AAM 05. INTERNAL CONTROLS

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AAM 05.010 Background and Definition (07-22)

The State of Alaska adopted the Standards for Internal Control in the Federal Government, issued by the Comptroller General of the United States Governments Accountability Office, commonly known as the ‘Green Book’. The Green Book sets internal control standards for Federal entities and may be adopted by any State or Local Government. The Green Book adapts the Committee of Sponsoring Organizations of the Treadway Commission (COSO) updated internal control guidance in 2013, which introduced the concept of principles related to the five components of internal controls, for government environments.

The State of Alaska uses the Green Book to design, implement, and operate internal controls to achieve its objectives related to operations, reporting, and compliance. The full version is available online at https://www.gao.gov/assets/gao-14-704g.pdf.

Additional information and material regarding internal controls is available through the Division of Finance web site at http://doa.alaska.gov/dof/controls.

Definition

Internal control is a process used by management to help an entity achieve its objectives.
Internal Controls helps an entity:

- Run its operations efficiently and effectively
- Report reliable information about its operations
- Comply with applicable laws and regulations

**Internal Control System** is a continuous built-in component of operations, effected by people, that provides reasonable assurance, no absolute assurance, that an entity’s objectives will be achieved.

See the *Green Book Section 1 – Fundamental Concepts of Internal Controls* starting on page 5 for further information on these definitions.

### AAM 05.020 Responsibility (07-22)

Policymakers and program managers are continually seeking ways to improve accountability in achieving the State of Alaska’s mission. A key factor in improving accountability is to implement an effective internal control system to help an entity adapt to shifting environments, evolving demands, changing risks, and new priorities. As programs change and we strive to improve operational processes and implement new technology, management must continually evaluate its internal control system so that it is effective and updated when necessary.

People are what make internal control work. Management is responsible for an effective internal control system. As part of this responsibility, management sets the entity’s objectives, implements controls, and evaluates the internal control system. However, personnel throughout an entity play important roles in implementing and operating an effective internal control system.

In general, roles in the State of Alaska’s internal control system can be categorized as follows:

- **Oversight body** – responsible for overseeing the strategic direction of the entity and obligations related to the accountability of an entity. This includes overseeing management’s design, implementation, and operation of internal control system. For the State of Alaska this includes the Office of the Governor, Office of Management and Budget (OMB), Department of Administration (DOA) Commissioners Office, DOA Division of Finance, DOA Personnel and Labor Relations, DOA Office of Procurement and Property Management, DOA Office of Information Technology, Department of Revenue (DOR) Treasury, and DOR Cash Management.

- **Management** – directly responsible for all activities of an entity, including the design, implementation, and operating effectiveness
of an entity’s internal control system. Managers’ responsibilities vary depending on their functions in the organizational structure. For State Agencies this may include Commissioners, Deputy Commissioners, Directors, Deputy Directors, Division Operation Managers, Finance Officers, Budget Managers, Program Managers, Admin Operation Managers, and other high-level management.

- **Personnel** – help management design, implement, and operate an internal control system and are responsible for reporting issues noted in the entity’s operations, reporting, or compliance objectives.

- **Internal Service Organizations** – perform certain operational processes for the entity, such as accounting and payroll processing, security services. Management retains responsibility for the performance of processes assigned to service organizations therefore management needs to understand the controls each service organization has designed, implemented, and operates for the assigned operational process and how the service organization’s internal control impacts the entity’s internal control system. For State of Alaska this may include DOA Shared Services Travel, Payables, Procurement, Human Resources, Lease Management, Central Mail, and DOA Division of Finance Payroll Services.

Division of Legislative Audit and other External Auditors are not considered a part of the State of Alaska internal control system. While management may evaluate and incorporate recommendations by auditors or Federal oversight agencies, responsibility of an entity’s internal control system resides with management.

See the Green Book Section 1 – Fundamental Concepts of Internal Controls, Roles in an Internal Control System starting on page 11 and Section 4 – Additional Considerations Service Organizations starting on page 17 for further information.

### AAM 05.030 Framework Components (07-22)

There are five interrelated components of an internal control framework: control environment, risk assessment, control activities, information and communication, and monitoring, 17 related principles, and the underlying attributes. These components, principles and attributes make up the minimum level of internal control an agency needs to have in place and are the basis against which internal control is evaluated.

See the Green Book Section 2 – establishing an effective Internal Control System and the sections dedicated to each component/principle/attribute starting on page 6 for further information on these standards.
Control Environment - the foundation for internal control system. It provides the discipline and structure to help an entity achieve its objectives.

The related Principles and underlying Attributes:

1. The oversight body and management should demonstrate a commitment to integrity and ethical values.
   a. Tone at the Top (and Tone in the Middle)
   b. Standard of Conduct
   c. Adherence to Standards of Conduct

2. The oversight body and management should oversee the entity’s internal control system.
   a. Oversight Structure
   b. Oversight for the Internal Control System
   c. Input for Remediation or Deficiencies

3. Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity’s objectives.
   a. Organizational Structure
   b. Assignment of Responsibility and Delegation of Authority
   c. Documentation of Internal Control System

4. Management should demonstrate a commitment to recruit, develop, and retain competent individuals
   a. Expectations of Competence
   b. Recruitment, Development, and Retention of Individuals
   c. Succession and Contingency Plans and Preparation

5. Management should evaluate performance and hold individuals accountable for their internal control responsibility.
   a. Enforcement of Accountability
b. Consideration of Excessive Pressures

Notable Items for State of Alaska

The oversight body and management must demonstrate the importance of integrity and ethical values through their directives, attitudes, and behaviors. This reinforces the commitment to doing what is right, not just maintaining a minimum level of performance necessary to comply with applicable laws and regulations, so these priorities are understood by all stakeholders, such as regulators, employees, and the general public.

Ethics, Integrity, Organizational Charts/Structures, Delegation of Authority forms, Position Descriptions, Recruitment, Staff Development, Retaining Competent individuals, Employee Evaluations are all integral parts of the State of Alaska’s Control Environment.

Organizational Structures and Delegation of Authority forms have built in Proper Segregation of duties to ensure authority, custody, and accounting are all performed by different departments or divisions within departments:

- **Authority-**
  - Budget/Funding Authority is delegated from the Commissioner to Division Directors and may be further delegated to program managers. Program staff create purchasing requisitions approved by the program manager and provide the appropriated budget authority available for the purchase.
  - Procurement/Purchasing Authority, as defined in the State Procurement Code and Alaska Administrative Manual 81 and 82. These employees purchase items primarily through purchase orders, delivery orders, or contracts based on the applicable procurement rules based on the amount the item or service costs.
  - Individual Purchasing Cards for small purchasing authority have agreements with specific restrictions and requirements.

- **Custody-**
  - Department of Revenue Cash Management and Treasury Divisions maintain custody over our cash and investment assets.
  - Custody of inventory and fixed assets must be safeguarded from theft, improper use or loss and strictly accounted for within the State Agency.

- **Accounting-**
  - Accounting is performed in the State of Alaska Accounting System primarily by DOA Division of Finance, each State Agency’s Division of Administrative/Support Services, and
internal service organizations within DOA Shared Services of Alaska.
  
  - Each State Agency has a designated Finance Officer to oversee the Agency’s Accounting and to be the point of contact for Division of Finance for all Accounting requests and information sharing.

Additional information and materials on more specific segregation of duties divisions and programs must consider is available through the Division of Finance web site at http://doa.alaska.gov/dof/controls.

See the Green Book Section – Control Environment starting on page 21 for further information on these standards.

### AAM 05.032 Component 2 – Risk Assessment (07-22)

**Risk Assessment** – Assesses the internal and external risks facing the entity as it seeks to achieve its objectives. This assessment provides the basis for developing appropriate risk responses.

The related Principles and underlying Attributes:

6. Management should define objectives clearly to enable the identification or risks and define risk tolerances.
   
   a. Definitions of Objectives
   
   b. Definitions of Risk Tolerances

7. Management should identify, analyze, and respond to risks related to achieving the defined objectives.
   
   a. Identification of Risks
   
   b. Analysis of Risks
   
   c. Response to Risks

8. Management should consider the potential for fraud when identifying, analyzing, and responding to risks.
   
   a. Types of Fraud
   
   b. Fraud Risks Factors
   
   c. Response to Fraud Risks

9. Management should identify, analyze, and respond to significant changes that could impact internal control system.
a. Identification of Change

b. Analysis of and Response to Change

Additional information and material defining the State of Alaska Base Objectives and walking State Agencies through how to identify, assess, and monitor their subobjectives is available through the Division of Finance web site at http://doa.alaska.gov/dof/controls.

See the Green Book Section – Risk Assessment starting on page 34 for further information on these standards.

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<th>AAM 05.033</th>
<th>Component 3 – Control Activities (07-22)</th>
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**Control Activities** – The actions management establishes through policies and procedures to achieve objectives and respond to risks in the internal control system, which includes the entity’s information system.

The related Principles and underlying Attributes:

10. Management should design control activities to achieve objectives and respond to risks.
   a. Response to Objectives and Risks
   b. Design of Appropriate Types of Control Activities
   c. Design of Control Activities at Various Levels
   d. Segregation of Duties

11. Management should design the entity’s information system and related control activities to achieve objectives and respond to risks.
   a. Design of the Entity’s Information System
   b. Design of Appropriate Types of Control Activities
   c. Design of Information Technology Infrastructure
   d. Design of Security Management
   e. Design of Information Technology Acquisition, Development, and Maintenance

12. Management should implement control activities through policies.
   a. Documentation of Responsibilities through Policies
b. Periodic Review of Control Activities

Control Activity can either be preventive or detective/corrective:

**Preventive control activity** – prevents the State of Alaska from failing to achieve an objective or address a risk.

**Detective/Corrective control activity** – discovers when an entity is not achieving an objective or addressing a risk before the entity’s operation has concluded and corrects the actions so that the entity achieves the objective or addresses the risk.

Examples of Common Categories of Control Activities

- Top-level reviews of actual performance
- Reviews by management at the functional or activity level
- Management of Human Capital (workforce)
- Controls over information processing
- Physical control over vulnerable assets
- Establishment and review of performance measures and indicators
- Segregation of duties – reduces the risk of error, misuse, or fraud
- Program execution of transactions
- Accurate and timely recording of transactions
- Access restrictions to and accountability for resources and records – reduces the risk of error, fraud, misuse, or unauthorized alteration
- Appropriate documentation of transactions and internal control – readily available for examination

Additional information and materials, including specific segregation of duties divisions and programs must consider are available through the Division of Finance web site at [http://doa.alaska.gov/dof/controls](http://doa.alaska.gov/dof/controls).

See *the Green Book Section – Control Activities* starting on page 44 for further information on these standards.

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<th>Component 4 – Information and Communication (07-22)</th>
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**Information System** – The quality information management and personnel communicate and use to support the internal control system. Effective information and communication are vital for the State of Alaska to achieve its objectives.

The related Principles and underlying Attributes:

13. Management should use quality information to achieve the entity’s objectives.
a. Identification of Information Requirements

b. Relevant Data from Reliable Sources

c. Data Processed into Quality Information

14. Management should **internally** communicate the necessary quality information to achieve the entity’s objectives.

   a. Communication throughout the Entity

   b. Appropriate Methods of Communication

15. Management should **externally** communicate the necessary quality information to achieve the entity’s objectives.

   a. Communication with External Parties

   b. Appropriate Methods of Communication

Some factors to consider when selecting the appropriate method of communication, such as written document or face-to-face meeting, for both internal or external communication:

- **Audience** – the intended recipients of the communication
- **Nature of information** – the purpose and type of information being communicated
- **Availability** – information readily available to the audience when needed
- **Cost** – the resources used to communicate the information
- **Legal or regulatory requirements** – requirements in laws and regulations that may impact communication

Additional information and material are available through the Division of Finance web site at [http://doa.alaska.gov/dof/controls](http://doa.alaska.gov/dof/controls).

See *the Green Book Section – Information and Communication* starting on page 58 for further information on these standards.

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**AAM 05.035 Component 5 - Monitoring (07-22)**

**Monitoring** – Activities management establishes and operates to assess the quality of performance over time and promptly resolves the findings of audits and other reviews. Internal control is a dynamic process that has to be adapted continually to the risks and changes the State of Alaska faces.

The related Principles and underlying Attributes:
16. Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.

   a. Establishment of a Baseline
   b. Internal Control System Monitoring
   c. Evaluation of Results

17. Management should remediate identified internal control deficiencies on a timely basis.

   a. Reporting of Issues
   b. Evaluation of Issues
   c. Corrective Action

Additional information and material defining the State of Alaska Base Objectives and walking State Agencies through how to identify, assess, and monitor their sub-objects is available through the Division of Finance web site at http://doa.alaska.gov/dof/controls.

See *the Green Book Section – Monitoring* starting on page 64 for further information on these standards.

### AAM 05.040 Annual Requirements for Agencies (07-22)

**Annual Assurance**

The Department of Administration, Division of Finance distributes an annual internal control acknowledgement letter that is signed by the designated officials. This acknowledgement provides the Division of Finance with reasonable assurance that controls are in place at the State Agency, sufficiently documented, continually monitored and reviews have taken place.

**Annual Internal Control System Review**

The State of Alaska Base Internal Controls are documented on Division of Finance Website, along with a workbook available to assist with document Internal Control Systems at http://doa.alaska.gov/dof/controls.

Each State Agency Management must use these documents, and follow the documentation requirements noted below, to ensure the State of Alaska base internal controls and all State Agency specific subobjectives and related controls are being identified, designed, implemented, and evaluated/updated timely as required.
The State Agency must document their annual assessments and provide to the Division of Finance each year along with their annual assurance.

**Documentation Requirements**

Documentation is a necessary part of an effective internal control system. Management uses judgment in determining the extent of documentation that is needed. Documentation is required for effective design, implementation, and operating effectiveness of an entity’s internal control system.

The **minimum documentation requirements** are as follows:

- If management determines that a principle is not relevant, management supports that determination with documentation that includes the rationale of how, in the absence of that principle, the associated component could be designed, implemented, and operated effectively.
- Management develops and maintains documentation of its internal control system.
- Management documents in policies the internal control responsibilities of the organization.
- Management evaluates and documents the results of ongoing monitoring and separate evaluations to identify internal control issues.
- Management evaluates and documents internal control issues and determines appropriate corrective actions for internal control deficiencies on a timely basis.
- Management completes and documents corrective actions to remediate internal control deficiencies on a timely basis.

See *the Green Book Section 4 – Additional Considerations, documentation requirements* starting on page 19 for further information.

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### AAM 05.050 Loss of Public Funds or Property (04-14)

In the event of the suspected loss of public funds or property, it is important that correct procedures are followed in order to:

- Minimize the loss.
- Ensure that investigations are not hampered.
- Ensure that extravagant settlements are not made.
- Ensure that bond claims are not jeopardized.
- Ensure that incorrect personnel actions are not taken.
Each agency should establish formal notification procedures to notify appropriate agency personnel when someone suspects a loss of public funds or property. Appropriate personnel not involved in the suspected loss should be notified prior to contacting outside agencies. This may include the agency head or deputies, chief financial officer or internal auditor depending upon the circumstances.

Per AS 37.10.090, whenever money, funds, or property of a city, school district, municipal government, or the state are illegally paid or are diverted for an illegal purpose, or paid to a person not authorized by law to receive them, they may be recovered by an action instituted by the attorney general.

The agency's Assistant Attorney General should be consulted on incidents involving the suspected loss of public funds or property. It is best to establish general procedures to follow upon learning of a suspected loss of public funds or property. In addition, it may be appropriate to contact local or state law enforcement officials.

Protect any pertinent records, regardless of format (i.e., paper, electronic, etc.), from destruction or manipulation.