

UNDERSTANDING OF INTERNAL CONTROL FORM

ENTITY NAME: _____

SECTION I—CONTROL ENVIRONMENT

The control environment encompasses the following factors:

- Integrity and ethical values
- Commitment to competence
- Board of directors (governing body) or audit committee participation
- Management’s philosophy and operating style
- The entity’s organizational structure
- Assignment of authority and responsibility
- Human resource policies and practices

| | Yes | No | N/A |
|--|-------|-------|-------|
| 1. Does management adequately convey the message that integrity cannot be compromised? | _____ | _____ | _____ |
| 2. Does a positive control environment exist, whereby there is an attitude of control consciousness throughout the organization, and a positive “tone at the top?” | _____ | _____ | _____ |
| 3. Is the competence of the entity’s people commensurate with their responsibilities? | _____ | _____ | _____ |
| 4. Is management’s operating style, the way it assigns authority and responsibility and organizes and develops its people appropriate? | _____ | _____ | _____ |
| 5. Does management understand the requirements of laws and regulations pertinent to its organization? | _____ | _____ | _____ |
| 6. Does management adequately consider the potential effects of taking unusual business risks? | _____ | _____ | _____ |
| 7. Are financial statements submitted to and reviewed by management, the governing body, or the audit committee at regular intervals? | _____ | _____ | _____ |
| 8. Does management demonstrate concern about and willingness to correct important weaknesses in the system of internal control? | _____ | _____ | _____ |
| 9. Does the entity maintain up-to-date accounting policies and a procedures manual? If yes, obtain copies. | _____ | _____ | _____ |
| 10. Is a chart of accounts maintained and does it describe the nature of each account? If yes, obtain a copy. | _____ | _____ | _____ |
| 11. Does management periodically review insurance coverage or delegate that task to someone? | _____ | _____ | _____ |
| 12. Does management have a history of establishing reliable accounting entries? | _____ | _____ | _____ |
| 13. Is there a low turnover of management positions, especially financial management? | _____ | _____ | _____ |
| 14. Are key operating positions adequately staffed, therefore avoiding constant crisis? | _____ | _____ | _____ |
| 15. Is there adequate coordination between accounting and EDP departments, resulting in timely reports and closings? | _____ | _____ | _____ |

| | Yes | No | N/A |
|--|-------|-------|-------|
| 16. Is there an organization chart that reflects the areas of responsibility and the line of reporting? If yes, obtain a copy. | _____ | _____ | _____ |
| 17. Are there formal job descriptions that clearly set out duties and responsibilities? | _____ | _____ | _____ |
| 18. Are backgrounds and references of applicants for financial and key personnel checked? | _____ | _____ | _____ |
| 19. Are personnel policies and employee benefit plans documented and adequately communicated? | _____ | _____ | _____ |
| 20. Is a formal conflict of interest policy or code of conduct in effect? If yes, obtain a copy. | _____ | _____ | _____ |
| 21. Are employees who handle cash, securities, and other valuable assets bonded? | _____ | _____ | _____ |
| 22. Do related employees, if any, have job assignments that minimize opportunities for collusion? | _____ | _____ | _____ |
| 23. Are employees adequately trained to meet their assigned responsibilities? | _____ | _____ | _____ |
| 24. Is rotation of duties enforced by mandatory vacations? | _____ | _____ | _____ |
| 25. Is job performance periodically evaluated and reviewed with employees? | _____ | _____ | _____ |
| 26. Has management established adequate policies and procedures for the development, modification, and use of computer programs and data files? | _____ | _____ | _____ |
| 27. Does the entity's governing body (board) or audit committee perform the following duties? | _____ | _____ | _____ |
| a. Does the board or committee take an active role in overseeing the entity's policies and practices? | _____ | _____ | _____ |
| b. Does the board or committee approve the appointment of the outside auditors? | _____ | _____ | _____ |
| c. Does the board or committee have sufficient knowledge, experience, and time to serve effectively? | _____ | _____ | _____ |
| d. Does the board or committee constructively challenge management's planned decisions and take appropriate action if necessary (for example, conducting special investigations)? | _____ | _____ | _____ |
| e. Does the board or committee meet in a timely manner with the chief accounting officer and internal and external auditors to discuss the reasonableness of the financial reporting process, the system of internal control, and other significant matters? | _____ | _____ | _____ |
| f. Does the board or committee review the scope of activities of the external and internal auditors at least annually? | _____ | _____ | _____ |
| g. Does the board or committee regularly receive and review key information, such as financial statements, significant contracts, and negotiations? | _____ | _____ | _____ |
| h. Does a process exist for informing the board or committee in a timely manner of sensitive information, investigation, and improper acts (e.g., significant litigation, investigations by regulatory agencies, embezzlement, misuses of assets)? | _____ | _____ | _____ |
| i. Is there appropriate oversight in determining the compensation and benefits of executive officers? | _____ | _____ | _____ |

| | Yes | No | N/A |
|---|-------|-------|-------|
| j. Is the board or committee sufficiently involved in establishing and evaluating the effectiveness of the “tone at the top” (e.g., approving the entity’s code of conduct or policy and procedure manual)? | _____ | _____ | _____ |

ADDITIONAL COMMENTS—CONTROL ENVIRONMENT

SECTION II—RISK ASSESSMENT

The risk assessment process is your “identification, analysis and management of risks relevant to the preparation of financial statements. Risks can arise or change due to circumstances such as the following: changes in operating environment; new personnel; new or revamped information systems; rapid growth; new technology; new lines, products, or activities; corporate restructurings; foreign operations; and accounting pronouncements.

| | Yes | No | N/A |
|---|-------|-------|-------|
| 1. Has management established clear entity-wide objectives and are they consistent with its operating plans and budgets? | _____ | _____ | _____ |
| 2. Has management established objectives for key activities and are they consistent with and linked to the entity-wide objectives and strategies? | _____ | _____ | _____ |
| 3. Has management identified the resources and critical factors that are important to achieving its objectives (e.g., financing, personnel, facilities, technology, etc.)? | _____ | _____ | _____ |
| 4. Does management consider risks arising from external sources (e.g., supply sources, credit demands, regulation, natural events)? | _____ | _____ | _____ |
| 5. Does management consider risks arising from internal sources (e.g., retention of key personnel or changes in their responsibilities, compensation and benefit programs to keep the entity competitive, the adequacy of back-up systems in the event of failure of systems that could significantly affect operations)? | _____ | _____ | _____ |
| 6. Does management identify and monitor significant shifts in the entity’s industry (e.g., changes in demographics, preferences, or spending patterns)? | _____ | _____ | _____ |
| 7. Does management consult with its legal counsel regarding the implications of any new legislation? | _____ | _____ | _____ |
| 8. Are new employees in key positions adequately supervised to ensure that they understand and perform in accordance with the entity’s policies and procedures? | _____ | _____ | _____ |
| 9. Are procedures in place to assess the effects of new or redesigned information systems and to monitor new technologies? | _____ | _____ | _____ |

| | Yes | No | N/A |
|--|-------|-------|-------|
| 10. Are procedures in place to handle rapidly increasing volumes of information? | _____ | _____ | _____ |
| 11. When considering development of new services, does management give appropriate consideration to major factors such as demand, delivery capabilities, and pricing implications? | _____ | _____ | _____ |
| 12. In connection with restructurings, are staff reassignments and reductions appropriately analyzed for their potential effect on operations or on the morale of the remaining employees? | _____ | _____ | _____ |
| 13. Is management aware of the existence of new accounting or reporting pronouncements and how they may affect the entity's financial reporting practices? | _____ | _____ | _____ |

ADDITIONAL COMMENTS—RISK ASSESSMENT

SECTION III—CONTROL ACTIVITIES

Control activities are the policies and procedures that help ensure that management's directives are effective in processing and preparing financial statements. To successfully address risks and achieve its objectives, management must institute various control activities, such as segregation of duties, physical controls, and a system of approvals.

| | Yes | No | N/A |
|--|-------|-------|-------|
| 1. Does management have clear objectives in terms of budget, and other financial and operating goals? If yes, are such objectives: | _____ | _____ | _____ |
| a. Clearly written? | _____ | _____ | _____ |
| b. Actively communicated throughout the entity? | _____ | _____ | _____ |
| c. Actively monitored? | _____ | _____ | _____ |
| 2. Do the planning and reporting systems in place: | | | |
| a. Adequately identify variances from planned performance? | _____ | _____ | _____ |
| b. Adequately communicate variances to the appropriate level of management? | _____ | _____ | _____ |
| 3. Does the appropriate level of management: | | | |
| a. Adequately investigate variances? | _____ | _____ | _____ |
| b. Take appropriate and timely corrective action? | _____ | _____ | _____ |
| 4. Has management established procedures to prevent unauthorized access to, or destruction of, documents, records, and assets? | _____ | _____ | _____ |

| | Yes | No | N/A |
|--|-------|-------|-------|
| 5. Has management established policies for controlling access to programs and data files? | _____ | _____ | _____ |
| 6. Does management adequately monitor such policies? | _____ | _____ | _____ |
| 7. Are amounts recorded by the accounting system periodically compared with physical assets? | _____ | _____ | _____ |
| 8. Are control and subsidiary accounts reconciled regularly and discrepancies reported to appropriate personnel? | _____ | _____ | _____ |
| 9. Are signatures required to evidence the performance of critical control functions, such as reconciling accounts? | _____ | _____ | _____ |
| 10. Are general journal entries, other than standard entries, required to be approved by a responsible official not involved with their origination? | _____ | _____ | _____ |
| 11. Are accounting estimates and judgments made only by knowledgeable and responsible personnel? | _____ | _____ | _____ |
| 12. Does the accounting system provide in a timely manner the necessary information for the preparation of financial statements and related disclosures in accordance with generally accepted accounting principles or an other comprehensive basis of accounting? | _____ | _____ | _____ |
| 13. Are financial statements and related disclosures prepared and reviewed by competent personnel who are knowledgeable of the factors affecting the company's financial reporting requirements? | _____ | _____ | _____ |

ADDITIONAL COMMENTS—CONTROL ACTIVITIES

SECTION IV—INFORMATION AND COMMUNICATION

Information is identified, captured, processed, and reported by information systems. Relevant information includes industry, economic, and regulatory information obtained from external sources, as well as internally generated information.

Communication is inherent in information processing. Communication involves providing a clear understanding of individual roles and responsibilities in an effective manner. This may be accomplished through policy manuals, accounting manuals, or other means, and can be made orally.

| | Yes | No | N/A |
|---|-------|-------|-------|
| Information | | | |
| 1. Does the organization have mechanisms in place to obtain relevant external information (e.g., on legislative or regulatory developments and economic changes) and internally generated information critical to the achievement of the organization's objectives? | _____ | _____ | _____ |

| | Yes | No | N/A |
|---|-------|-------|-------|
| 2. Is the information provided to the right people in sufficient detail and on time to enable them to carry out their responsibilities efficiently and effectively? | _____ | _____ | _____ |
| 3. Is the development or revision of information systems over financial reporting based on a strategic plan and interrelated with the entity's overall information systems and is it responsive to achieving the entity-wide and activity-level objectives? | _____ | _____ | _____ |
| 4. Does management commit the appropriate human and financial resources to develop the necessary financial reporting information systems? | _____ | _____ | _____ |

Communication

| | | | |
|---|-------|-------|-------|
| 5. Does management communicate employees' duties and control responsibilities in an effective manner? | _____ | _____ | _____ |
| 6. Are communication channels established for people to report suspected improprieties? | _____ | _____ | _____ |
| 7. Does communication flow across the organization adequately to enable people to discharge their responsibilities effectively? | _____ | _____ | _____ |
| 8. Does management take timely and appropriate follow-up action on communications received from taxpayers, customers, vendors, regulators, or other external parties? | _____ | _____ | _____ |
| 9. Do other parties outside the organization review and follow up on the organization's actions (e.g., state auditor or regulatory body)? | _____ | _____ | _____ |

ADDITIONAL COMMENTS—INFORMATION AND COMMUNICATION

SECTION V—MONITORING

Monitoring is a process that assesses the quality of internal control performance over time. It involves (1) timely evaluation by appropriate personnel of the design and operation of controls, (2) identifying areas of improvement and corrective actions, and (3) follow-up procedures to determine that necessary actions are implemented. Monitoring can be accomplished in manners such as the following: ongoing internal activities, internal audit function, and external monitoring activities.

| | Yes | No | N/A |
|---|-------|-------|-------|
| 1. Is operating information used to manage operations integrated or reconciled with data generated by the financial reporting system? | _____ | _____ | _____ |
| 2. Are customer complaints about billings investigated and any internal control deficiencies corrected? | _____ | _____ | _____ |

| | Yes | No | N/A |
|--|-------|-------|-------|
| 3. Are communications from vendors and monthly statements of accounts payable used as a control monitoring technique? | _____ | _____ | _____ |
| 4. Are internal control recommendations made by external auditors (and internal auditors, if applicable) implemented? | _____ | _____ | _____ |
| 5. Does management receive feedback from training seminars, planning sessions, and other meetings on whether controls operate effectively? | _____ | _____ | _____ |
| 6. Does the organization take a fresh look at the internal control system from time to time and evaluate its effectiveness? If yes: | _____ | _____ | _____ |
| a. Does the evaluation process include checklists, questionnaires, or other tools? | _____ | _____ | _____ |
| b. Are the evaluations documented? | _____ | _____ | _____ |
| 7. Does the entity have an adequate internal audit function? If yes, do the internal auditors: | | | |
| a. Possess adequate training and experience? | _____ | _____ | _____ |
| b. Adhere to applicable professional standards? | _____ | _____ | _____ |
| c. Have an adequate documentation of the organization's internal control? | _____ | _____ | _____ |
| d. Perform tests of controls and substantive tests? | _____ | _____ | _____ |
| e. Have adequate documentation of their work? | _____ | _____ | _____ |
| f. Submit reports on their findings to the governing body or audit committee in a timely manner? | _____ | _____ | _____ |
| g. Follow up on corrective actions taken by management? | _____ | _____ | _____ |
| h. Have direct access to the governing body or audit committee? | _____ | _____ | _____ |
| i. Have direct access to records and the scope of their activities is not limited? | _____ | _____ | _____ |

ADDITIONAL COMMENTS—MONITORING
