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SANGATH ONLINE TRAINING PROGRAMME

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MODULE V

Areas of Internal Control

Table of Contents

1. INTRODUCTION:	3
2. IMPORTANCE OF INTERNAL CONTROLS	3
3. CHARACTERISTICS OF INTERNAL CONTROL	4
4. BENEFIT OF CONTROL SYSTEM	5
5. TYPES OF INTERNAL CONTROLS	7
5.1 SETTING UP OF POLICIES	7
5.2 BUDGETARY CONTROL	10
5.3 RECEIPT MANAGEMENT	12
5.4 EXPENDITURE CONTROLS	14
5.5 PURCHASE CONTROLS	16
5.6 BANK TRANSACTIONS	17
5.7 CASH TRANSACTIONS	18
5.8 FIXED ASSET MANAGEMENT	19
5.9 ADVANCE CONTROL	20
5.10 SEGREGATION OF DUTIES	21

1. INTRODUCTION:

For an organization to function effectively, certain goals and objectives must be set clearly. Control in a way, helps to measure the progress towards the accomplishment of such goals. It should be noted that plans are realized only through effective managerial control. Internal control system of an organization consists of all actions that are taken to ensure that the objective of the organization is achieved. It ensures that programmes and its activities are conducted effectively with maximum efficiency and reliable reporting is done. It also ensures that all the applicable laws of land are properly followed. Control will be enhanced if the duties of the members of the organization are divided so that one person does not handle all aspects of day to day operation from beginning to end. Although a complete separation of functions may not be feasible for small organization, some measures of effective control may be obtained by planning the assignment of duties carefully.



2. IMPORTANCE OF INTERNAL CONTROLS

The effective implementation and monitoring of a sound internal control system helps ensure that the organization meet their objectives. Good internal controls will:

- Help to align the performance of the organization with the overall objectives through continuous monitoring of the performance and activities carried out by the organisation.
- Encourage good management and allow the management to receive timely and relevant information on performance against targets, as well as key figures that can indicate variances from targets.
- Ensure proper financial reporting by maintaining accurate and complete reports required by legislation and management, and minimizing the time lost in correcting errors and ensuring that the resources are correctly and efficiently allocated
- Safeguard assets ensuring the organization's physical, intellectual property and monetary assets are protected from fraud, theft and errors.

- Deter and detect frauds and errors ensuring that the systems quickly identify errors and fraud when they occur.
- Reduce exposure to risks and minimize the chance of unexpected events.

3. CHARACTERISTICS OF INTERNAL CONTROL

Internal Control has some basic characteristics. These are:

3.1 End Function: Control, being an end function of the management process is not the beginning, but a follow up to the other functions of Management. Control is said to be the end function, since, it judges the performance of different factors engaged in the attainment of the objective of the enterprise.

3.2 Continuous Process: Just like planning, control process is also continuous. Control should also be prompt in dealing with deviations. A Manager should monitor the performance of his staff continuously and assure himself that they are on the right track.

3.3 Flexible Activity: Controlling process cannot be rigid. It has to be flexible and is required to be adjusted according to the needs and situations arising from time to time. As plans and objectives may change according to the needs of the situation, control must also adjust itself to them.

3.4 Forward Looking: Control is related to the future though it lives in the present. It is the present over which control is exercised with a view to guard against future loss and wastage which may arise due to deviations from plans, policies, programs and schedules, etc.

3.5 All Level Exercise: Control, like all other managerial functions, is exercised at all levels of Management. Its nature and degree may change according to the level but it is to be performed throughout the organisation. It is a non-interfering process. It does not curtail the right of an individual or of a group.

3.6 Employee Behavior: Control guides and integrates the employee's behaviour towards attaining organisational goals. It guides the employees to work according to the predetermined standards, motivating and instructing them in achieving the organisational goals. Supervising will help in integrating their behaviour towards

attaining the goals of the enterprise.

3.7 Anticipating Probable Changes: Changes can be anticipated via information collected.

Reports and information from people working on different jobs will enable the management to anticipate that :

- > It is economically realistic.
- > It is accurate - timely - objective and comprehensive.
- > It focuses on strategic control points.

4. BENEFIT OF CONTROL SYSTEM

At this specific point, it should be agreed that control is vital to an organization. But in what ways? The following points will make this clearer:



4.1 Proper Implementation of Plans:

Control through the feedback information will enable the Management for the proper implementation of plans. Plans are related to the future and the controlling process will provide adequate information to Management so that these plans are implemented in a proper manner.

4.2 Detection of Weaknesses:

Control highlights omissions (if any) and makes it possible to take corrective measures. Control keeps a check on other functions for ensuring successful management. It is the control function of Management that reveals and brings necessary feedback for indicating managerial weaknesses and determination of remedial actions. It helps the Management in knowing which department needs more attention.

4.3 Proper Action:

Control gives the correct picture of the nature of corrective action to be taken. Taking corrective action may lead to modification of planning, organizing and directing. If anything is wrong with planning, organizing and directing, it is brought to light through the process of control.

4.4 Decision Making:



Control is basic to decision making. According to W.T. Lerome, “Control is needed both to simplify the making of subsequent decisions and to ensure the realization of the objectives implicit in the original long range policy decisions”. The process of control is complete only when corrective action is taken.

4.5 Consistency:

Control enables top Management to get the feedback information which helps them to ensure that the decision taken at the lower levels are consistent with the policies and the interest of the enterprise. The modern trend towards decentralization, calls for a systematic attempt for controlling.

4.6 Co-ordination:

Control facilitates co-ordination by keeping the routine activities and efforts within the fixed boundaries established by the pre-determined goals and objectives. It also provides guidance to each member of the organisation to move towards common goals through coordinated directions.

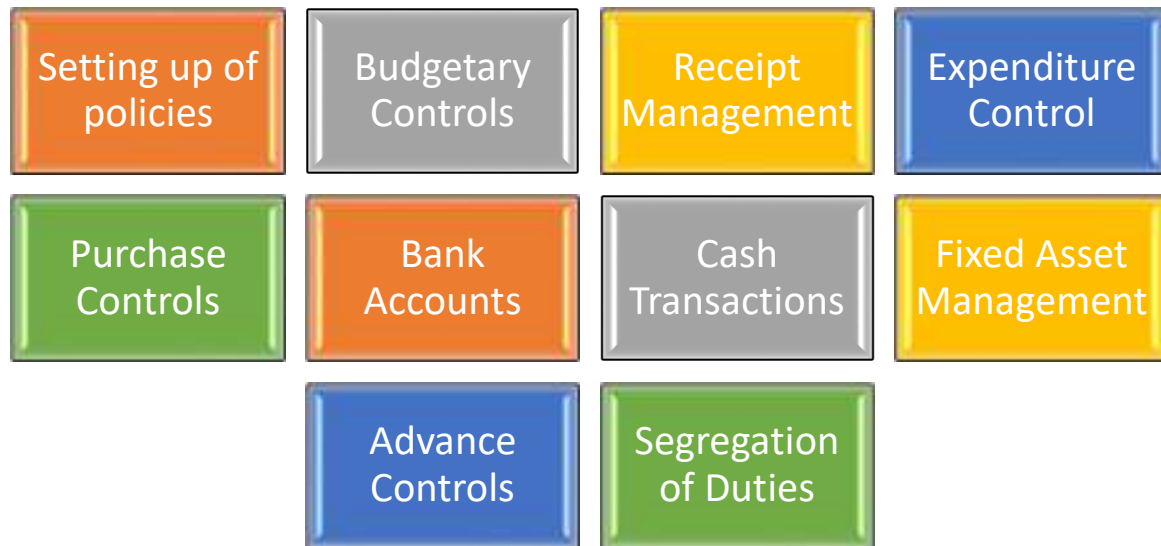


4.7 Positive Impact:

The existence of a control system has a positive impact on the behavior of employees who tend to be more cautious as their performance is being observed by the Manager or compared with the pre-determined goals. It keeps the subordinates under check and brings discipline among them. Employees, knowing that they are being observed, will try to work more efficiently and according to standards.

5. TYPES OF INTERNAL CONTROLS

We can subdivide the internal control system into ten categories, the details of which is provided below:



5.1 SETTING UP OF POLICIES

Policy is an implicit framework that guides the day to day actions on a job. Policy includes a range of elements which are:

- ✓ Policy creates a **framework for action** within the organization so that there is a clear picture in the minds of all the employees as in how a work is to be carried out.
- ✓ Policy should be grasped and **known to all the employees** so that they can act on it accordingly.
- ✓ Policy creation is **an ongoing process**, as mentioned earlier the good practices can be recognized and formally documented as a policy.
- ✓ Policy is a **wider framework** within which the organization works.

5.1.1 Need of policy

It is needed so that people working in an organization can have a framework for action that helps them get on with the job they do. So that people don't have to discuss and re-discuss again and again the same issues. One thought out decision can be applied to many similar cases. This helps in increasing the efficiency of the organization. Further, policy documents help to ensure that statutory requirements are met and it also ensure that quality of work is improved. The following are the key requirement of having the policy documents in the organization:-

- ✓ To ensure consistency
- ✓ To promote transparency
- ✓ To promote accountability
- ✓ To guide how decisions are made

5.1.2 What does policy look like?

Policy has many forms. What is included in a particular organization's policy is often related to the size of the organization. In a small organization of let's say Board of Management and 10 staff, an Organizational policy of less than 100 pages could include most of the significant policies the organization may need. However, in a large organization there may be a series of organizational manuals such as:

- ✓ Human Resource Policies and Procedures
- ✓ Administration Policies and Procedures
- ✓ Finance Policy and Procedures etc.

Some of these could run to hundreds or even thousands of pages each. So, the bottom line is that the look of a policy will always depend on the size of the organization. Moreover, as stated earlier, Policy making is an ongoing process. So, just as the size of organization will keep on changing, the policy will also keep changing accordingly.

5.1.3 Criteria to develop a good policy

- ✓ A good policy must have clarity
- ✓ A good policy must be user-friendly
- ✓ A good policy must be robust
- ✓ A good policy must be implementable

5.1.4 Results of a good policy

- ✓ A good policy recognizes the issues and addresses them.
- ✓ A good policy brings uniformity in the organization.
- ✓ It eliminates discretion of personnel.
- ✓ Reduces risk by bridging gaps.

Key Points to Remember:

- ✓ Organisation should identify all the **good practices** of the past experiences and good practices should be **formalized and documented** in form of policies.
- ✓ The organization should have **a clear policy** for Human Resource Management, Financial Procedure, Advance Management, Assets Management, Procurement & Purchase Management, Cash and Bank Management etc.
- ✓ Organisation should develop such policy which **must be implementable**.
- ✓ The management should try to **address the issues as per the policy** of the organisation.
- ✓ The management should ensure that risk is being **reduced by bridging gaps**.
- ✓ Organisation should a **level of approving authority** for the authorization and approval procedure.

5.2 BUDGETARY CONTROL

- An organization makes budget on the basis of plan to achieve the objective. Budget gives the quantitative picture of the plan of action. Along with the document for plan of action,



budget provides a tool to control the implementation of the project. The actual work is compared to the planned work along with the comparison of actual expenditure with that of planned expenditure. The deviation between the actual and plan/budget is analysed to take corrective action.

- Budget is also a tool for the cost control. The budget gives a standard for the expenditure for activities and prevents unnecessary extravagance in the work. This is very important control since excess expense in one activity has negative effect on the implementation of rest of the activities as fewer amounts would be left to carry out some of the other activities.
- Budget as a document prepared at the planning stage helps in monitoring as well as review of activities in line with the expenditure.

The essentials of budgetary controls are:

- Establishment of budgets
- Executing responsibilities in order to perform the specific tasks to attain the desired objectives
- Continuous comparison of actual performance with standard performance
- Taking corrective actions, if there are deviations
- Revision of Budgets

5.2.1 Why Budgetary Control is important?

- **Restricted & Specific Purpose:** - In general, project funds received by NGO's are restricted. The restriction is imposed on its usage and can only be utilize for the specific purpose as agreed upon between the donor and NGO.

- **Time Bound:** - As we know that a budget describes an amount of money that an organization plans to raise and spend for a set purpose over a given period of time. Therefore, it is very important that the planned activities are completed in the time set in accordance with the budget.
- **Programme. Vs. Administrative Expenditure:** - It very important to have control over the administrative expenditure, as it is always a better practice to have minimum administrative expenditure in the overall project cost. All organizations should assess and book the administrative expenditures separately, as there can be a matter of compliances like FCRA. Sometimes, donors also give instructions to the organizations in matters related to administrative expenditure and program expenditure.
- **Cost Plan:** - Since, budget is made to track the expenditures, therefore, before any expenditure it is suggested to refer to the cost plan.
- **Coordination between various costs:** - Budgetary control helps to verify various individual program costs and keeps a check on overspending.
- **Clarity on the progress of the project:** - As discussed earlier, budgets provide a clear estimation of the various programme costs. This in return acts as a reference point as organizations can refer back to the budget and find out the achievements and progress of the project.
- **Deviation from the Budget** –The event of deviating from the budget would be considered as deviation from the financial track set. Since the deviation which may be positive or negative i.e. over expenditure or under expenditure may change the overall scenario of the project, it is vital to monitor it in line with the planned activity. For example, in the project of building houses for poor where the construction is done step by step and which ends basically with the roof and finishing's, the over

expenditure in case of initial construction steps may leave the house without roof and doors. This will lead to total failure of the project.

- **Actual Implementation** - For any type of control mechanism we need to have a reference point. Budget acts as reference for control over actual implementation of the project. Thus, we have to compare the actual happening with that of the plan/budget.
- **Comparison statement:** - Comparison statement as mentioned above in itself does not serve the purpose of control process. It merely gives an idea of deviation that may require our attention. Control process means taking action against something which is not favorable.
- **Timely Corrective Decisions can be made:** - Since budgets act as a reference point for projects, any variance in the actual and estimated budget can be detected and rectified in due time.

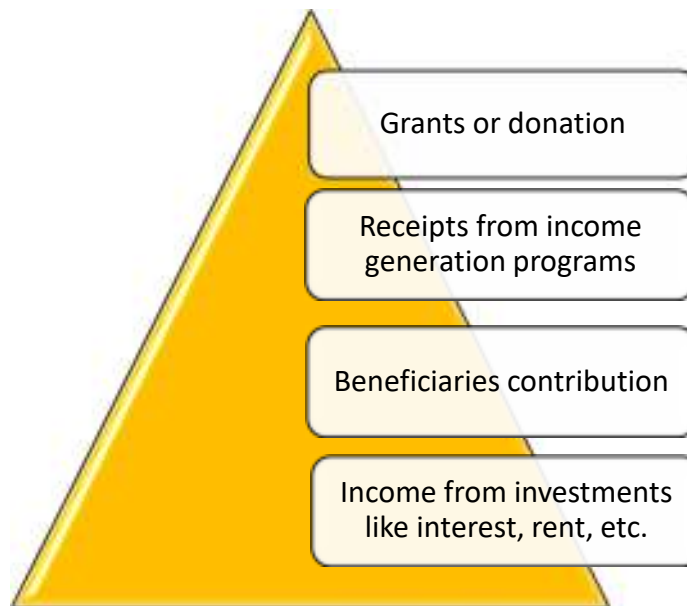
5.3 RECEIPT MANAGEMENT

Organizations should have systems to secure their incomes. There are some basic checks and control to ensure that money received by the organization is not leaked and properly accounted for. Some of such checks and controls are:

- Opening official mails at secured place and in the presence of more than one person as the mails may contain cheques.
- Receipt should be issued immediately for all cash receipts. If this system is not in place then, the cash received may go unaccounted and would result in loss of revenue of the organization.
- Any receipt should immediately be recorded in the books of account.
- All the receipts should be deposited in bank account to have a proper trail.
- There should be system of regular check to ensure that all the incomes are being recorded properly on time.

Types of Receipts

Normally, the nature of receipts includes the following:



Key Points to Remember:

As regards receipt of Grant/Donation:

Receipts through cheques

- ✓ It is to be ensured that the grants are received in the name of the organisation and through A/c Payee cheques, bank transfers or bank drafts.
- ✓ The grant should be received by the Head of the Organization or by any person authorized by the Board and pre-numbered receipt should be issued for every grant received.

Receipts through cash

- ✓ In case where donations are received in cash, it should be received by the Head of the Organization or by the person authorized by the Board or authorized by Head of the Organisation.
- ✓ Pre-numbered receipt should be issued for every donation received and the amount collected should be handed over to the Cashier who will check the receipts from the counterfoil of the pre numbered receipt book.

As regards Beneficiaries Contribution:

- ✓ All the contributions from the beneficiaries at various centers and at the Head Office may be collected by the Center-in-charge or Project-in-charge or any other authorized persons and it should be duly documented either by:
 - issuing a pre-numbered receipt, or
 - in case of small contributions, through maintaining a contribution receipt register.
- ✓ The person on daily or periodically basis will deposit the total cash collected to the Cashier who will check the total collection made with the receipts issued.

5.4 EXPENDITURE CONTROLS

Expenditure Control is an approach to ensure that the funds are utilized for the intended purpose and objective of the organisation and is within the scope and framework as defined under the policies of the organization or any other contractual agreement/laws of the land. There should be proper control over expenditure to ensure that all the expenditures are reasonable and as agreed with the donor, which finally leads to achieve the project objective.

To strengthen the internal control over the expenses, the organisation should ensure the following –

- Ensure that all the expenditures should be recorded with appropriate voucher with adequate supporting document.
- Ensure that authorization is in place.
- A senior staff should authorize the expenditure before it is paid.
- The person authorizing expenditure should be different from the one who prepares and signs cheques.
- All payments to suppliers be made against original invoice. In case the payment is made on the basis of scan/ photocopy of the invoice, there should be necessary controls to ensure the receipt of original invoice to avoid the duplicate payment.
- It is required to use the requisition form for the withdrawal of funds and project advances.
- Monitoring of the existing balance in the fund/project.

All the activities of an organization involve expenditure. All the expense should be done on proper authorization by the person conversant with the overall programme for which the expenses are done. For e.g. Programme Coordinator of a particular project should always be part of authorization/ approval system, so that the viability and validity of expense is properly referred and linked to respective budget head. As far as possible, the payments should be made only on receipt of proper and original documents supporting the expenditure. Payment to vendors should always be done on receipt of original invoice.

It is very important that the expenditure incurred against one budget should not be booked under another budget. Further, expenditure which does not pertain to the project should not be charged to the project.

Key Elements of the Expenditure Control –

- **Activity Plan** –Every organisation should develop clear plans as it is very essential to carry out the activity in a systematic/timely manner. It should be in line with the vision and mission of the organisation. Activity plan and finance plan needs to be clearly linked so that the resources can be utilized in an effective and efficient manner.
- **Project Budget** – Project budget should be made to ensure time plan, remittance and usage of funds for the programmes and it should be strictly adhered to. The same should be reviewed on regular basis.
- **Accounting Structure** – the accounting head should be structured in sync with the budget head. This will help in correct booking of expenditure as well as monitoring on regular basis.
- **Program and Natural Heads** – The accounting structure should enable to track natural head expenses under the respective program heads. This will help in ensuring better control over the project/program expenses.
- **Approval and Authorization** - Expenditure should be approved & authorized by the authorized signatory (senior staff).

- **Booking of Expenditure** – It should be ensured that the expenditure has been booked to the project to which it belongs and as per the approved budget. Further, it should be checked twice whether the expenditure has been booked under the correct head on quarterly basis (time period depends upon the size of the organizations).
- **Regular Updation of the Books of Account** – Proper books of account should be maintained and it should be regularly updated.
- **Role of Audit** – Auditor should report that the expenditure are in conformity with the project objective, donors compliances etc.. Project has been implemented according to the approved budgets. Adequate notes/disclosures should be made by the auditor for transparency.

5.5 PURCHASE CONTROLS

Another aspect of control system is the purchase process. Purchases involving considerable amount should properly be processed to avoid any possibility of excess payment as well as inferior products being received. There should be proper purchase policy in the organization that ensures that correct decisions are taken regarding the purchase to be made as well as the vendor from whom it is purchased.

Following simple steps should be followed while ensuring control over purchases:

- Check the Approved Budget
- Requisition / Demand letter
- Approval from the Senior Management or Purchase committee
- Collect at least three quotation
- Ensure the comparative analysis
- Take the approval from the committee or appropriate authority
- Prepare a contract
- Issue purchase order
- Deliveries reported to the management.

Purchase Committee is responsible for all matters pertaining to purchases (as per guidelines of the finance manual) of the organisation. The Purchase Committee should consist of a group of members from various departments of the organisation such as Finance, Admin, Programme and the target community.

Key Points to Remember:

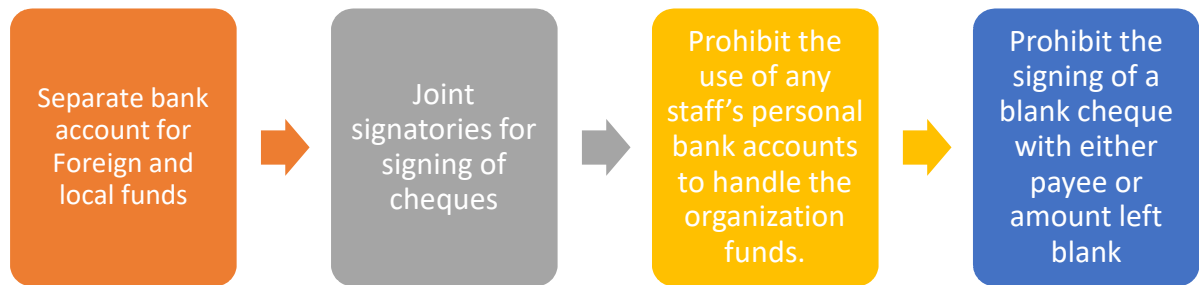
- All purchases from vendors and contractors should be made against an approved budget and payment.
- A minimum of three quotations should be ensured for comparison of rates and quality assurance.
- All payments to vendors should be made ***only against the original invoice*** by A/c payee cheque / DD only.

5.6 BANK TRANSACTIONS

In India it is mandatory to have a separate bank account for foreign contributions notified by the Ministry of Home Affairs. It should be ensured that only foreign contributions are received in this account and no domestic receipts of any nature should be deposited in this account. For local funds, separate account has to be made and such funds should not be mingled with foreign contribution account. Every month the organization must prepare a bank reconciliation statement. It should be verified by the internal and the statutory auditor. The bank account should be operated on joint signatory basis. Postdated cheques should not be issued. The authorized signatories should never sign blank cheques. It is advisable to have two or three authorized signatories for the operation of the bank account. NPO's should maintain cheque issue register and "Account Payee Cheque" should only be issued unless it is office cash withdrawal. Cheque books should be kept under lock and key with some responsible and accountable person. Cheques received should be deposited on the same day or the next day. Any delay should be reported with reasons. The organization should issue cheques only if they have sufficient balance in their accounts as bouncing of the cheques is a serious crime as per Indian

law. A bank balance confirmation certificate should be obtained from each of the banks for the purpose of audit.

Key Points to Remember:



5.7 CASH TRANSACTIONS

Control over cash, both transaction and the physical cash is very important since it involves high risk. Cash remaining unaccounted is cash lost. Hard cash is also more prone to theft. Cash if not properly handled and monitored may pose problem at the time of cash reconciliation and the accountant may get into trouble. Likewise, cash payment should also be properly handled as cash payment done without accounting for the same may cause the actual cash and the balance as per book to mismatch. Cash advance, like advance to staffs also should be properly recorded and tracked.

Some of the ways for Cash control are following;

- Cash should always be kept at a secured place within lock and key. A person should be designated as cash custodian who should be responsible for cash transactions and keeping track of the same
- Where there is high cash transaction done and balance kept in the office premise is large, appropriate cash insurance should be taken. This is true in case of high and frequent cash in transits.
- Cashier/cash custodian and the person recording the transactions should be different.
- There should be system of immediate recording of cash transactions in the cash book as transaction not entered may remain unaccounted for.

- Receipt should be issued immediately for all the cash received. There should be system of triplicate cash receipt. The original receipt should be given to the payee, one carbon copy should be attached with the receipt voucher and another carbon copy should be left in the receipt book. The receipt issued should be pre-numbered. Full receipt book should be used before taking out another receipt book which should also be numbered chronologically. Receipt books should be kept in the custody of higher authority and issued only after ensuring that the last one is used. The authority issuing the receipt books should verify the last used receipt book before issuing the next.
- There should be policy for cash payment where maximum possible cash payment should be specified. Cash payment over and above the limit should always be specifically approved by higher authority.
- There should be a system of regular cash count and surprise cash count by the senior authority.

Key Points to Remember:

- ✓ Wherever possible cash function should be separated from accounts function.
- ✓ The cashier must maintain a hard cash book recording all the cash receipts and payments therein.
- ✓ Cash balance as per the hand cash book needs to be daily reconciled with the physical balance.
- ✓ Periodically, the Head of Finance department shall also certify the physical verification of cash and its reconciliation with the book balance.

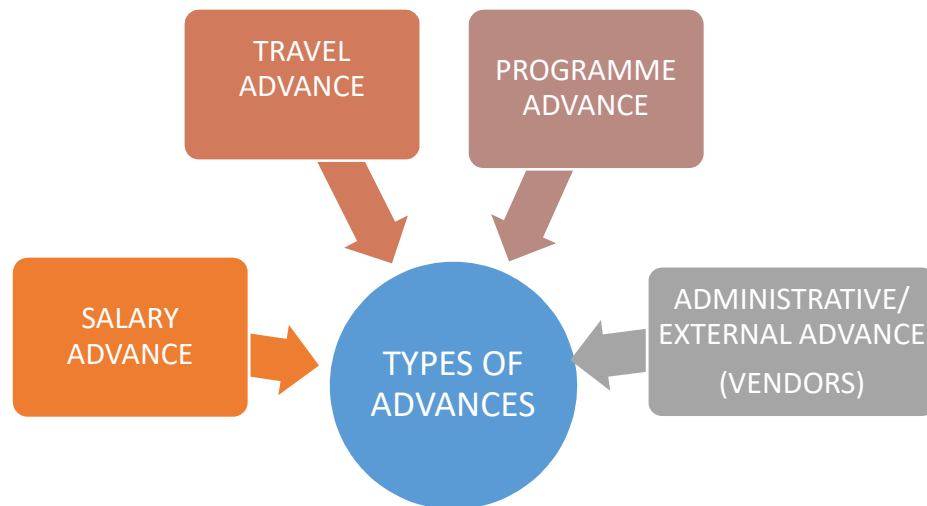
5.8 FIXED ASSET MANAGEMENT

Organisation's resources include assets that are used for carrying out the activities for achieving the objective. Safeguarding assets of the organization is an important area of internal control mechanism. Therefore, the access and use of the assets should be properly monitored. In doing so, following options may be used;



- There should be proper authorization for using valuable assets like vehicle, Computers etc.
- All the assets should be in the name of the organisation and not personal name
- The office premise should be properly secured
- Proper insurance should be taken for all the assets of the organization as well as the office premise.
- There should a policy for use of assets by staff
- Above all, there should be detailed and proper record for all the assets and period physical verification should be done. Condition of all the assets should be noted and assets that are no longer usable should be disposed of after proper authorization.
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5.9 ADVANCE CONTROL



Advances in an organization can be given both internally and externally. Internally the advances can be given in the form of salary advances for personal use, travel advances for official purpose and programme advances for implementation of programmes. Similarly, advances can also be given externally to vendors. Advance given to the staff as well as vendors should be settled within the specified period of time. Advance if left unsettled for long and not tracked may remain unsettled forever. This is because, the staffs who have taken advance may leave the organization,

the vendor may close down etc. In these cases, the advance given and not settled would become loss to the organization.

Following would help to avoid the above situations;

- A clear policy should be made for the advance provision as well settlement.
- Advance should be given only on proper authorization. There should be policy of mandatory settlement of advance within a specified time limit, say 7 days of completion of travel in case of travel advance etc.
- Status of all the advance should be review at the end of specified period, say a month
- No second advance should be provided to the same person without the first being settled
- All the balances including the advances should be properly checked at the time a staff leaves the organization.
- There should be a recourse for recovery of long due advances and action should be taken on time in all such cases.

5.10 SEGREGATION OF DUTIES

- The principle of internal check where one person's work is automatically checked by other due to the process followed is applicable at each level and for all the work whether it is cash management, asset management, bank transactions, accounting or other. Proper segregation of duty in itself is a control mechanism which along with operational control keeps moral check too.
- Segregation of duties also helps in detection of errors caused by omission or otherwise as well as frauds and intentional errors.
- Internal control is must in all organization irrespective of the size and nature of the organization. However, the extent and vastness of the system would depend on the size and nature of the organisation.

