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U.S. Department of Transportation
Federal Highway Administration

Finance
Internal control
Introduction to Internal control

Federal-aid Essentials
for Local Public Agencies

Federal-aid
Simplified.

Certain processes and procedures can help your agency ensure its activities comply will all laws, regulations, and accepted practices

Internal controls are a series of processes and procedures that can help your agency ensure that its activities comply with all laws, regulations and accepted practices. Internal controls are essential to the proper management and operation of any organization.

ALL PERSONNEL PLAY ROLES, BUT MANAGEMENT IMPLEMENTS CONTROLS

All personnel in your organization play important roles in supporting internal controls, but management is responsible for designing and implementing the controls based on related cost and benefits. Management also sets the objectives, puts the control mechanisms and activities in place, and monitors and evaluates the controls.

The principal objectives of internal controls are to ensure the effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. In addition, Federal-aid recipients, whether grantees or sub-grantees, should ensure that transactions are properly recorded and accounted for; transactions are executed in compliance with the provisions of the grant – and that those funds, property, and other assets are safeguarded against loss from unauthorized use, transfer, exchange, sale, or disposal.

The Committee of Sponsoring Organizations of the Treadway Commission developed the most widely used Internal Control-Integrated Framework in the United States, known as the COSO Framework. Public and private organizations use this framework to design, implement, and evaluate controls that facilitate management and compliance with regulations.

The five components of the COSO Framework include the Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring. These five components provide a clear and effective means to implement and analyze the internal controls of an organization.

Let us look at each component, starting with the Control Environment. Management and

employees should have a positive and supportive attitude toward internal controls.

Management should convey integrity and ethical values and ensure they are not compromised; have a commitment to the competence of its staffs by improving their skills, knowledge and experience; have a philosophy and operating style appropriate to the development and maintenance of effective internal control; ensure the organizational structure and assignments of authority and responsibility contribute to effective internal control; and monitor oversight groups to ensure all audit reports and communications are received and all findings and recommendations are adequately addressed.

All organizations and agencies have a purpose or goal, and they achieve these goals by fulfilling specific objectives. However, a risk can endanger achieving an objective. Risk Assessment is the process used to identify, analyze, and manage potential risks. Risk identification methods may include qualitative and quantitative ranking activities, management conferences, forecasting and strategic planning, and consideration of previous audit findings.

Risk analysis methods may include prioritizing the probability and rate of occurrence, evaluating the vulnerability of assets to any threats, and estimating the quantitative and qualitative costs of those potential threats on assets or operations.

Risk management methods may include monitoring the situation, minimizing the risk, taking preventive or corrective action, and continually or periodically reassessing the risk.

Control Activities include policies, procedures, techniques, and control mechanisms developed and implemented to ensure that your organization's directives are followed. Specific Control Activities should be established in every area and department to ensure these directives are applied consistently.

Some examples of Control Activities are:

Access Control provides the access a person may have to an asset or resource. Examples are permission or controls to limit access to records and documents, buildings and offices, and information systems.

Segregation of Duties reduces the risk of error or fraud by one person. Your organization should have adequate segregation of duties in review and authorization of transactions.

Authorization Control allows only authorized employees to execute and review specific transactions. For example, a clerk may have reviewer authority while a supervisor would have sole approval authority.

Completeness Control verifies that all pertinent transactions are processed.

Accuracy Control verifies that transactions are accurate and calculated using acceptable methodologies.

An organization's information and communication systems must convey information clearly, completely and in a timely manner. Information may be shared formally, such as reporting to management or other agencies, or it may be shared informally, perhaps as a communication with a supplier, customer or internal employees.

Whatever the form, the information should be identified, captured, and communicated in a way and time that give people the means to fulfill their duties.

Monitoring is a continuous process that assesses the performance quality of the five internal control components over time. Monitoring determines if internal controls are present, sufficient and effective.

Internal controls are an ongoing process that involves everyone in an organization and provides reasonable assurance that all objectives are met. Because factors outside the control or influence of management can affect the agency's ability to achieve all of its goals, no matter how well designed and operated, internal control cannot provide absolute assurance that all objectives will be met.

Your agency and staff are responsible for understanding and implementing internal control. Your agency will benefit from implementing internal controls that allow for effective and efficient operations, increase the reliability of financial reporting, and ensure compliance with applicable laws and regulations.

For more information about internal controls, contact your State department of transportation.

CONTROL ENVIRONMENT
RISK ASSESSMENT
CONTROL ACTIVITES
INFORMATION AND COMMUNICATION
MONITORING

Are controls present?

Address observations promptly.

External audits, reviews and internal assessments are forms of Monitoring. Any findings, observations or recommendations from monitoring activities should be addressed promptly. One of the most important concepts to remember is that internal control is a process, not a single event, regulation or form.

Additional Resources

- GAO standards for internal control
  http://www.gao.gov/products/AIMD-00-21.3.1

- OMB Circular A-133 Compliance Supplement, Part 6, describes characteristics of internal control
  http://www.whitehouse.gov/omb/circulars_default

The content of this document is not a substitute for information obtained from State departments of transportation, appropriate FHWA Division Offices, and applicable laws. Scenarios have been simplified for emphasis and do not necessarily reflect the actual range of requirements applicable to the scenario or this topic. This document was created under contract number DTFH63-11-F-00026 by the Federal Highway Administration, U.S. Department of Transportation, and is offered to the public to heighten and focus awareness of Federal-aid requirements within the local public agencies community and reinforces the importance of these necessary policies, procedures, and practices.

This Companion Resource is the script content for the video production of the same name.