

## II. INTERNAL CONTROL

Internal control provides management with reasonable assurance that its policies and procedures are implemented and consistently followed to ensure efficient and effective organizational operation. The traditional system of an internal control plan consists of all the methods used to safeguard assets, to promote accuracy and reliability of the organization's accounting data and records, to encourage compliance with all policies and procedures prescribed by management, and to promote the operational efficiency of the organization.

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued the Internal Control – Integrated Framework for organizations to use to assess and enhance their internal control systems. COSO is a voluntary, private sector organization dedicated to improving the quality of financial reporting through business ethics, effective internal controls and corporate governance. The framework has been used as a blueprint for the private and public sectors for establishing internal controls that promote efficiency, minimize risks, help the reliability of financial statements and comply with laws and regulations. COSO defines a control activity as policies and procedures that help ensure that management directives are carried out. Reconciliation controls are designed to detect if two items are consistent and are an integrated part of any internal control structure.

While each organization's control structure consists of a large range of policies and procedures, one of the key elements critical to assurances on the financial statements as defined by the American Institute of Certified Public Accountants (AICPA) Professional Standards AU3 19.06 is control procedures. Some of the basic objectives implicit to control procedures are as follows:

- Transactions are properly authorized. A properly authorized document must have the correct number of signatures as required by the organization's internal policy and this manual.
- Proper supporting documentation for all financial documents is required and is defined as invoices, logs, worksheets, memos, or additional documentation that provides support for the purpose and amount of the transaction.
- Duties are sufficiently segregated.
- Access to assets is limited in accordance with management's authorization.
- A comparison or check of recorded assets with existing assets is performed by staff independent of the financial area responsible for recording the amounts.

### A. MANAGEMENT'S RESPONSIBILITY

A key ongoing objective of the State's financial officers is that all levels of responsibility and authority operate in an environment with internal controls.

Management must:

- Create a control environment by communicating the importance of internal controls.
- Identify and assess potential risks.
- Design, implement and maintain specific control related policies and procedures.
- Communicate policies and procedures throughout the organization.
- Monitor control related policies to ensure that they are continuing to function properly.

- Endorse the review of the organization's internal controls by the Division of Accounting.
- Oversee the implementation of recommendations of the Division of Accounting reviews.

## **B. METHODS OF ACHIEVING INTERNAL CONTROL**

One of the basic and most successful methods of achieving internal control is through the segregation of duties. The segregation of duties divides the responsibility for a transaction or activity among different parties so that no one employee has complete control over the processing of transactions. This method of control increases the likelihood that if one person makes an error, another will discover it. Segregation of duties also reduces the risk that one person would perpetrate and/or conceal errors in the normal course of his or her duties.

A rule of thumb in establishing proper segregation of financial duties is that the party that has access to or possession of an asset should not be the party that maintains the accounting records for the asset. A few examples are:

- The division of responsibility for accounts receivable records and cash receipts.
- The preparation of monthly bank reconciliation by an employee not responsible for disbursing checks or depositing cash.
- The division of responsibility between a person with the ability to enter or change data in an automated system and a person who provides the approval for the transaction.

To ensure that internal control is properly maintained over the disbursement of funds:

- State organizations are required to have procedures in place to ensure that the individual who generates the payment does not approve it.
- Checks resulting from approved payments must not be returned to the person that initiated or authorized the payment.
- Such procedures must be maintained in writing and included in the organization's written internal controls policies/procedures manual.

While segregation of duties is usually a superior method of achieving internal controls when compared to other methods, it is not always practical in a small agency with limited staff. When the segregation of duties is impossible or impractical, management should look for other methods of ensuring internal control such as regular periodic supervisory reviews, rotation of duties, edits built into automated systems, unannounced verification of assets, etc.

## **C. ESTABLISHING CONTROLS OBJECTIVES**

Internal control systems vary from one entity to another. The control objectives and features are dependent on the organizational complexity of an entity and management objectives for that entity. Regardless of the differences in entity size and technical specialization, however, certain characteristics must be present in all systems.

- A structural plan of the organization that provides the framework for the division of authority, responsibility and duties in an appropriate manner.
- An accounting system designed to measure results of operations and financial position.
- Personnel policies designed to employ, train, evaluate, and compensate employees.

While the above control objectives are broad enough to provide management with reasonable assurance that its policies and procedures are being carried out, these objectives are too general to

help the financial manager design or evaluate a system of accounting controls. The following specific control objectives are widely accepted as elements of good control and should be used by management and financial managers:

- Authorization – ensuring that all transactions are approved by management.
- Validation – ensuring that recorded transactions represent real transactions.
- Capture – ensuring that all transactions are recorded.
- Valuation – ensuring that all amounts recorded for transactions are accurate.
- Classification – ensuring that all transactions recorded are assigned to the proper categories (i.e. assets, liabilities, revenues, expenses) and subcategories (i.e. type of expenses).
- Cut-off – ensuring that transactions are recorded in the appropriate accounting period.
- Access – ensuring that only authorized individuals, consistent with their job responsibilities, have appropriate access to assets.

A well designed system of controls must include written policies and procedures to ensure that each control objective is met. Failure to meet control objectives constitutes a weakness in the organization's internal control system. Managers should continuously monitor and improve the effectiveness of the internal controls associated with internal programs. This continuous monitoring and other periodic evaluations provide the basis for management's verification that existing internal controls are sufficient to safeguard the organization's assets. By signing the monthly Certification of Internal Controls (See Exhibit XII-A), management acknowledges that:

- There were no deficiencies that arose which could adversely affect the agency's ability to record, process, summarize and report financial data, and that no material weakness in internal controls were identified.
- The transactions have been properly reviewed and authorized prior to processing to ensure the proper delivery and receipt of goods/services.
- Appropriations reflect accurate charges and all discrepancies identified have been corrected.

In addition, responsible officers will certify that they conducted an annual review of their organization's Delaware Financial Management System Internal Control Plan and that they analyzed their operations to ensure compliance with the plan. This certification will be included in the Letter of Representation that is submitted as part of the GAAP year end package.

#### **D. LIMITATIONS OF INTERNAL CONTROLS**

Internal controls are not foolproof. Management's monitoring of and attitude toward adherence to control procedures is critical to making controls work. The objective of internal controls is to provide reasonable assurance that management's policies and procedures are being carried out. The concept of reasonable assurance recognizes that the cost of the system of internal accounting controls should not exceed the benefits expected to be derived, and also recognizes that the evaluation of the cost-benefit relationship requires estimates and judgments by management.

#### **E. ANNUAL RECONCILIATIONS**

In order to assure accuracy in accounting reports and statements, reconciliations will be performed at least annually, during the month of June, to determine agreement between the financial data keyed into the Delaware Financial Management System (DFMS) and what is actually recorded on

Division of Accounting reports. These reports are available through the use of DocumentDirect, a client-server product from Mobius.

**RECONCILIATION PROCESS:**

1. The preparer of the financial document is required to initial and date the document as evidence of preparation and data entry.
2. Management should review DFMS reports for balance verification as part of the reconciliation and sign and date the Monthly Certification of Internal Controls as evidence of reconciliation and review.

The requirement of a yearly reconciliation report does not relieve state organizations of reconciling and monitoring their transactions and accounts on a daily, weekly or monthly cycle. Furthermore state organizations should report any discrepancies in any transaction or account to Division of Accounting as soon as they become aware of a discrepancy.

The Director of Accounting is responsible for authorizing corrections to the accounts and records maintained by the Department of Information and Technology. State organizations will make corrections by using an EX document. The Division of Accounting will assist state organizations in achieving an accurate reconciliation, if needed.

EXHIBIT XII-A

M-E-M-O-R-A-N-D-U-M

TO: Director  
Division of Accounting

FROM: \_\_\_\_\_

DEPT.: \_\_\_\_\_

DIV(s) \_\_\_\_\_

SUBJECT:REPORT OF RECONCILIATION – FY 20\_\_\_\_

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**IMPORTANT\*\*\*\*\*ACTION IS REQUIRED**

I certify that ALL transactions that were entered into DFMS for FY \_\_\_\_\_ have processed correctly. Therefore all Budgetary Activity, Unliquidated Encumbrances, Revenue Activity and Federal Detail Reports for all appropriations have been reviewed and reconciled for the above department/division(s).

ALL discrepancies are listed below (and/or attached):

SIGNED: \_\_\_\_\_  
Responsible Officer

DATE: \_\_\_\_\_

**\*\*\*\*\*IMPORTANT REMINDER\*\*\*\*\***

This form is due by: \_\_\_\_\_