

## **FOUR STEP PROCESS FOR INTERNAL CONTROL**

The Internal Control Act requires all State agencies (including SUNY) to take specific actions to enhance controls over operations. These steps are defined in the Act and explained further in Budget Policy and Reporting Manual item B-350. In addition, various internal control concepts, standards, and guidelines are contained in the "Internal Control Guide" which the Division of the Budget (DOB) distributed to each agency and the "Guide to Internal Controls" distributed at the training sessions sponsored by DOB.

This document will assist the State College of Optometry develop and follow a process which identifies and reviews controls over its operations. The process involves identifying agency functions, conducting Vulnerability Assessments and Internal Control Reviews, and taking necessary corrective actions. This process is an important part of any successful and well-integrated internal control program.

To evaluate its internal controls, the College should:

- Identify the functions it performs in support of its stated mission and program objectives;
- Assess the risks and consequences which are likely to occur if those functions are not properly performed, i.e., the vulnerability of the function to errors, irregularities, or unintended program results;
- Review existing controls , scheduling such reviews according to functions' levels of vulnerability;
- Take appropriate steps to correct internal control weaknesses.

### **STEP ONE; IDENTIFY FUNCTIONS**

The most effective way to begin an evaluation of internal control systems is to segment the College into organizational units and to develop an inventory of the functions and responsibilities of those units. This inventory should cover all program and administrative functions necessary for the College to carry out its mission. These functions should also be defined clearly enough to facilitate the conduct of a meaningful Vulnerability Assessment of each area.

Functions can be easily identified through organizational charts, departmental budget, policy and procedure manuals, job descriptions, and program and financial management information systems. A sample Function Identification Form is attached as a guide in completing this inventory.

### **STEP TWO; THE VULNERABILITY ASSESSMENT**

A Vulnerability Assessment is a general review of the susceptibility of a function to errors, irregularities, unauthorized use, or inappropriate program results. It is used to determine the likelihood that something could go wrong and to evaluate the seriousness of those consequences.

The Vulnerability Assessment is intended to provide the following:

1. A road map for what functional areas should get priority attention from management because of the nature, sensitivity, and importance of the function's operations.
2. A preliminary judgment from managers about the adequacy of existing internal control techniques to minimize or detect problems; and
3. An early indication of where potential internal control weaknesses exist which should be corrected.

As a general rule, to properly assess the current level of risk associated with a function, the Vulnerability Assessment would have to address such factors as:

- The attitude of management toward maintaining effective internal control systems;
- The technical or administrative complexity of the operation;
- The existence of adequate organizational charts, lines of communication, and clear designation of work assignments;
- Demonstrated adherence to prescribed policies and procedures;
- The fiscal implications of the program, including the size of the budget and the extent to which the function involves the handling of cash receipts or the approval of contract or grant funds;
- The sensitive nature of the program and the extent to which program decisions can be influenced by external sources, time constraints, or conflicts of interest on the part of College officials;
- The professional training and technical proficiency of staff needed to correctly perform the function;
- The stability of the operations in terms of frequently changing functional responsibilities, staff turnover, permanence of the functional unit, or re-configurations of the organizational structure;
- The frequency of internal or external audits of the function and the significance of reviews' findings and
- The inherent risk associated with the function regardless of the existence of adequate internal controls.

The results of the Vulnerability Assessment allow managers to classify functions as High, Moderate, or Low risk. The results may also highlight specific weaknesses where immediate remedial steps can be taken by management. More importantly, however, the Vulnerability Assessment process offers the opportunity to rank functions in priority order -- most important to least, most vulnerable to least--to schedule, on a systematic basis, reviews to determine how well internal controls are working.

After the initial Vulnerability Assessment is completed, it should be updated periodically at the discretion of management. Revisions should be made upon organizational, staffing, or program changes or if an Internal Control Review, audit, or other management analysis uncovers unexpected weaknesses. A change in a unit manager usually indicates the need for a new Vulnerability Assessment. A sample Vulnerability Assessment form is attached.

### **STEP THREE; THE INTERNAL CONTROL REVIEW**

The need for an Internal Control Review of a function is related to the level of risk assigned by the Vulnerability Assessment. Functions identified as more vulnerable could be candidates for Internal Control Reviews regardless of whether the Vulnerability Assessment actually identified an internal control weakness. Depending on the cause and level of the vulnerability, management priorities, or resource availability, an Internal Control Review should be conducted periodically as needed.

An Internal Control Review can take a variety of forms:

- Observing if staff perform the function properly;
- Discussing with staff how the function is performed and if those steps are reasonable;
- Examining documents and procedures followed by staff to determine if they are adequate and complete; and
- Evaluating and testing actual work products to confirm that procedures are being followed and that the results are consistent with planned program outcomes.

The nature of the Internal Control Review will vary depending on the significance and complexity of the function being reviewed, the level of identified risk, and the controls in place. The greater the potential vulnerability, the greater the need for probing internal controls and, therefore, the greater the need for regular and more formal evaluation.

The results of the Internal Control Review should be documented and should ask the following questions:

- What are the objectives of the function? What is it trying to achieve? (Control objectives)
- What steps are followed to achieve those objectives? (Control techniques)
- What internal control weaknesses exist – including excessive controls--which inhibit achieving the control objectives?
- What cost-effective corrective actions can be taken to eliminate or reduce these weaknesses?

A sample Internal Control Review Form is attached which may be used by managers to document the results of their reviews.

#### **STEP FOUR; THE CORRECTIVE ACTION PLAN**

The fourth step in the process is to correct internal control weaknesses identified through the Vulnerability Assessment or Internal Control Review Process. A plan of corrective action should assign responsibility, establish time frames for implementing improvements, and report on progress toward these improvements. Senior management should approve the plan to assure that recommended actions are cost effective. Internal auditors or independent auditors may be used to monitor adherence to the plan and to offer recommendations on appropriate corrective actions.

Some corrective actions may be implemented immediately, e.g., refine procedures, document procedures, conduct training, etc. More time may be needed for those which require organizational changes, redeployment of resources, or a fundamental rethinking of the function's objectives.

Merely identifying vulnerability or a weakness in a control procedure is not sufficient to comply with the intent of the Internal Control Act. Implementing a plan of corrective action within a reasonable time period is equally important and will result in long-term benefits to the College. A sample Corrective Action Plan Form is attached and can be used to monitor the progress toward correcting weaknesses.