BJMP MUTUAL BENEFIT
ASSOCIATION, INC.
(BJMPMBAI)

INTERNAL CONTROL SYSTEM MANUAL

By: AUDIT COMMITTEE

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CHAPTER III

INTERNAL CONTROL FRAMEWORK

Definition of Internal Control

Internal control is defined as a process effected by an organization's structure, work and authority flows, people and management information systems, designed to help the organization accomplish specific goals or objectives. It is a means by which an organization's resources are directed, monitored, and measured. It plays an important role in preventing and detecting fraud and protecting the organization's resources, both physical (e.g. machinery and property) and intangible (e.g., reputation or intellectual property). At the organizational level, internal control objectives relate to the reliability of financial reporting, timely feedback on the achievement of operational of strategic goals, and compliance with laws and regulations. At the specific transaction level, internal control refers to the actions taken to achieve a specific objective (e.g., how to ensure the organization's payments to third parties are for valid services rendered.) Internal control procedures reduce process variation, leading to more predictable outcomes. Internal controls within business entities are also referred to as operational controls.

In general terms, internal controls are simply good business practices. They include anything which serves to safeguard the Association assets or to improve the effectiveness and efficiency of operations.

Objectives of Internal Control

Internal controls are the methods and procedures designed by management to safeguard assets and to manage resources. It's the system of checks and balances. A system of internal control serves to minimize errors in accounting records in the accounting records and to deter fraud embezzlement and theft by employees, customers and suppliers. The system of internal control provides reasonable assurance of the following:

- Safeguarding assets
- Reliable financial and operational reports
- Efficient and effective operations
- Compliance with applicable laws and / or regulations and university policies and procedures

As department head, you are responsible for setting the "tone at the top" of your department's control environment and ensuring that adequate controls are included in your daily operations. In plain language, a system of internal controls is essentially a system of checks and balances. This system of checks and balances over financial transactions is needed for much the same reasons why such systems are needed for democratic governments: absolute power leads to undesirable results. In government, absolute power can result in despotism; total control by one person over financial transaction can result in theft of fraud.

There are four objectives of BJMPMBAI:
- Protection of Assets
- Effectiveness and Efficiency of Operations
- Reliability of Financial Reporting
- Compliance with Applicable Laws and Regulations

The definition reflects certain fundamental concepts:

- It's a process. It's a means to an end, not an end in itself
- It's accomplished by people. It's not merely policy, procedures and forms.
- It can provide only reasonable but not absolute assurance that assets and resources are safeguarded.

BJMPMBAI Roles

Your Role in Internal Controls:

1. Establish the "tone at the top" and promote an ethical business environment by providing structure, feedback, discipline.
2. Assess risks specific to your operations and develop a control system to address risks that could prevent achieving established goals.
3. Establish and maintain control activities such as reconciliations, approvals, and review of operating activities.
4. Ensure appropriate access to and use of university information and systems.
5. Monitor control system and activities to identify and correct breakdowns timely.

Types of Internal Controls:

- Detective controls – are designated to detect errors of irregularities that may have occurred
- Corrective controls – are designed to correct errors or irregularities that have been detected.
- Preventive controls – are designed to keep errors or irregularities from occurring in the first place.

ROLES AND RESPONSIBILITES IN INTERNAL CONTROL

Everyone in an organization has responsibility for internal control to some extent. Virtually all employees produce information used in the internal control system or take other actions needed to effect control. Also, all personnel should be responsible for communicating upward problems in operation, noncompliance with the code of conduct, or other policy violations or illegal actions. Each major entity in corporate governance has a particular role to play:

Management: The Chief Executive Officer (the top manager) of the organization has overall responsibility for designing and implementing effective internal control. More than any other individual, the chief executive sets the "tone at the top" that affects integrity and ethics and other factors of a positive control environment. The chief executive fulfills this duty by providing leadership and direction to senior managers and reviewing the way they're controlling the business. Senior managers, in turn, assign responsibility for establishment of more specific internal control policies and procedures to personnel responsible for the department functions.

Board of Directors: Management is accountable to the board of directors, which provides governance, guidance and oversight. Effective board members are objective, capable and inquisitive. They also have a knowledge of the entity's activities and environment, and commit the time necessary to fulfill their board responsibilities. Management may be in a position to override controls and ignore or stifle communications from subordinates, enabling a dishonest management which intentionally misrepresents results to cover its tracts. A strong, active board,

particularly when coupled with effective upward communications channels and capable financial, legal and internal audit functions, is often best able to identify and correct such a problem.

Auditors: The internal auditors and external auditors of the organization also measure the effectiveness of internal control through their efforts. They assess whether the controls are properly designed, implemented and working effectively, and make recommendations on how to improve internal control. They may also review Information technology controls, which relate to the IT systems of the organization. There are laws and regulations on internal control related to financial reporting, process are effective, they are tested by the external auditor (the organization's public accountants), who are required to opine on the internal controls of the company and the reliability if it's financial reporting.

PARTIES AFFECTED BY INTERNAL CONTROL

While all of an organization's people are an integral part of internal control, certain parties merit special mention. These include management, the board of directors (including the audit committee), internal auditors, and external auditors.

The primary responsibility for the development and maintenance of internal control rests with an organization's management. With increased significance placed on the control environment, the focus of internal control has changed from policies and procedure to an overriding philosophy and operating style within the organization. Emphasis on these intangible aspects highlights the importance of top management's involvement in the internal control system. If internal control is not a priority for management, then it will not be one for people within the organization either.

As an indication of management's responsibility, it includes the Association's financial report to the members a statement indicating that management has established a system of internal control that management believes is effective. The statement may also provide specific details about the organization's internal control system.

Internal control must be evaluated in order to provide management with some assurance regarding its effectiveness. Internal control evaluation involves everything management does to control the organization in the effort to achieve its objectives. Internal control would be judges as effective if its components are present and function effectively for operations, financial reporting, and compliance. The board of directors and its audit committee have responsibility for making sure the internal control system within the organization is adequate. This responsibility includes determining the extent to which internal controls are evaluated. Two parties involved in the evaluation of internal control are the organization's internal auditors and their external auditors.

Internal auditors' responsibilities typically include ensuring the adequacy of the system of internal control, the reliability of data, and the efficient use of the organization's resources. Internal auditors identify control problems and develop solutions for improving and strengthening internal controls. Internal auditors are concerned with the entire range of an organization's internal controls, including operational, financial, and compliance controls.

Internal control will also be evaluated by the external auditors. External auditors assess the effectiveness of internal control within the organization to plan the financial audit. In contrast to internal auditors, external auditors focus primarily on controls that affect financial reporting. External auditors have a

responsibility to report internal control weaknesses (as well as reportable conditions about internal control) to the audit committee of the board of directors

Why are monthly reconciliations and reviews so important?

Monthly reviews of reconciliations prepared by the staff and the concurrent reviews of the detail transactions posted to the funds in your department are some of the most important internal accounting control procedures that you will perform. Reviews and reconciliations are detective controls. They accomplish two primary objectives. First, these reviews are one of the key processes in the system of checks and balances (internal controls) needed in your department to prevent fraud, theft, or inappropriate use of public funds. Second, these monthly reviews can also enable you to assess the effectiveness and efficiency of the business practices in your department.

The department head must delegate responsibility and authority for some of the clerical and administrative functions of your department to the staff. To build effective working relationships with such employees, you must trust these employees to do the right thing and treat them with respect.