

# PEMPAL

## PEMPAL TCoP

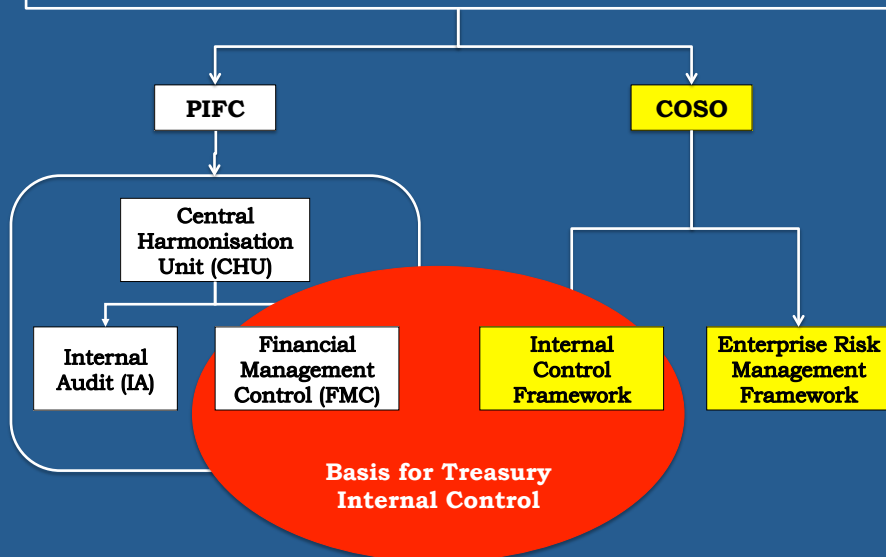
### Treasury Internal Control

Kiev  
April 2013

www.michaelparry.com

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## Approaches to Internal Control



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## Public Internal Financial Control (PIFC)

- EU concept
  - Applicable to member and accession countries
  - Model of best practice for all countries
- PIFC aims
  - “to provide a reasonable assurance that public funds are being used for the objectives selected by the budgetary authority ...[and] ... preventing corruption and fraud”
- Financial Management (or Internal) Control a key component of PIFC
  - Based on COSO framework

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## COSO

- COSO – Committee of Sponsoring Organisations
  - 5 US professional accounting and auditing bodies
- Developed internationally recognised Internal Control (IC) Framework
  - Generic for all public and private sector entities
  - Principle based
  - Suitable basis for Treasury Internal Control
- New COSO Internal Control Framework to be issued in 2013
  - This presentation based on Exposure Draft for new COSO framework

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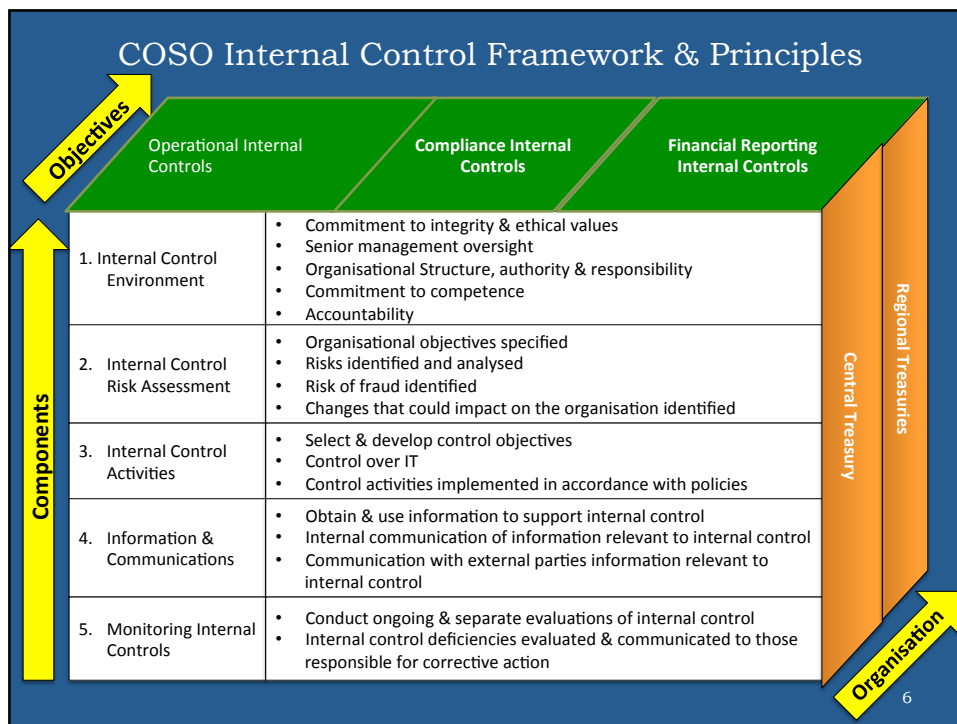
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## COSO definition of internal control

Internal control is a *process*, effected by an entity's board of directors, management and other personnel, designed to provide a *reasonable assurance* regarding the achievement of the objectives in the following categories:

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

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## Applying COSO to Treasury: The Groups of Objectives

<b>Operational</b>	<ul style="list-style-type: none"><li>• Effective and efficient cash management, payments and collections</li><li>• Minimizing fiduciary risks – fraud, theft, loss or misuse of money</li><li>• Minimizing transaction costs</li><li>• Use of money for purpose intended</li></ul>
<b>Reporting</b>	<ul style="list-style-type: none"><li>• Reliable, timely and relevant internal and external reporting</li><li>• Internal reports useful for management decisions and control</li><li>• External reports including financial statements in accordance with international standards</li></ul>
<b>Compliance</b>	<ul style="list-style-type: none"><li>• Compliant with national laws and regulations</li><li>• Compliant with international standards and best practice</li></ul>

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## APPLYING COSO TO TREASURY: FIVE COMPONENTS OF INTERNAL CONTROL

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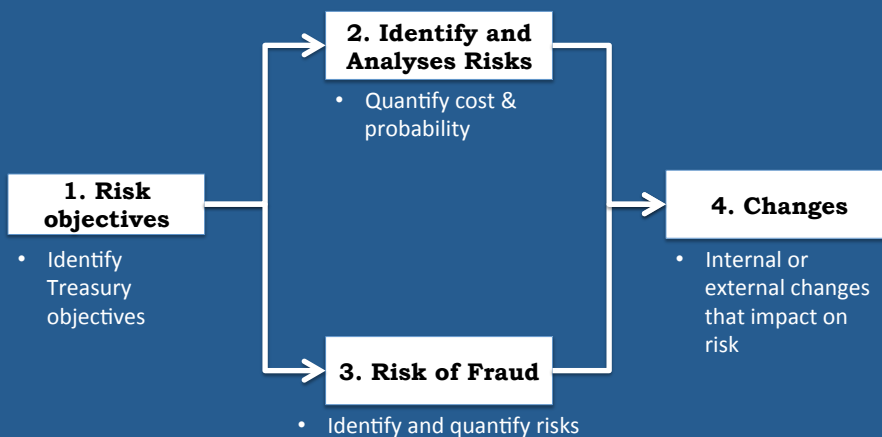
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## 1. Treasury Internal Control (IC) Environment

<b>1.1 Integrity &amp; ethical values</b>	<ul style="list-style-type: none"> <li>• Management commitment</li> <li>• Ethics included within staff training</li> <li>• Professionalization &amp; professional values</li> </ul>
<b>1.2 Management oversight</b>	<ul style="list-style-type: none"> <li>• Oversight structure e.g. Audit Committee, Central Harmonization Unit</li> <li>• Actions on identified issues</li> </ul>
<b>1.3 Organisational structure</b>	<ul style="list-style-type: none"> <li>• Clearly defined roles &amp; responsibilities</li> <li>• Job descriptions</li> <li>• Segregation of duties</li> </ul>
<b>1.4 Commitment to competence</b>	<ul style="list-style-type: none"> <li>• Effective HR management</li> <li>• Recruitment of high quality staff</li> <li>• Structured and ongoing training</li> <li>• Professionalization</li> </ul>
<b>1.5 Accountability</b>	<ul style="list-style-type: none"> <li>• Identified responsibility leads to accountability</li> <li>• Internal and external accountability for actions</li> <li>• Rewards and sanctions</li> </ul>

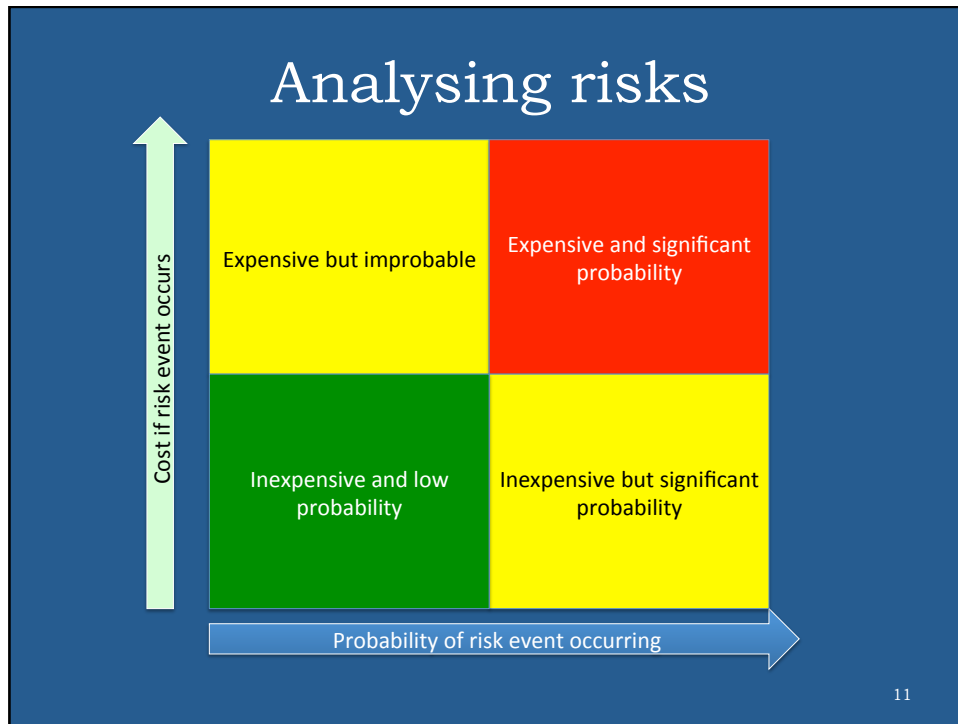
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## 2. Treasury Risk Assessment

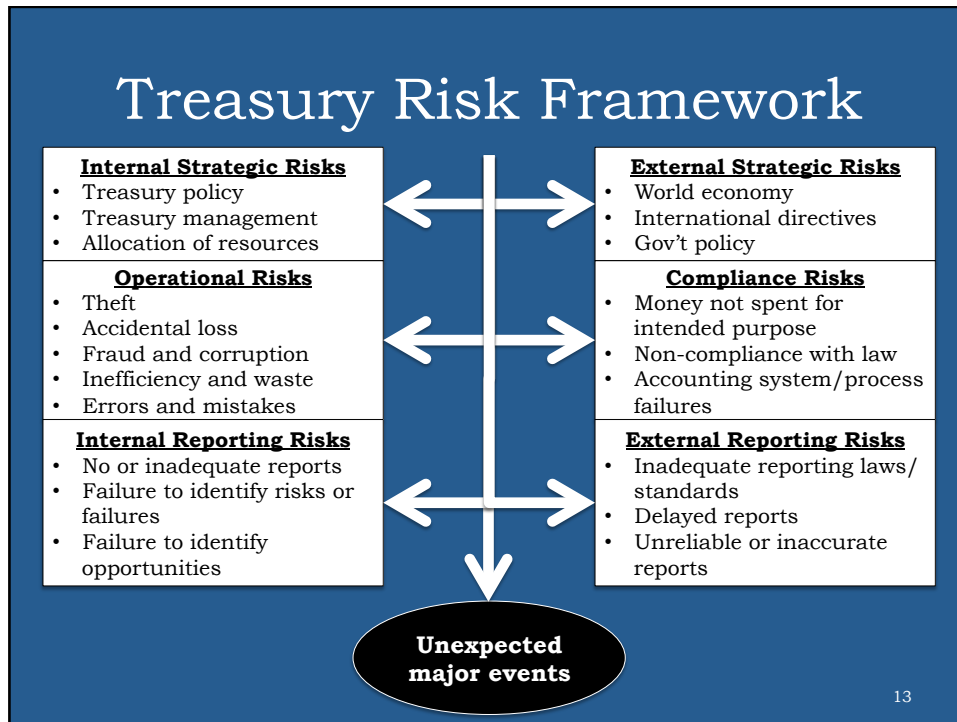


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## 3. Treasury IC activities (1)

<b>Process controls</b>	<ul style="list-style-type: none"> <li>• Documented procedures</li> <li>• Staff trained in procedures</li> <li>• Procedures operated in accordance with instructions</li> </ul>
<b>3.1 Organizational controls</b>	<ul style="list-style-type: none"> <li>• Segregation of duties</li> <li>• <b>Clearly defined responsibilities &amp; accountability</b></li> <li>• Job descriptions</li> <li>• Hierarchy of payment approval limits</li> <li>• Regular holidays and rotation of staff</li> <li>• Effective disciplinary procedures</li> </ul>
<b>3.2 Budget execution controls</b>	<ul style="list-style-type: none"> <li>• Procedures for releasing budget allocations (warranting)</li> <li>• Managing expenditure within budget/release limits (commitment management)</li> <li>• Early signaling of budget overspend</li> </ul>
<b>3.3 Cash management controls</b>	<ul style="list-style-type: none"> <li>• Procedures for cash management</li> <li>• Revenue/expenditure profiling and cash forecasts</li> </ul>
<b>3.4 Loan payment controls</b>	<ul style="list-style-type: none"> <li>• Debt management system integrated with debt payments</li> <li>• Loan/interest payments made on time</li> </ul>

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## 3. Treasury IC activities (2)

<b>Payment procedures</b>	<ul style="list-style-type: none"> <li>• Payment separated from authorization</li> <li>• Approved list of suppliers</li> <li>• Payment by bank transfer</li> <li>• Identification &amp; review of large or unusual payments</li> </ul>
<b>3.5 Payroll controls</b>	<ul style="list-style-type: none"> <li>• Dedicated payroll system/procedures</li> <li>• Integrated with personnel records</li> <li>• Payment through bank transfers</li> <li>• <b>Physical verification of employees</b></li> </ul>
<b>3.6 Supplier payments</b>	<ul style="list-style-type: none"> <li>• Approved list of suppliers</li> <li>• Procedures for ordering, receipting goods/services linked to payment authorization</li> <li>• Early recording invoices/bills (accrual accounting)</li> <li>• Payment through bank transfers</li> </ul>
<b>3.7 Controls through external evidence</b>	<ul style="list-style-type: none"> <li>• <b>Identified and documented government bank accounts</b></li> <li>• Regular bank reconciliations &amp; resolution of reconciling items</li> <li>• Regular reconciliation with supplier records</li> </ul>

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## 3. Treasury IC activities (3)

<b>Advances and prepayments</b>	
<b>3.8 Advances and prepayments</b>	<ul style="list-style-type: none"> <li>• Authorization procedures</li> <li>• Accounting records (accrual) or registers (cash accounting)</li> <li>• Regular reconciliation and confirmation</li> <li>• Clearance of all balances within specified time limits</li> </ul>
<b>3.9 Records management</b>	<ul style="list-style-type: none"> <li>• Documents filed and accessible</li> <li>• <b>Electronic authorization - ability to identify individuals providing authorization</b></li> <li>• Policies on document retention</li> </ul>
<b>3.10 Physical controls</b>	<ul style="list-style-type: none"> <li>• Physical security of cash and assets</li> <li>• Security of cash in transit</li> </ul>
<b>3.11 Revenue and other cash receipts</b>	<ul style="list-style-type: none"> <li>• Reconciliation with document identifying planned receipts, e.g. tax demands</li> <li>• Segregation revenue demands from receiving cash</li> <li>• Bank transfers and/or automatic receipting machines</li> <li>• Regular reconciliation anticipated and actual revenue receipts</li> </ul>

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## 3. Treasury IC Activities (4) – IT

System development controls	<ul style="list-style-type: none"> <li>• Documented specification including internal control requirements</li> <li>• Rigorous and documented system testing</li> <li>• Control over opening balances</li> <li>• Controls over system administrator access (all access logged and no “back doors”)</li> </ul>
3.12 Management and supervision	<ul style="list-style-type: none"> <li>• Non-IT managers trained to manage IT functions</li> <li>• Controls over data input</li> <li>• System generated logs of control issues, exceptions, etc.</li> <li>• Regular review and follow up of logs</li> </ul>
3.13 Process controls	<ul style="list-style-type: none"> <li>• System controls, e.g. authorizations, parameters</li> <li>• Automatic generation of standard and exception reports</li> </ul>
3.14 Security	<ul style="list-style-type: none"> <li>• <b>Non-IT management of security and access rights to systems and data</b></li> <li>• Access controls (password or biometric)</li> <li>• Controls to prevent unauthorized access and viruses</li> <li>• Physical security of systems, networks and hardware</li> </ul>

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## The Big Man Problem



You are a junior clerk responsible for payments

One day the Minister approaches you personally and says “Make this payment NOW – on my authority”

You know this is an improper payment – but how can you say no? Your career will be at risk.

**BUT you can say NO if there is a good internal control system:**

“Minister I want to help – but the system will not allow me to make this payment unless proper procedures are followed.”

- The Minister is controlled by the system
- The junior clerk is protected by the system

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## 3. Treasury IC activities (5) – Disaster & business continuity

- 3.15 Contingency plans for physical or system disasters/failures
- 3.16 Data regularly backed up as multi generation off site records
- 3.17 Contingency provision for off site data processing
- 3.18 All business continuity procedures regularly tested

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## 4. Treasury IC Information & Communication

<b>Reports to support internal control</b>	<ul style="list-style-type: none"><li>• Logs, exception reports, reconciliations, etc.</li><li>• Specific reports on internal control issues, e.g. by internal audit</li><li>• Follow up action on reports</li></ul>
<b>4.1 Internal reporting</b>	<ul style="list-style-type: none"><li>• Management reports to support decision making and control</li><li>• Reliable, understandable, timely and relevant reports</li><li>• Reports utilised by management</li></ul>
<b>4.2 External reporting</b>	<ul style="list-style-type: none"><li>• <b>Financial statements in accordance with international standards</b></li><li>• <b>Published independent audit reports of financial statements adds credibility</b></li><li>• Other external reports, e.g. monthly/quarterly financial bulletins</li><li>• Statistical reports to international agencies, e.g. IMF GFS</li><li>• Reliable, understandable, timely and relevant reports</li></ul>

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## 5. Treasury IC Monitoring

Monitoring process	<ul style="list-style-type: none"><li>• Ongoing monitoring of internal control, e.g. by internal audit</li><li>• Monitoring of new or emerging risks, e.g. cyber attacks</li><li>• Structure to manage internal control and risk monitoring and responses</li></ul>
5.1 Evaluation of internal control issues	<ul style="list-style-type: none"><li>• Identified issue, potential loss, probability and cost of actions to address issue</li><li>• Referred to management</li><li>• <b>Decision on actions</b></li></ul>
5.2 Corrective actions	<ul style="list-style-type: none"><li>• Action taken</li><li>• <b>Follow up review and evaluation</b></li></ul>

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## Treasury Internal Control: Conclusions

1. Internal Control part of good governance
  - Essential for EU membership as part of PIFC
  - Good practice for all governments
2. Treasury internal control
  - Key component of public sector internal control
  - Cash receipts and payments especially vulnerable
3. No system of internal control can provide complete protection
  - Balance of cost of controls compared to amount and probability of loss

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