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INTERNAL CONTROL EVALUATION GUIDE

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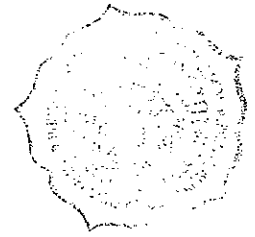
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INTERNAL CONTROL EVALUATION GUIDE



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Abstract

Absence of an applicable procedure or control may indicate a weakness which we should bring to the clients attention, even though the evaluation, as evidenced by control analysis form, indicates there are otherwise effective control procedures to prevent or detect material errors. Therefore, the auditor's judgment is always required in using the guide.

INTRODUCTION

The purpose of the Internal Control Evaluation Guide is to provide reminders of information needs and major points to be considered in the study and evaluation of internal control. That is, in other words, to give the auditor an idea of the effective internal control procedures which often times exist in commercial enterprises. Once this information is determined for a particular client, it can be used as a reference when identifying control procedures which the client uses to prevent or detect errors for control analysis form purposes.

USE OF THE GUIDE

Each section of the guide is organized in two parts: (1) conditions indicative of satisfactory internal control, and (2) procedures and controls. The first parts describes major elements of control which are characteristics of satisfactory operations. Emphasis is placed upon the identification, by name, of the persons or departments responsible for the function listed. Person directly responsible for the functions are identified, not the department head or other official only nominally responsible.

The second part of each guide section contains a list of reminders of points to be covered in the study and evaluation of internal controls. However, it should be noted that the guide is not used as a basis for direct questioning of client personnel. Although the lists of considerations are comprehensive, they do not necessarily cover all the points may be significant in the specific client circumstance. Absence of an applicable procedure or control may indicate a weakness which we should bring to the clients attention, even though the evaluation, as evidenced by control analysis form, indicates there are otherwise effective control procedures to prevent or detect material errors. Therefore, the auditor's judgment is always required in using the guide.

WORKING PAPER DOCUMENTATION

The guide is not intended as a working paper documentation technique. Flow charts, supported by narratives where appropriate, and control analysis form, etc. are the required form of documentation in the working papers. The applicable procedures and controls suggested in the lists of considerations are documented on the control analysis forms and control environment memorandum.

As an example, we will describe just only (1) the general practices, procedures and control and (2) sales and account receivable.

Performance of function working paper is included at the end of the guide for listing persons responsible for the various functions and noting conflicting duties.

I. GENERAL PRACTICES, PROCEDURES AND CONTROLS

A. CONDITIONS INDICATIVE OF SATISFACTORY INTERNAL CONTROL

A properly function system of internal control depends, in part, on an efficient organization and on the competence of officers, department heads and other key employees who carry out prescribed procedures in an efficient and economical manner.

Consider who is:

- Responsible for the accounting function.
- Responsible for insurance coverage
- Responsible for the internal auditing activities
- Responsible for the electronic data processing.

B. PROCEDURES AND CONTROLS

The considerations which follow are suggested to help assure completeness in our walkthrough, documentation, and evaluation of the client system. Narrative is the preferable form of documentation for the applicable procedures and controls suggested below. An evaluation of controls is included in the working papers along with significant strengths and weaknesses. Cross-referenced to the audit program covering the specific auditing procedures undertaken is appropriate.

General – Consider:

1. If there are definitions of duties by department for officers and employees.
2. Whether there is an organization chart reflecting the actual lines of responsibility.
3. Those procedures used to insure uniformity of accounting such as:
 - a. An accounting manual maintain on a current basis.
 - b. A chart of accounts.
4. How the accounting records are maintained, e.g.:

- a. How often the detailed records (for accounts receivable, accounts payable, etc) are balanced periodically with control accounts.
 - b. The adequacy of the protection provided for the accounting records and valuables.
 - c. What the controls are over branch office accounting.
 - d. Whether journal entries are adequately explained and approved.
 - e. If the accrual accounts which are maintained provide adequately control over Income & Expense.
5. The use of operating budgets:
 - a. The extent of their use
 - b. If the comparison of budgets with actual results is effectively used for control purposes.
 - c. By whom
 6. How operating statements are prepared for management, e.g.:
 - a. The frequency of preparation.
 - b. Whether detail is sufficient for the level of management receiving them.
 - c. If "highlight reviews" are submitted to management.
 7. If there are any serious defects in the cost system providing information as to costs and profits for individual product, lines, divisions, etc, which would preclude its being an effective element of an internal control, e.g., consider the degree of integration with the financial records.
 8. If the internal audit function is an effective element of internal control by determining:
 - a. The degree of its independence from the accounting department and its functions.
 - b. The level of management to which the internal auditor reports.
 - c. The adequacy of audit programs and areas audited, including surveillance over computer operations.
 9. The supervision the client maintains over the accounting for related organizations such as credit unions or employee associations.
 10. The personnel practices, etc:
 - a. Whether adequately fidelity bonds are obtained on officials and employees in appropriate positions.
 - b. If a policy of compulsory vacations and rotation of duties is followed.
 - c. The adequacy of audit programs and areas audited, including surveillance over computer operations.
 11. Whether a professional insurance broker or an employee with specialized insurance knowledge is used in arranging and reviewing coverage, and whether client has business interruption insurance.



SALES AND ACCOUNTS RECEIVABLE

A. CONDITIONS INDICATIVE OF SATISFACTORY INTERNAL CONTROL

1. There are effective controls that all shipments are billed and properly recorded.
2. Sales are accounted for by prenumbered invoices supported by shipping or delivery documents.
3. Sales prices are properly approved.
4. Accounts receivable details records are maintained in balance with the control accounts.
5. Non-cash credit are properly approved.
6. There is adequate segregation of duties among invoicing, receivables, cash and inventory function. Consider who performs the following duties:
 - a. Issues sales orders
 - b. Approves credit granting
 - c. Authorized shipment
 - d. Prepares billings
 - e. Etc.

B. PROCEDURES AND CONTROLS

The considerations which follow are suggested to help assure completeness in our walkthrough, documentation, and evaluation of the client system. Flowchart supplemented by outlines or narrative are the preferable form of documentation for the applicable procedures and controls suggested below. An evaluation of controls is included in the working papers along with significant strengths and weaknesses. Cross-referenced to the audit program covering the specific auditing procedures undertaken is appropriate

1. Pre-shipping – consider
 - a. If written orders from customers are required in all cases.
 - b. Who has authority to accept orders.
 - c. Whether credit is granted by a credit official or department separate from sales and accounts receivable prior to acceptance of an order.
 - d. What types of sales backlog record is maintained and how it is prepared.
2. Shipping – consider
 - a. How shipment are initiated.
 - b. What safeguards are in effect to prevent to prevent unauthorized shipments.

- c. If shipping documents are prepared and accounted for with respect to all shipments.
3. Billing – consider
- a. If the billing department receives a record of all shipments directly from the shipping department.
 - b. If the billing department receives directly from purchasing or accounts payable departments a record of items shipped directly to customers from suppliers.
 - c. What procedures are in effect to assure that shipping records are controlled and correlated with sales invoices.
 - d. If invoices are controlled and accounted for.
 - e. If voided invoices are approved and retained
 - f. How prices are determined, and, if prices are not based on standard lists, whether they are approved by an executive outside of the sales department.
 - g. How invoices are priced, extended and independently verified.
 - h. If invoices are mailed either by the billing department or delivered directly to a mailing department.
 - i. Whether the billing department sends a copy of all invoices directly to the accounts department.
 - j. What procedures assure returned goods are received before credits are granted.
 - k. If pro forma billings, consignments, shipments, to outside processors, samples, etc, are excluded from sales.
 - l. What procedures insure the receipt by the company of material revenue from all other sources, such as:
 - * Sale of scrap
 - * Sale of fixed asset
 - * Sale of securities
 - * Interest and dividend income
 - * Rents & Royalties
 - * Tax refunds.
4. Receivables – consider
- a. If the accounts receivable department receives a copy of all invoices directly from the billing department.
 - b. Whether accounts receivable detailed ledgers are balanced periodically with general ledger, and how often.
 - c. If statements are prepared and mailed monthly to all customers with accounts balance.
 - d. Whether aged trial balances are prepared periodically and reviewed by the credit department or other designated employees separate from those who handle sales, cash or accounts receivable.

- e. Whether the individuals approving credit receive current information as to delinquent accounts and notes.
- f. Whether notes are approved by an officials before acceptance by the client.
- g. If detailed records are maintained of notes receivable and collateral, including notes discounted, and balance with general ledger accounts periodically.
- h. Whether notes and collateral are periodically inspected by a responsible official other than the custodian.
- i. Who is responsible for collection follow-up on delinquent accounts.
- j. Whether all bad debts write-offs are approved by responsible official.
- k. Whether the right of offset is investigated before write-off.
- l. Who maintains a record of accounts written-off as uncollectible and when procedures for recovery follow-up insure that recovery proceeds are controlled.
- m. What procedures are in effect regarding advances to and receivable from employees



PERFORMANCE OF FUNCTION

Client name: _____

Adequate segregation of duties is one condition indicative of satisfactory internal control. This form maybe helpful in analyzing potential conflicting duties within each function and across all functions and can be included in the working papers as documentation of the analysis. When the form is used indicate the person who perform or is responsible for the procedure or function indicated below and whether that individual has any conflicting business.

GENERAL	Name	Conflicting duties
Responsible for accounting functions	_____	_____
Responsible for insurance cover	_____	_____
Direct internal audit activities	_____	_____
Responsible for EDP functions	_____	_____
EDP FUNCTION		
Responsible for system design	_____	_____
Responsible for programming	_____	_____
Responsible for processing	_____	_____
Equipment operation	_____	_____
Librarian	_____	_____
Responsible for data flow control	_____	_____
Input	_____	_____
Error re-entry	_____	_____
Output	_____	_____
Report distribution	_____	_____
SALES & ACCOUNT RECEIVABLES		
Issues sales orders	_____	_____
Authorizes shipment	_____	_____
Approved credit granting	_____	_____
Prepares billing	_____	_____
Posts accounts receivable	_____	_____
Initiated credit memo	_____	_____
Approved credit memo	_____	_____
Reconcile receivable to control	_____	_____
Approves bad debt write-off	_____	_____

DAFTAR PUSTAKA

1. Ernst & Young, Manual, Internal Control.
2. GE, Manual, Corporate Audit Staff.