

# **INTERNAL CONTROLS**

## **TABLE OF CONTENTS**

System Of Internal Controls	2
Internal Controls	3
Summary Of Internal Controls	
Controls Vs. Risks	6
Fraud Awareness & Prevention	10

## **SYSTEM OF INTERNAL CONTROLS**

The system of internal controls is comprised of the plan of organization and the methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting and operations data, promote operational efficiency, and encourage adherence to prescribed managerial policies. A policy statement has recognized the importance of management to the control environment on management controls. Management is committed, as a matter of Association Policy, to promoting an environment supportive of internal controls.

# **INTERNAL CONTROLS**

## **SUMMARY OF INTERNAL CONTROLS**

### **PERFORMANCE AND ACCOUNTABILITY**

PPOA should have a Conflict of Interest and Business Ethics Policies that essentially states, “The books and records of the Association should be kept in a complete and accurate manner, which fairly reflect its activities. Any willful omission or falsification of PPOA records is prohibited”.

To a large extent the Board relies on financial, statistical and narrative reports as the basis for decision and action. The General Manager should make sure that procedures are in place to assure the accuracy, reliability and completeness of all reports issued. Compliance with such procedures should be monitored on a continuing basis.

In short good business ethics means that our business should be conducted so that no one is ever embarrassed whenever all of the facts and circumstances are made known about our dealings and transactions.

### **APPROVAL AUTHORITY**

PPOA exercises control over its activities through delegations of authority. The Board should review the current monetary level of authority delegated to determine if it is reasonable. The Board should hold accountable those who are entrusted with signing and obligating the Association.

### **COST VERIFICATION**

Cost should be reviewed on a regular and timely basis to detect and report any inappropriate or erroneous charges. While it is not necessary to trace all charges back to confirming, receiving and approved copies of documents, such a comparison should be made on all significant charges and on a test basis for all other charges. In short, someone independent of the transaction should make calls or check on the validity of bids, prices and the like.

### **INVOICE VERIFICATION**

The primary responsibility for the validity of an invoice rests with the General Manager. His signature of approval on an invoice signifies that:

- The goods or services covered by the invoices were received or satisfactorily performed and in conformance with the terms of the agreements.
- The quantities, prices and payment terms are correct as stated in the invoice and the proper accounts are charged to reflect fairly the result of operations.
- The payment in process has been checked to determine that payment has not already been made.

Specific responsibility should be assigned for the verification and accuracy of invoices. Employees assigned this responsibility should have copies of all payment terms. Nevertheless, the General Manager has the bottom line responsibility.

Records should be retained in sufficient detail to easily verify invoices by matching independently prepared documents. The Controller is usually tasked this responsibility but the General Manager is ultimately responsible.

Payments should be made only against original invoices, and any alterations thereto should be questioned.

## **ORDERING AND HANDLING MATERIALS**

An underlying control principle to achieve is segregation of duties so that no one individual has approval authority over all the activities of establishing the requirement, getting the bids, ordering, receiving, storing and issuing materials. Points should be designated in PPOA to control these activities and procedures implemented to assure the materials are charged to the operating account where the material is used.

Delegation of authority to order materials should be made only to personnel whose positions require it and should be limited to the maximum extent possible.

Access to stored materials should be limited to authorized personnel. Gate passes should be required to remove any PPOA material or equipment from PPOA. Association vehicles should be checked on a periodic basis and records kept of those checks.

Perpetual inventory records should be maintained on stored materials.

Confirming copies of documents should be reviewed upon receipt for validity of transactions. The documents should be filed for later use in verifying cost.

## **SAFEGUARDING, PLANT, TOOLS, AND EQUIPMENT**

All individual items, pieces of equipment, installations or facilities that meet the established criteria of capital asset should be capitalized as required by established policy.

A list of fixed and mobile assets should be maintained regardless of their book value. Asset records should show a plant numbers and physical location of the assets to facilitate physical inventories and to fix responsibility for custodianship.

Physical inventories of fixed assets that are pilferable or mobile should be completed periodically and records maintained of those inventories. The principle of segregation of duties entails the separation of responsibilities for asset custody from the asset record-keeping function. This means that the custodian of the asset should not conduct the inventory and the asset custodian should not keep the records.

Items of equipment charged to expense that are valuable and pilferable (e.g., cameras, calculators) should be assigned internal control numbers and accounted for similarly to fixed

assets. If appropriate, a tool check or craftsman card system should be used to control issue of such tools and instruments. Periodic physical inventories should also be conducted similarly to fixed assets.

APPROVED BY THE BOARD OF DIRECTORS (March 23, 2000)

# **CONTROLS vs. RISKS**

## **PERFORMANCE AND ACCOUNTABILITY**

### **Control**

As stated in the PPOA Conflict of Interest and Business Ethics Policies:

The books and records of PPOA shall be kept in a complete and accurate manner, which fairly reflect the activities of PPOA. Any willful omission or falsification of PPOA records is prohibited.

To a large extent, the Board of Directors (BOD) and Management rely on financial, statistical and narrative reports as the basis for decision making and action. The Controller should implement procedures to assure the accuracy, reliability and completeness of reports. Compliance with such procedures should be monitored on a continuing basis.

### **Risk**

Employees might alter or falsify PPOA books and records or internal reports for their own personal gain or to conceal inappropriate activities.

## **APPROVAL AUTHORITY**

### **Control**

PPOA exercises control over its activities through delegations of authority by the BOD. The BOD should review with the General Manager the current monetary level of authority delegated to determine if the current operation warrants reduction or increasing these levels. The General Manager should also assure that the department's approval authorities are understood and not exceeded. For downward or upward redelegations to exercise of the authority redelegated remains with the BOD.

### **Risk**

Limits on authorities of subordinates are needed to assure management involvement on significant transactions. Failure of subordinates to know and comply with their limits of authority can result in misjudgments or deliberate errors being implemented by unauthorized personnel.

## **VERIFICATION OF COST REPORTS**

### **Control**

Cost reports should be reviewed on a regular and timely basis to detect and report any inappropriate or erroneous charges to PPOA. While it is not necessary to trace all charges on a cost report back to confirming, receiving or approved copies of documents, such a comparison should be made on a test basis.

For invoice charges and work orders, the benefiting organization should review costs for reasonableness and for non-consumables and equipment not required in the work order definition.

For cash disbursements, the initiating organization should ensure that disbursements are in compliance with established policies and procedures, and petty cash disbursements are within the scope and intent of funds. These funds should be kept in a secure location and periodically counted on a surprise basis.

**Risk**

Incidents of fraud, irregularities or erroneous charges can be missed if the cost sheets are not adequately reviewed.

**INVOICE VERIFICATION**

**Control**

The primary responsibility for the validity of an invoice rests with the proponent. The proponent's signature of approval on an invoice signifies that:

- The services covered by the invoices were satisfactorily performed and in conformance with the terms of the agreement between the parties.
- The quantities, prices and payment terms are correct as stated in the invoice and the proper accounts are charged to reflect fairly the results of operations.
- The payment in process has been checked to determine that payment has not already been made.
- Specific responsibility should be assigned for the verification and accuracy of invoices. Employees assigned this responsibility should have copies of the payment terms as contained in the contract or agreement as well as copies of the contract, amendments and change orders, as applicable.
- Records should be retained by the proponent in sufficient detail to easily verify contractor/vendor invoices by matching independently prepared documents.
- Payments should be made only against original invoices, and any alterations thereto should be questioned.

**Risk**

Invoices could be inflated or they could be submitted for services not performed or goods not received.

**MATERIAL ORDERING AND HANDLING**

**Controls**

An underlying control principle to achieve is segregation of duties so that no one individual has approval authority over all the activities of ordering, receiving, storing and issuing materials. Points should be designated in PPOA to control these activities and procedures implemented to assure materials are charged to the operating account where the material is used.

Delegations of authority to order materials should be made only to personnel whose positions require it and should be limited to the maximum extent possible.

Access to stored materials should be limited to authorize personnel.

If the size of the operation warrants, perpetual inventory records should be maintained on stored materials.

Confirming copies of shipping documents should be reviewed promptly upon receipt for validity of transactions. The documents should be filed for later use in verifying cost sheets.

### **Risk**

The opportunity for theft or diversion of materials ordered by and charged to PPOA significantly increases when the same individual who does the ordering is also responsible for receiving. The risk increases when the person ordering or receiving is also responsible for conducting inventories.

PPOA is also more at risk when large quantities of materials are store in areas where access is not limited.

## **PLANT, TOOLS AND EQUIPMENT**

### **Control**

Assure that individual items, pieces of equipment, installations or facilities costing \$ 750 or more are capitalized as required by established procedures.

A list of PPOA fixed assets should be maintained. Asset records should show the plant numbers and physical location of the assets to facilitate physical inventories and to fix responsibility for custodianship.

Physical inventories of fixed assets that are pilferable or mobile should be completed periodically. The principle of segregation of duties entails the separation of responsibilities for asset custody from the asset record-keeping function.

Items of equipment charged to expense that are valuable and pilferable (e.g. cameras, computers, other office equipment) should be assigned internal control numbers and accounted for similarly to fixed assets. If appropriate, a tool check or craftsman card system should be used to control issues of such tools and instruments.

### **Risk**

Outright theft of PPOA assets. Employees for personal gain may use company assets. Without adequate records, it may be difficult to locate needed equipment. This could result in renting similar equipment when PPOA equipment is idle.

## **PAYROLL PROCEDURES**

### **Control**

Exception time should be recorded daily and a subsidiary record kept of the overtime showing approval by supervisors. Someone other than the timekeeper to assure that time cards were processed correctly should compare these records to the monthly time report on a sample basis. Employee paychecks to be distributed within PPOA by authorized employees should be securely locked up, by a clearly identified custodian, prior to distribution. When an employee is not present to receive his paycheck, the check should be securely locked up until his return.

**Risk**

Time records may be falsified to overpay employees. Paychecks may also be stolen and fraudulently cashed.

**COMPUTER ENVIRONMENT****Control**

Data is an asset. There is an increasing trend throughout PPOA for more data to be maintained on computers. The General Manager should see to it that control procedures are in place to retain and protect this data such as:

- Back up of data should be made on a regular basis.
- Access to data should be granted only on need to know basis.
- Access privileges should be suspended on a timely basis when an employee is transferred or scheduled to be released, and Password s should be protected.

The increased use of computer-automated systems required that the General Manager review his delegation of authority and supervisory review procedures to assure that controls data are still adequate and effective.

**Risk**

Unauthorized persons may obtain Confidential and sensitive data. Essential operating data can be inadvertently or deliberately changed or destroyed. Unauthorized issue of materials may be generated without proper accountability.

## **FRAUD AWARENESS & PREVENTION**

An important step for the BOD and Management to take in the prevention and detection of fraud is to recognize that fraud exists and that any organization can become a victim of fraud.

There are many "indicators" of conditions, which provide the initial recognition that something is wrong and that further attention is needed to correct the wrong. Knowledge of the fraud indicators by all employees, especially Management personnel, coupled with a need to be sensitive to the conditions that invite fraud, abuse, and waste are needed to detect the problem.

The following are some of the more obvious conditions and situations that, if allowed to exist, lend themselves to fraud, waste, and abuse:

- Concentration of authority over and responsibility for resources of an entire process in one person.
- Inadequate feedback on results of projects or operations.
- Lack of standards for judging the results of projects or operations.
- Lack of independent verification of the accuracy of records, transactions and reports.
- Vague and confusing procedures.
- Inadequate physical safeguards over resources.
- Inability to identify responsibility.
- Lack of adequate supervision.
- Changes in an employee's behavior.
- Unreasonable budgetary and procurement requirements.
- Failure to strictly enforce contract provisions.
- Failure to correct deficiencies identified by existing control systems.

Mere compliance with accepted Company procedures does not necessarily prevent fraud. One of the best ways for the BOD and Management to detect fraud is to get feedback from employees regarding situations that are questionable. Employees need to know that the BOD and Management are interested about combating fraud, waste, and abuse.

The Controller and independent public accountants are authorized and required by Association Policy to promptly report directly to the Audit Committee of the Board of Directors, without interference or censorship by Management, all major irregularities including:

- Violation of laws or regulations
- Falsification of records or reports
- Major violations of PPOA Policy
- Matters relating to conflicts of interest
- Fraud
- Theft