Authorities Budget Office
Recommended Guidance

This Recommended Governance Practice bulletin on internal controls is intended for use by policymakers, and directors, officers and officials of public authorities. These bulletins are intended to delineate best practices and encourage their consideration and incorporation into the management and oversight of public authorities.

Subject: Assessment of the Effectiveness of Internal Controls

Provisions: Section 2800 (1)(a)(9) and Section 2800 (2)(a)(9) of Public Authorities Law require all public authorities to complete an annual assessment of the effectiveness of their internal control structures and procedures. Additionally, State authorities with a majority of the members appointed by the Governor must establish and maintain a system of internal control and a program of internal control review as provided in Title 8 of Public Authorities Law.

Objectives: The importance of an adequate system of internal control is to: (a) promote effective and efficient operations so as to help the authority carry out its mission; (b) provide reasonable, but not absolute, assurance that assets are safeguarded against inappropriate or unauthorized use; (c) promote the accuracy and reliability of accounting data and financial reporting to ensure transactions are executed in accordance with management's authorization and recorded properly in accounting records; (d) encourage adherence to management's policies and procedures for conducting programs and operations; and (e) ensure compliance with applicable laws and regulations. Furthermore, a successful system of internal control includes performing an annual assessment to identify potential weaknesses in policies or procedures and to implement corrective actions.

For purposes of complying with the requirements of Section 2800, an internal control assessment is an annual evaluation performed by management to determine the effectiveness of its internal control system. This assessment should be sufficiently thorough so as to identify significant weaknesses in controls, recognize emerging or inherent risks, and to enable early detection of existing or potential problems. If an internal control system is working effectively, management will have a reasonable indication of the reliability of its operating practices and the accuracy of the information it is using to measure its activities and performance. Any deficiencies identified as a result of the assessment could be quickly addressed.

Recommended Practice:

As a recommended practice, the Authorities Budget Office has identified five major components of an internal control assessment.

A. Define the Authority's Major Business Functions
The first step is to articulate the mission of the authority and to determine its primary operating responsibilities, including various business units, operations and functions that have been put in place to achieve the goals of the authority. Every authority should have a written mission statement that clearly defines the purpose of the authority. The authority should also define its objectives and ensure they are understood by staff. Additional policies, procedures and guidelines should be in place to guide staff in the operations of each specific business function, communicate the objectives, and provide the methods and procedures used to assess the effectiveness of those functions.

B. Determine the Risks Associated with Its Operations
Management should assess the risk exposure and associated vulnerability of each function and assign a corresponding risk level (i.e. high, medium, or low). Risk can originate both internally and externally. Control activities should be tailored to the individual operation based on management’s identification and evaluation of applicable risks.

Once a risk is identified, management must determine how to best handle it by evaluating its significance, likelihood, and cause. Based on the assigned risk levels, management should determine how frequently to review the controls in place for each function (i.e., high risk functions to be reviewed more frequently than lower risk functions).

C. Identify the Internal Control Systems in Place
Internal controls are the policies, practices, attitudes, guidelines and other actions adopted by the authority that, when followed, provide reasonable assurance that staff understand and properly carry out their responsibilities, that appropriate professional and ethical conduct is observed, and that the authority will honor its purpose and mission. Management and staff throughout the organization should understand and be aware of the policies and practices in place to ensure that the authority is effective and to address the risks that are relevant to the operation.

D. Assess the Extent to Which the Internal Control System is Effective
The assessment of internal controls should be a structured and monitored process to identify and report any weaknesses of the internal control structure to the authority. This process should determine if the existing control structure and procedures are adequate, to then mitigate risk, minimize ineffectiveness and deter opportunities that could lead to the abuse of assets. The assessment should provide management with information as to whether the authority's

policies and operating practices were understood and executed properly, and whether they are adequate to protect the organization from waste, abuse, misconduct, or inefficiency. This assessment can be completed through a combination of inquiry and observation, a review of documents and records, or by replicating transactions to test the sufficiency of the control system.

E. Take Corrective Action
When a weakness is identified, a corrective action plan should be developed, adopted by the board, and monitored by management to ensure that the vulnerability is addressed.

Internal Control Assessment:

To satisfy the requirement of Sections 2800 (1) (a) (9) and 2800 (2)(a)(9) of Public Authorities Law, authorities should incorporate, either within their annual report or as a separate document, a statement explaining that the authority has conducted a formal, documented process to assess the effectiveness of their internal control structure and procedures, and indicating whether or not the internal controls are adequate. This statement should be posted to the authority's website. An example of this statement is provided below:

This statement certifies that the [Name of Authority] followed a process that assessed and documented the adequacy of its internal control structure and policies for the year ending [Month,Date,Year]. To the extent that deficiencies were identified, the authority has developed corrective action plans to reduce any corresponding risk.

The authority should retain this documentation. If the authority has found any deficiencies with the internal controls over its functions or operations, additional documentation should be maintained to demonstrate that the authority has adopted corrective action plans to address these weaknesses. This documentation should be made available upon request to the authority's independent auditor or to the Authorities Budget Office compliance review staff.

Public Authorities Reporting Information System (PARIS): As part of the PARIS Annual Report tab, state and local authorities will be required to indicate whether or not they have prepared this assessment and to provide the URL link to the statement.

Additional material that may be helpful in establishing and evaluating internal controls can be found on the Office of the New York State Comptroller's web site:

http://www.osc.state.ny.us/localgov/pubs/lgmg/managementsresponsibility.pdf

http://www.osc.state.ny.us/localgov/pubs/lgmg/practiceinternalcontrols.pdf .