

Spring Hill ISD
Administrative Procedures
Internal Controls

The TEA Financial Accountability System Resource Guide details recommendations for internal controls and that information is included in this section.

The business manager is responsible for developing internal controls as directed by the superintendent. Care is taken to be certain that the assets of district are protected and that the internal controls are sufficient to deter fraud and to protect the integrity of the financial statements while allowing staff members to obtain the supplies and materials needed to meet the educational goals of the district. Additional internal controls and related procedures apply to expenditures from state and federal grants. Information for expenditures from these sources is detailed in the state and federal grants section of the business office procedures.

Internal controls are evaluated and updated annually as well as when any area of concern is identified.

FOR MORE INFORMATION

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1.5 Internal Control

A strong system of internal control enables the school district to ensure that resources are properly handled, properly used and are available for management's and the board's designation. In addition, the various agencies of the federal and state governments, including such agencies as the Office of Management and Budget, the Government Accountability Office, Texas Education Agency and others, require school district auditors to report on the internal control structure as a whole and as it relates to the federal financial assistance area.

This section provides both general and specific guidance on the fundamental principles of an effective system of internal control and addresses the following topics:

- Internal control defined
- Common types of control procedures
- Internal control check list
- Suggested areas for consideration of the internal control

Of particular interest to school district business officials is the Internal Control Check List and a listing of suggested areas for consideration relating to the internal control structure. These resources can be used to aid in assessing and improving the internal controls in place in a school district.

1.5.1 Internal Control - Defined

The extent of internal control that a school district should establish is a judgment that must be made by management. Management's judgment regarding the extent of internal control necessary is affected by circumstances such as the size of the organization and the number of personnel available. Consideration must be given to the relationship between costs and benefits. In addition, the nature of internal control is such that even appropriate internal control methods and systems will not guarantee that a school district's objectives will be achieved, nor will they ensure its success.

Internal control is defined as “a process - effected by an entity’s board of trustees, management and other personnel - designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Reliability of financial reporting
- Effectiveness and efficiency of operations
- Compliance with applicable laws and regulations”

Internal control consists of five interrelated components:

- Control environment
- Risk Assessment
- Control activities
- Information and communication systems
- Monitoring

1.5.1.1 Control Environment

The control environment establishes the school district management’s attitude toward internal control. It is the basis for all other elements of the system of internal control. AU 314.67 states that the control environment “sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.”

The collective effort of various factors affects the control environment, including the following:

- Integrity and ethical values

- Commitment to competence
- Participation of those charged with governance
- Management’s philosophy and operating style
- Organizational structure
- Assignment of authority and responsibility
- Human resource policies and practices

The substance of controls is more important than their form because the controls may not be effectively implemented and maintained. An auditor should weigh the collective effect on the control environment of strengths and weaknesses of the organization’s internal control. It may be that a particular weakness may have a significant effect on the control environment.

1.5.1.2 Risk Assessment

Risk assessment is defined as the “entity’s identification, analysis, and management of risks” relevant to the preparation of GAAP financial statements.

Risks can arise or change as a result of the following factors:

- Changes in operating environment
- New personnel
- New or revamped information systems
- Rapid growth
- New technology

- New grant activities, building projects and other activities
- Organizational restructuring
- Accounting pronouncements
- Federal regulations
- School finance statutes

1.5.1.3 Control Activities

Control activities are “the policies and procedures that help ensure that management directives are carried out.” Control activities can be divided into four categories:

- Authorization
- Asset accountability
- Safeguarding
- Segregation of duties

The application of control activities, such as segregation of duties, is affected to some degree by the size of the school district. In smaller school districts, control activities will be less formal than in larger school districts. Additionally, certain types of control activities may not be relevant in a smaller entity.

1.5.1.4 Information and Communication

Information and communication are “the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.” Information systems encompass procedures and documents that:

- Identify and record all valid transactions

- Describe, on a timely basis, the transactions in sufficient detail to permit proper classification of transactions for financial reporting
- Measure the value of transactions in a manner that permits recording their proper monetary value in the financial statements
- Determine the time period in which transactions occurred to permit recording of transactions in the proper accounting period
- Present properly the transactions and related disclosures in the financial statements.

Top management should deliver a clear message to school district personnel that control responsibilities must be taken seriously. School district personnel must understand their own role in the internal control system, as well as how individual activities relate to the work of others. In addition, school district personnel must have a means of communicating significant information to upper levels of management. In addition to internal communication, effective communication with external parties such as parents, TEA and various agencies of the federal government when necessary should be made available. Communication also includes policy manuals as well as accounting and financial reporting manuals.

1.5.1.5 Monitoring

Monitoring is “a process that assesses the quality of internal control performance over time.”

Ongoing activities include regular management and supervisory activities and other actions taken during the normal performance of an individual’s daily responsibilities.

The nature and timing of *separate evaluations* depend on the effectiveness of ongoing activities and the risk that the internal controls are not performing as intended by school district management.

Deficiencies in the system of internal controls should be reported to management at the appropriate level.

One type of monitoring activity that management may perform is to examine certain ratios or financial indicators. These ratios and indicators are measures of performance reflecting key variables of the organization that normally lead to or indicate the current or future effectiveness of the school district.

The extent to which a manager is held accountable for the effectiveness of control procedures will probably determine the extent to which the manager monitors their performance. Management of a school district should assign responsibility and delegate authority with sufficient care to ensure that:

- Persons who perform control procedures are held accountable for their performance by those who monitor their activities
- Persons who monitor the performance of control procedures are held accountable by senior management, the board of trustees or the audit committee

If management routinely uses accounting information in making operating decisions, it is likely to establish effective controls and hold lower-level managers and employees accountable for their performance. In addition, if management routinely uses accounting information in measuring progress and operating results, it is likely to investigate significant variances between planned and actual results. This investigation may detect the causes of significant variances and affect the steps necessary to correct control procedures that failed to prevent misstatements.

1.5.2 Common Types of Control Procedures

Numerous control procedures and monitoring activities are performed by individuals in various organizations to accomplish particular objectives. All of these controls, however, can be categorized as a variation of one of the basic types of controls described below. Detailed control procedures or monitoring activities may be included within each of the categories below, depending on the size of the school district and the sophistication of the particular control environment.

1.5.2.1 Controls over Unauthorized Access or Obligations

Certain controls are designed to prevent access to assets by persons not authorized by management to have access. Often these controls are physical in nature, for example, storing inventories of supplies and commodities in locked storage areas, storing currency in

a vault or locked drawer and using alarm systems to discourage vandals. If controls relating to unauthorized access to assets are not effective, assets may be lost or stolen. However, if detective control procedures such as physical inventory counts are appropriately performed, shortages should be discovered in a timely manner. Changes in Federal banking laws in recent years have potentially increased risk of loss to ISDs from authorized access to bank accounts.

In some cases, unauthorized access to assets may be gained through access to records – especially those records maintained on computer systems. For example, if warehouse requisitions can be issued through a computer terminal, access to inventory may be gained through the system. Controls over unauthorized access to assets through computer records may be physical (e.g., terminals are kept in a locked room) or logical (e.g., access to the computer program or data files may be obtained only with the proper password or other user-identification method).

Monitoring of control procedures that address unauthorized access includes activities such as observing physical control procedures, reviewing established access privileges with the manager of information systems or reviewing reports of attempted computer access violations. Internal auditors often perform such activities.

1.5.2.2 Controls over Authorized Access or Obligations

Access controls do not necessarily prevent persons who have authorized access to assets from misappropriating them. Persons who have authorized access to both assets and related accounting records may be in a position to conceal shortages of the assets in the records. If duties are properly segregated, persons who have authorized access to assets will not also have access to related accounting records in which they might conceal shortages. In some cases, access to assets may be authorized only for two or more persons acting jointly. This access restriction is referred to as “dual control.” For example, management may require that two people open the mail and list cash receipts to prevent one of them from pilfering cash receipts before they are initially recorded.

Controls over authorized access to assets are important to a business, not only to prevent thefts, but to ensure that assets of the school district are committed only after proper consideration by persons who are knowledgeable and experienced. Authorization and approval are types of controls over access to assets that are designed to prevent invalid or inappropriate transactions from occurring. An example is a procedure designed to assure that disbursements are made only when authorized orders for goods and services have been received. In many computerized systems, access to computerized records (e.g., shipping requests) can result in access to assets; therefore, controls over authorized *access to assets* need to consider controls over *access to such records*.

1.5.2.3 Reconciliations and Comparison of Assets with Records

The purpose of reconciliations and comparisons of assets with records is to ensure that independent checks cover the output of a system, either by maintenance of a separate independent control record with which the processed data are reconciled or by direct comparison of the output with the related assets. Monitoring is usually accomplished by reviewing reconciliations or by participating in comparisons of assets. Examples of reconciliations of assets with records are reconciliation of physical inventory to accounting records and reconciliation of bank balance to general ledger balance

1.5.2.4 Analytical Reviews

The purpose of analytical reviews is to evaluate summary information, usually resulting from a series of transactions or processes, by comparing it with expected results. Analytical reviews are often performed by management to determine whether the entity is performing as planned. For example, a common analytical review procedure is the comparison of budget to actual, with investigation of variances. Often, analytical reviews serve as monitoring of various other underlying control procedures.

1.5.2.5 Authorization and Approval

The purpose of authorization and approval is to prevent invalid transactions from occurring. The effectiveness of these controls is often dependent on general computer controls over information security.

1.5.2.6 Reviews of Output

Reviews of output should be performed by personnel who have the knowledge and experience to identify errors. Such reviews could be performed in both computer and manual systems. The purpose of such reviews is to check the validity and accuracy of output by comparing it in detail with expected results. For example, a purchasing manager may compare recorded amounts or quantities purchased with separate records of purchase orders.

1.5.2.7 Transactional Reviews

The purpose of transactional reviews is to check the validity and accuracy of output by comparing it in detail with expected results. Reviews of output are often performed with the use of exception reports, which are reports (usually computer-generated) listing items for which processing was rejected because the items did not match specified criteria. For example, a computer-generated check may be rejected if it is for an amount large enough to require manual signing. Monitoring of these types of control procedures is often performed by reviewing results at various levels of management.

1.5.2.8 General Computer Controls

Computer systems frequently have common areas of control and related control procedures referred to as general computer controls. These controls directly or indirectly affect all systems that operate within one computer processing environment. General computer controls include all the usual elements of effective internal control, which includes a person or group responsible for control, control procedures and monitoring activities. Monitoring of the performance of general computer controls is usually performed by managers of the information systems department. Monitoring activities include observation, exception reporting, reviews of work performed, reviews of program changes, oversight by information system steering committees and the monitoring of user complaints. For example, the effectiveness of programmed control procedures such as edit checks and approvals depends on general computer controls that ensure that program changes are not made improperly. General computer controls include controls over computer operations, systems acquisition development and maintenance, information security and information systems support.

Computer Operations - The computer operations staff is responsible for the day-to-day processing activities of the school district's system. It ensures that jobs are scheduled and processed as planned. It is also responsible for physical control of data stored on the system or tapes, as well as timely and accurate distribution of reports.

Systems Acquisition, Development and Maintenance - The systems acquisition, development and maintenance staff is responsible for the planning, acquisition or programming, testing and implementation of new application systems and changes to existing application systems. Such controls are usually important in larger processing environments where there is more development and maintenance activity. The systems are more complex and there is less reliance on purchased software.

Information Security - The information security function is responsible for the administration and maintenance of a school district's information security program,

including both physical and logical security. The primary goal of such a program is to ensure that access to program data, on-line transactions and other computing resources is restricted to authorized users.

Information Systems Support - Information systems support includes functions such as system software maintenance, data base administration, communications and network management, end user computing and other groups with technical and administrative support responsibilities.

Certain school districts may use service organizations for executing and recording certain transactions. In such situations, the school district needs to ensure that the service organization has adequate controls over processing the transactions.

1.5.3 Internal Control Check List

Presented in Exhibit 46 is a check list that may provide assistance to management in determining if a school district has areas where internal control procedures should be enhanced. The questionnaire below should be completed by placing a “√” in the appropriate column. Any “NO” responses could indicate that there is an internal control weakness and that further review should be performed to determine if there are other control procedures in place to mitigate potential risk.

Exhibit 46. Internal Control Check List

INTERNAL CONTROL CHECK LIST

		YES	NO	COMMENTS
1.	Are the following functions performed by someone other than the accounts receivable bookkeeper(s):			
	(a) Handling cash and maintaining cash records?			

		YES	NO	COMMENTS
	(b) Opening incoming mail?			
	(c) Credit collection, if applicable?			
	(d) Review and mailing of tax statements?			
	(e) Approval of and adjustments of uncollectible delinquent taxes?			
2.	Are accounts receivable ledgers unavailable to the cashiers?			
3.	Are subsidiary ledgers regularly balanced with control accounts?			
4.	Are subsidiary ledgers occasionally balanced with control accounts by someone other than the accounts receivable bookkeeper(s)?			
5.	Are tax statements sent at regular intervals to all taxpayers?			
6.	Are securities, insurance policies and similar instruments under the control of a responsible official?			
7.	Are all persons having access to securities properly bonded?			
8.	Are securities kept in a safe-deposit box and does access to the safe-deposit box require the presence of two or more employees?			

		YES	NO	COMMENTS
9.	Does the accounting department maintain a record of each security, its cost, description and certificate number, and are all securities periodically accounted for and reconciled to the records?			
10.	Are inventory records maintained for supplies and capital assets?			
11.	Are inventory records verified by physical inventories at least once each year?			
12.	Are discrepancies between inventory records and the physical count promptly investigated and appropriate adjustments of the records made?			
13.	Are trial balances of inventory records taken at regular intervals and balanced with the general ledger control account?			
14.	Are inventory records maintained by persons who have no access to the supplies stored?			
15.	Are prenumbered receiving reports used, and are copies thereof forwarded to the accounting department for use in verifying invoices?			
16.	Are materials and supplies held in a central location and issued only on properly approved requisitions?			
17.	Are stolen goods promptly reported to a local law enforcement officer?			

		YES	NO	COMMENTS
18.	Are accounts payable personnel independent of purchasing and of the cashier or persons signing checks?			
19.	Are prenumbered purchase orders used, and are copies transmitted to the accounts payable department?			
20.	Are prices established at the time of placing orders?			
21.	Do the procedures for verification of invoices in the accounts payable department require a signature to ensure that:			
	(a) Quantities billed on the invoice agree with those called for on the purchase order and shown by the receiving report?			
	(b) Prices, discounts, credit period and terms of shipment per the invoice match with those specified on the purchase order?			
	(c) Extensions, footings and deduction of discounts are correct?			
22.	Are accounts payable balanced monthly to the general ledger control account?			
23.	Are monthly statements from vendors regularly reconciled to accounts payable ledgers?			

		YES	NO	COMMENTS
24.	Are returned purchases controlled in a manner to ensure that the school district receives proper credit against charges?			
25.	Are there established procedures to call attention to invoices not paid within the discount period?			
26.	Are all loans approved by the board and signed by the president or vice president and secretary?			
27.	Are invoices and supporting documents marked when approved for payment in a manner which precludes the possibility of submission a second time (duplicate payments)?			
28.	Are employees paid by prenumbered payroll checks?			
29.	Are spoiled payroll checks voided in a manner which prevents reuse, and filed in a numerical sequence with paid checks?			
30.	Is a check protector used?			
31.	Are various phases of payroll work, such as timekeeping, compilation of payroll, writing paychecks, filling envelopes and distribution of employees, divided among a sufficient number of persons?			
32.	Is there a reasonable rotation of duties, when possible, among timekeepers, paymasters and persons preparing payrolls?			

		YES	NO	COMMENTS
33.	Are undelivered payroll checks forwarded to an appropriate official for deposit after a specified period of time?			
34.	Is the payroll bank account reconciled monthly by employees having no other connection with payroll work?			
35.	Does the reconciliation of the payroll bank account include examination of endorsements on paid checks, accounting for numerical sequence of checks, and comparison of checks with payroll records?			

1.5.4 Suggested Areas for Consideration of the Internal Control Structure

Presented below is an extensive listing of areas that could require internal control procedures. The areas addressed are:

- Budgets and Planning
- Cash
- Investments and Investment-Related Activity
- Revenues and Receivables
- Capital Assets
- Expenses/Expenditures and Liabilities

- Employee Compensation
- Information Technology
- Financial Reporting

This listing should not be considered all-inclusive. Also, procedures in all of these areas would not necessarily be desirable or required for all circumstances.