

# Internal Control Concepts and Applications

---

Kansas State University

Internal Audit

# Internal Audit Office

---

214 Anderson Hall

Phone 2-7308

Steve LaFever, MSA, CPA, Director, Phone: 2-5460 [sdlafever@ksu.edu](mailto:sdlafever@ksu.edu)

Toynia Smith, CIA, Senior Internal Auditor, Phone 2-5413, [toynia@ksu.edu](mailto:toynia@ksu.edu)

Jana Clark, MBA, CIA, Internal Auditor, 2-6746, [jjoy@ksu.edu](mailto:jjoy@ksu.edu)



# Mission

---

- Our mission is to serve the University by providing independent assurance and consulting services to add value, strengthen internal controls, improve compliance with Federal, State, Kansas Board of Regents, and University rules and regulations and improve operations.

# Philosophy and Vision

---

- Internal Audit provides value-added audit and advisory services with objectivity, transparency, and independence using the Institute of Internal Auditors' professional and ethical standards as guidance.
- We develop our staff through continuous training to provide management with expert service to improve operations and provide value-added change with utmost integrity.



# Audit Process

---

## Audit Selection

The Annual Audit Plan is prepared using a University risk assessment and requests from University administrators including Vice Presidents, Deans and Directors.

# Audit Process

---

## Review of Internal Controls and Testing

- During the review of internal controls and tests of transactions phase of the audit, the auditor meets with staff and management to understand the unit's procedures and internal controls. The auditor identifies controls that reduce risk, as well as any missing controls.
- The auditor tests a sample of transactions, with emphasis placed on higher risk items, to verify that controls are functioning as intended, or determine where improvements are needed.

Audits of revenues and expenditures typically include tests of revenues, accounts receivable, purchases, business procurement card purchases, inventory, property, travel, and payroll.



# Reporting Process-Draft Report

---

- The auditor-in-charge meets informally with management to discuss probable report observations to ensure the recommendations are feasible.
- The report is drafted and sent to management for review prior to discussion at the exit conference.
- At the exit conference, it is agreed with management that responses with action plans and an implementation date are expected to be submitted to Internal Audit within 30 days. The Vice President for Administration and Finance may approve extensions given extenuating circumstances.
- The University President will be informed if a timely management response is not received.

# Final Report

---

- The final report reflects changes discussed at the exit conference as well as management's action plan.
- The report is addressed to administrators including the Department Head, Director, Dean, Vice President for Administration and Finance and other appropriate personnel.
- If fraud or material financial weaknesses are found, the final audit report is sent to the Kansas Board of Regents in compliance with the Kansas Board of Regents Policy.



# Follow-up Review

---

- After audit recommendations are scheduled to be implemented, Internal Audit will follow-up with management to determine whether the recommendations were successfully implemented.
- To perform the follow-up, the auditor inquires about progress in implementing the recommendation and reviews a limited sample of transactions related to the recommendation.

# What is Internal Control?

---

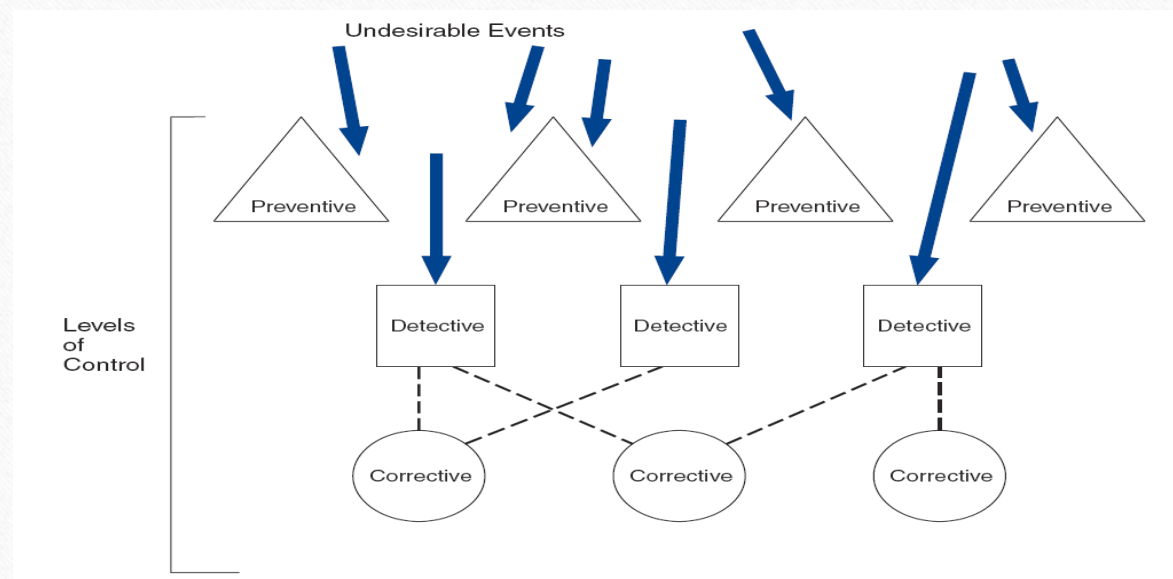
- Internal control refers to the processes and procedures used to provide a “reasonable” level of assurance that goals and objectives will be achieved.
- They include anything which serves to safeguard university assets or to improve the effectiveness and efficiency of operations.
- In general terms, internal controls are simply good business practices.
- It is important to remember that implementing internal controls is a continuous process requiring everyone’s attention to ensure goals and objectives are achieved.



# The Internal Control Shield



# Levels of Controls





# Five Types of Internal Controls

---

- **Preventive** controls, the first line of defense, are designed to keep errors and irregularities from occurring in the first place - stops something from happening.
- **Detective** controls are designed to detect errors or irregularities that may have occurred - finds out what happened, alerts you as it happens or shortly after.
- **Corrective** controls are designed to correct errors or irregularities that have been detected – follow detective controls, recovery from consequences of an error or unexpected event.
- **Directive** controls are those designed to establish the desired outcomes – tells you what should happen.
- **Compensating** controls are those used to compensate for controls that are otherwise lacking. Generally, close supervision is used to compensate for lack of separation of duties.

# Preventive Controls

---

## Preventive Controls Examples.

- Segregation of duties, remember the “ARC” (separates Accountability (or Authorization) from Reconciliation, from Custody (of asset). No person should perform more than one function.
- Physical controls over assets
- Authorized signers
- University payables review and approval of travel vouchers prior to processing
- Reminders of policies, procedures, and expectations



# Detective Controls

---

Detective Control examples:

- Account reconciliations
- Management review of reconciliations
- Physical inventories
- P-Card logging, reconciliation, and approval
- Review of budget to actual
- Year to year expenditure trending

# Corrective Controls

---

Corrective Control examples:

- Error communication and reporting
- Systems Documentation or processes
- Improvement initiatives



# Directive Controls

---

Directive controls:

- Kansas State University Policies and Procedures Manual
- Kansas Board of Regents Policy and Procedures  
<http://www.kansasregents.org/resources/PDF/2582-BoardPolicyManual.pdf>
- • College policies
- • Unit procedures

# Who is Responsible for Internal Control?

---

- PPM 3210
- Everyone within the University has some role in internal controls.
- The roles vary depending upon the level of responsibility and the nature of involvement by the individual.
- The Kansas Board of Regents, President and senior executives establish the presence of integrity, ethics, competence and a positive control environment.
- The directors and department heads have oversight responsibility for internal controls within their units.
- Managers and supervisory personnel are responsible for executing control policies and procedures at the detail level within their specific unit.
- Each individual within a unit is to be cognizant of proper internal control procedures associated with their specific job responsibilities.



# Primary Assumptions of Internal Control

---

## **Management Responsibility**

The establishment and maintenance of a system of internal control is the responsibility of management.

## **Reasonable Assurance**

The cost of achieving the objectives of internal control should not outweigh its benefits.

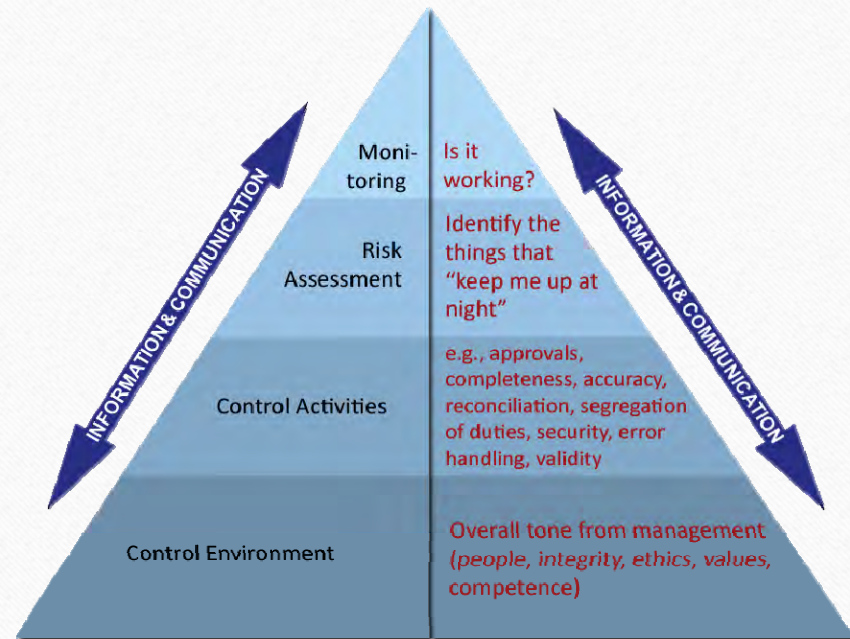
## **Methods of Data Processing**

The techniques of achieving the objectives will vary with different types of technology.

# Components of Internal Control

<http://www.k-state.edu/internalaudit/internal-controls/>

- Internal control consists of five interrelated components, each of which is an integral part of the management process and plays a specific role in departmental internal control procedures.





# Control Environment

---

- The control environment sets the tone of the organization, influencing the control consciousness of its people. After all, the core of any educational institution is its people.
- Leaders of each department, area or activity establish a local control environment.
- It is the foundation for all other components of internal control, providing discipline and structure.

# Control Environment Continued

---

Control environment factors include:

- Integrity and ethical values;
- The commitment to competence;
- Leadership philosophy and operating style;
- The way management assigns authority and responsibility, and organizes and develops its people;
- Policies and procedures.



# How YOU Can Improve the Control Environment

---

- Communicate clearly
- Accuracy counts...do not rush
- Don't just talk the talk, *walk the walk*
- Use exceptions/errors as opportunities to teach what's right
- Don't let abuse or misuse go
- Don't be a party to circumvention of controls
- Perform an annual risk assessment in tandem with a review/update of your unit's strategic plan

# Control Principles/Activities

---

- These are the policies and procedures that help assure management that directives are being implemented at all levels of the organization and include:

**Transaction Authorization-** Authorization to initiate or approve transactions should be limited to specific personnel. Authorizations can be limited by type of transactions or amount of transactions.

- Used to ensure that employees are carrying out only authorized transactions
- General (everyday procedures) or specific (non-routine transactions) authorizations



# Control Principles/Activities Cont.

---

**Separation of duties-** provides that one employee does not have the responsibility for all phases of a transaction.

- Generally, an employee with physical access to an asset should not also be responsible for accounting records relating to that asset.
- The employee should also not authorize the transaction. A compensating control in the event separation of duties is not possible is close supervision

# Control Principles/Activities Include Cont.

---

- **Accurate documentation of transactions** in a timely manner and retention of records in an organized manner.
- **Validation** to ensure that all recorded transactions fairly represent the economic events that actually occurred, are lawful in nature, and have been executed in accordance with management's general authorization.
- **Physical safeguarding of assets** including maintaining an inventory and limiting access to assets.
- **Audit trails of transactions**
- **Reconciliations of ledgers to accounting records** should be prepared periodically and reconciling items should be resolved timely.



# Control Principles/Activities Include Cont.

---

## Independent Verification

Examples of independent verification controls include:

- reconciling subsidiary account totals with general ledger control account balances.
- reviewing computer generated reports that summarize transaction processing activities.
- comparing physical inventory counts with quantities in the perpetual inventory records.

# Control Principles/Activities Include Cont.

---

- Counting physical assets periodically, recording results of the counts, and comparing to accounting records. Discrepancies should be reported to appropriate administrators and investigated.
- Error handling to ensure that errors detected at any stage of processing receive prompt corrective action and are reported to the appropriate level of management.
- Training, supervising, and monitoring the performance of employees to help certify that control processes function properly.