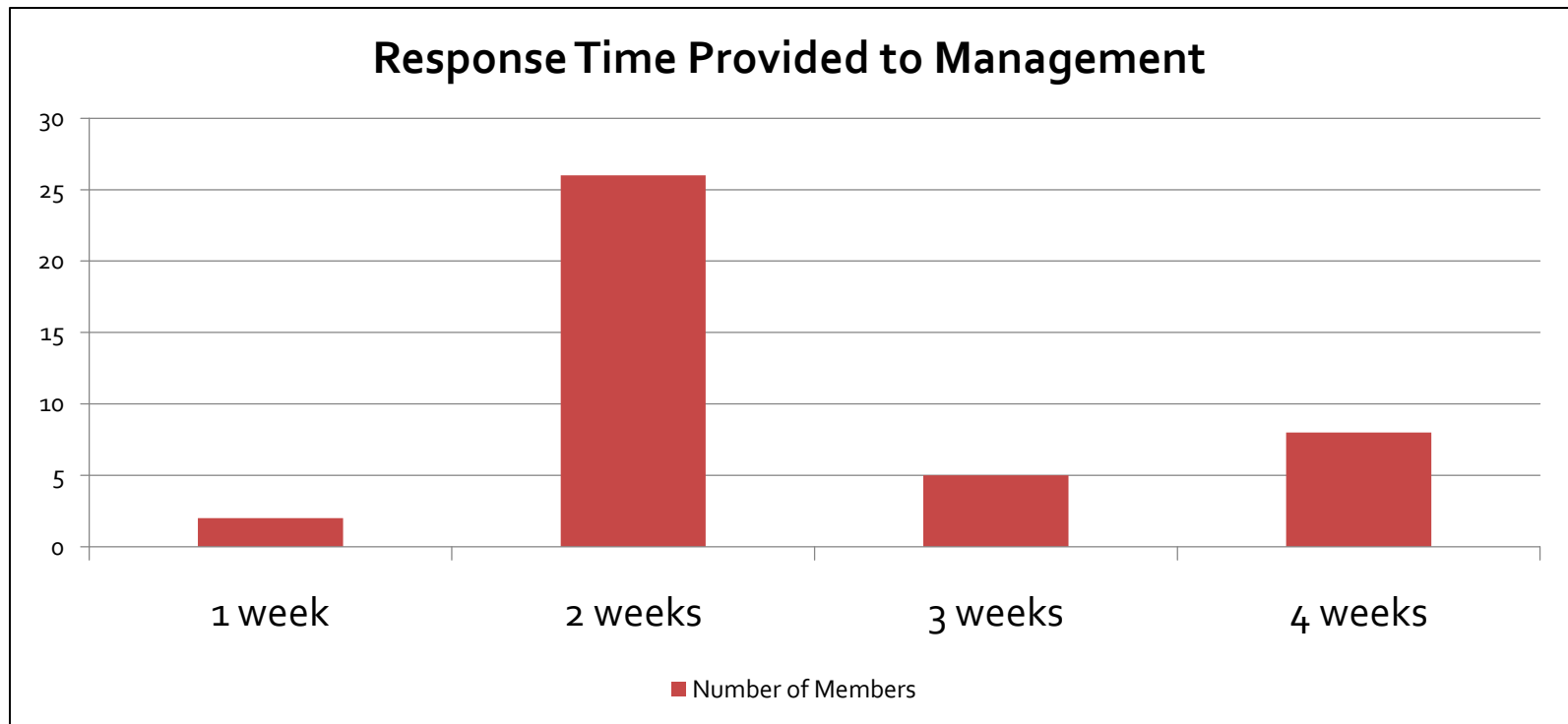
Management Responses

- The template for management responses is sent to management along with Draft Audit Report

- Ask management to indicate whether they agree or disagree
  - If they agree, indicate action plan and time frame
  - If they disagree, include management comments as to why they disagree

Management Responses

- According to GAS 7.37 – If the auditors disagree with management comments, they should explain in the report their reasons for disagreement

- According to GAS 7.38 – If management refuses or is unable to provide comments within a reasonable period of time, the auditors may issue the report without receiving comments

Other Municipalities

- ALGA performed a survey of its members and asked what response time is given to management for them to respond to audit recommendations

Response Time Provided to Management

Number of Members

Conclusion and Questions

- Management input is required throughout the audit process – from planning to drafting recommendations

- It is important that management responds to draft audit report in a timely fashion

- Proper management responses are imperative so that Audit can perform follow-up and report back to Council