



CIRCULAR

STATE OF NEW JERSEY

DEPARTMENT OF THE TREASURY

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EFFECTIVE DATE: 10-01-18	EXPIRATION DATE: INDEFINITE	SUPERSEDES: 03-08-OMB
SUBJECT: ANNUAL INTERNAL CONTROL REPORTING		
ATTENTION: DIRECTORS OF ADMINISTRATION AND FISCAL OFFICERS		
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I. AUTHORITY

The Director of the Office of Management and Budget ("OMB") has statutory authority set forth at N.J.S.A. 52:19-11 to "...examine, audit, adjust and settle all accounts due to or presented against the State, and certify the amount adjusted or allowed, to the Treasurer for receipt or payment."

To facilitate effective government operations, OMB delegates its authority to pre-audit expenditures to State agencies. This authority places heightened responsibility on State agencies to maintain effective internal controls that include a robust compliance program.

II. OBJECTIVES

This circular requires State agencies to perform an annual self-assessment of internal controls. To satisfy this requirement, the Chief Executive Officer and/or Board Chairman, where applicable, must evaluate the agency's system of internal control and compliance program to identify possible deficiencies within their areas of responsibility.

The Chief Executive Officer and/or Board Chairman and Chief Financial Officer shall annually transmit an Internal Control Assessment Report to the OMB Director on or before July 1.

III. DEFINITION OF INTERNAL CONTROL

Internal control is a process, effected by the entity's management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

IV. COMMITMENT TO COMPLIANCE

A successful internal control environment requires management's commitment and support. Management's goal is not to make each person an expert concerning internal controls, but to increase awareness and understanding of why we need them and how we use them.

Executive management must continually demonstrate, in appearance and fact, their commitment to internal controls and compliance and strongly encourage adherence to the program for the betterment of the State of New Jersey.

Although management is primarily responsible for implementing internal controls, every employee participates in establishing, properly documenting, and maintaining internal controls.

Neither management nor employees should allow anything to compromise their integrity. Every employee has the responsibility to resist pressure to participate in improper activities. The internal control system needs to include channels outside normal reporting lines, permitting each staff member to report concerns without fear of reprisal. The Conscientious Employee Protection Act ("CEPA") N.J.S.A. 34:19-1 et seq., which is also known as New Jersey's whistleblower law, encourages employees to report illegal or fraudulent workplace activities, policies or practices. CEPA prohibits an employer from taking retaliatory action against an employee for reporting violations. In accordance with CEPA, employees may report illegal or fraudulent workplace activities, policies or practices to their supervisor or their Division's coordinator.

V. TYPES OF CONTROLS

Controls can be either preventative or detective. Preventative controls attempt to deter or prevent undesirable events from occurring. Separation of duties, proper authorization, adequate documentation, passwords, and physical control over assets are all examples of preventative controls.

Detective controls attempt to detect errors or irregularities which have already occurred. Reviews, analyses, reconciliations, periodic physical inventories, audits, and surveillance cameras are all examples of detective controls.

Both types of controls are essential to an effective internal control system. From a quality standpoint, preventative controls are essential because they are proactive. However, detective controls play a critical role providing evidence that preventative controls are functioning effectively.

VI. ASSESSMENT OF INTERNAL CONTROLS

The Department of the Treasury, Office of Program Accountability and Audit, developed an Internal Control Assessment questionnaire agencies must utilize to conduct a self-assessment of their system of internal control and compliance program. The Office of Program Accountability and Audit will periodically visit State agencies to review the documentation supporting the assessment of internal controls and to conduct performance reviews and audits, when determined appropriate and necessary.

The methodology for the self-assessment utilizes the *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO Framework"). The COSO Framework includes the five integrated components of internal control considered when assessing the effectiveness of a system of internal control, which includes:

1. **Control Environment** - The control environment sets the foundation for all other components of internal control, and is a product of management's governance. Senior management establishes a tone at the top by expressing their support in implementing and maintaining effective internal controls. This tone should successfully integrate ethical values and integrity, sound reporting structures, appropriate

levels of authority and responsibility, and the independence of senior management. Internal controls are most effective in a positive control environment. Management helps foster a positive control environment by practicing the most effective philosophy, style and supportive attitude, and maintaining high levels of morale.

2. **Risk Assessment** - The risk assessment process is conducted to identify and analyze the risks to achieving objectives, and helps form a basis for how risks should be managed. Objectives must be clearly defined for a risk assessment to be most effective. When assessing risks, management should consider changes in the external business environment, internal business model, and the potential for fraudulent activities.

3. **Control Activities** - Management should establish appropriate control activities, as well as employee expectations in performing these activities, in all policies and relevant procedures to help ensure management's directives to mitigate risks are achieved. Control activities are performed at all levels, at various stages of business processes, and over technology. Among other activities, these include segregation of duties, timely reconciliations, and supervisory review.

4. **Information and Communication** - Communication of relevant, reliable, and quality information is essential in carrying out internal control responsibilities. Objectives and responsibilities for internal control are communicated internally, allowing employees to understand the importance of, as well as their role in, maintaining effective internal controls. Use of effective communication provides the information necessary to carry out the day-to-day internal control activities.

5. **Monitoring Activities** - Management should establish a monitoring system to evaluate the internal controls in place to ensure they are adequate and functioning correctly. Monitoring internal controls should be ongoing, with identified weaknesses or deficiencies communicated in a timely manner. Deficiencies that are more serious in nature must be reported to senior management and the board. Corrective actions must also be regularly monitored to ensure they are implemented timely and effectively.

VII. LIMITATIONS

Any system of internal control has inherent limitations. Among other things, staff size limitations may obstruct efforts to segregate duties, which requires the implementation of compensating controls to ensure the achievement of objectives. The element of human error (misunderstandings, fatigue, and stress) is also a limiting factor. Accordingly, a system of internal control can only provide reasonable assurance concerning the likelihood of a positive outcome.


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