

# INTERNAL CONTROLS

## TYPES OF INTERNAL CONTROL

- Organisation
- Authorisation + Approval
- Personnel
- Supervision
- Physical
- Arithmetical + Accounting
- Segregation of Duties
- Management

## TESTING INTERNAL CONTROLS

- narrative notes
- questionnaires
- checklists
- flowcharts

### *Tests of Control*

- observation and enquiry
- inspection of documents (for authorisation , review)
- examine evidence of mgt. views (minutes)
- re performance of control procedures

### Consider

- how controls were applied
- by whom
- consistency of application

## ***INTERNAL CONTROLS AND THEIR INHERENT LIMITATIONS***

### **Objectives of Internal Controls:**

- authorisation
- transactions are recorded promptly ; at correct amount ; in the appropriate accounts and in the proper acc. period
- safeguard the assets (authorisation for access)
- recorded assets are regularly compared to existing assets and differences investigated

### **Inherent Limitations**

- directed at routine not non - routine transactions
- cost / benefit analysis
- human error
- fraudulent collusion
- override
- inadequacy of procedures after a time
- deterioration of compliance over time

i.e. auditors cannot obtain all their evidence from tests of the IC system

## ***INTERNAL CONTROLS IN THE SMALL BUSINESS***

- little segregation of duties
  - strong supervisory controls
  - risk of mgt. Override
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## Appendix

### TYPES OF INTERNAL CONTROLS

The following is a description of some of the types of controls which the auditor may find in many enterprises and on some or a combination of which he may seek to place some degree of reliance.

- 1 **Organisation.** Enterprises should have a plan of their organisation, defining and allocating responsibilities and identifying lines of reporting for all aspects of the enterprise's operations, including the controls. The delegation of authority and responsibility should be clearly specified.
- 2 **Segregation of duties.** One of the prime means of control is the separation of those responsibilities or duties which would, if combined, enable one individual to record and process a complete transaction. Segregation of duties reduces the risk of intentional manipulation or error and increases the element of checking. Functions which should be separated include those of authorisation, execution, custody, recording and, in the case of a computer-based accounting system, systems development and daily operations.
- 3 **Physical.** These are concerned mainly with the custody of assets and involve procedures and security measures designed to ensure that access to assets is limited to authorised personnel. This includes both direct access and indirect access via documentation. These controls assume importance in the case of valuable, portable, exchangeable or desirable assets.
- 4 **Authorisation and approval.** All transactions should require authorisation or approval by an appropriate responsible person. The limits for these authorisations should be specified.
- 5 **Arithmetical and accounting.** These are the controls within the recording function which check that the transactions to be recorded and processed have been authorised, that they are all included and that they are correctly recorded and accurately processed. Such controls include checking the arithmetical accuracy of the records, the maintenance and checking of totals, reconciliations, control accounts and trial balances, and accounting for documents.
- 6 **Personnel.** There should be procedures to ensure that personnel have capabilities commensurate with their responsibilities. Inevitably, the proper functioning of any system depends on the competence and integrity of those operating it. The qualifications, selection and training as well as the innate personal characteristics of the personnel involved are important features to be considered in setting up any control system.
- 7 **Supervision.** Any system of internal control should include the supervision by responsible officials of day-to-day transactions and the recording thereof.
- 8 **Management.** These are the controls exercised by management outside the day-to-day routine of the system. They include the overall supervisory controls exercised by management, the review of management accounts and comparison thereof with budgets, the internal audit function and any other special review procedures.

## **ISA 265 Communicating deficiencies in internal control to those charged with governance and management**

This states that a significant deficiency in internal control is a deficiency or combination of deficiencies in internal control that, in the auditor's professional judgement, is of sufficient importance to merit the attention of those charged with governance.

Examples of matters the external auditor should consider in determining whether a deficiency in internal controls is significant include:

- The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
- The susceptibility to loss or fraud of the related asset or liability.
- The subjectivity and complexity of determining estimated amounts.
- The financial statement amounts exposed to the deficiencies.
- The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- The importance of the controls to the financial reporting process.
- The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.
- The interaction of the deficiency with other deficiencies in internal control.

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