Evaluation of Internal Controls
IFTA/IRP Audit Workshop
January 4, 2004

Summary of Sample Evaluation Procedures

Initial Contact

Mail internal control questions as part of pre-audit questionnaire

Hold pre-audit conference with registrant
   Has accounting system changed during audit period?
   Has accounting system been audited before?
   How much of system is paper vs. how much is automated.
   Identify what documents are used
   Identify what edit checks are done on the documentation.
   Identify all personnel involved in all processes
   Identify if recaps are kept on a daily, weekly, or monthly basis.
   Identify if fuel information is handled by the same person as is the distance information.
   Identify retention periods for all applicable records

Sample the system(s)
   Take one or two trip reports and track it through all applicable processes.
   Determine if information on those documents were included in summaries, and eventually, the totals used for reporting.
   For IFTA audits, do the same with several fuel receipts.
   Ask where any reviews or approvals are done with the information either before or after the information is entered into the system. Check for things such as initials of those who review the documents.
   Consider all controls in place, and whether other controls might help keep better control of the information flow.
   Record all processes used and weaknesses or strengths found.

Report on Weaknesses
   Auditor determination of strengths and weaknesses
   Scope and results of tests should be documented
   Any serious weaknesses should be discussed with the registrant
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Purpose of Internal Control Evaluation
To study the accounting system used by the registrant for an understanding of the flow of information from the original documents to the reports.

An effective study of the internal controls of a carrier will contain several phases (IFTA Audit Manual A640):
- Review and Documentation
- Preliminary Evaluation
- Tests of Compliance
- Report on Weaknesses

The same guidelines apply to IRP and IFTA audits in evaluating internal controls.

Suggested steps in an effective evaluation of internal controls:

**Written and verbal communications.**

Most jurisdictions use a specific internal controls questionnaire, or a more detailed questionnaire that includes questions about internal controls. This questionnaire may be mailed in advance to the carrier, or may be used during an opening interview.

An effective questionnaire will include at a minimum, questions about:
- Types of records maintained
- How records are compiled and stored (are they kept by trip, by month, by driver, etc?)
- Normal flow of information, including names of individuals involved in the process, and if applicable, the different departments of the business involved in the reporting process.
- Changes made to the accounting system during the audit period

The auditor may identify weaknesses in the accounting system just through the initial interview and questionnaire. Audit procedures should be based on the outcome of the internal control evaluation tests at all levels. Obviously, if the internal controls are found to be weak, or non-existent, the auditor will not be able to rely on summary reports as well as they would at locations where good internal controls are in place. At any point in the process of evaluating internal controls, if the auditor identifies any area of weakness, those issues should be discussed with the registrant at that time. It is possible that the method for compiling the information may have been mis-communicated, and the auditor may be able to use different methods of testing the system to make a determination of adequacy.
Testing controls for compliance

Based on the questionnaire and preliminary interviews, the auditor may choose to test the system by taking several trips or fuelings and tracing them through the accounting system. The decision on whether the tests shall be made, and how many transactions will be necessary will probably be determined by the auditor once they have looked at the results of their initial tests.

While testing the system, the auditor should ask questions about what kind of review or edit is done on the compiled information during the various stages in the record keeping process. Such questions may include:

- Are weekly, monthly, or quarterly totals edited regularly?
- Are the source documents reviewed before the information they contain is entered into the accounting system?
- How is continuity assured? Are documents sequentially numbered? Are documents reviewed for continuity of dates, or travel points?

If the auditor has determined that the preliminary tests identify weaknesses in the controls that will preclude reliance on the accounting system, further tests of the accounting system will probably not be beneficial. The audit procedures should be based on other methods of testing. If the auditor has determined that the registrant's record keeping system is sufficient to enable good records to be maintained, the auditor must next determine if the individual records are sufficient for audit.

Report on Weaknesses

Information gathered during the evaluation of internal controls needs to be summarized and included as part of the audit file. Both strengths and weaknesses should be recorded and that information should be shared promptly with the registrant.

Audit Process

The balance of the audit will rely on the findings in the evaluation of internal controls. The auditor needs to determine how to apply those findings to the choice of sample size, or stratification of records during the balance of the audit.
After Erin Brockawitch failed to return the Internal Control Questionnaire before the start of the audit, you asked the appropriate questions at the opening interview. It seems as though a year and a half ago, there was a change made in the retention of trip sheets. Anchor Transport invested in document management software that allowed the trip sheet to be imaged and indexed in several ways so they could always be retrieved electronically. The original trip sheets that are being used are the same ones the drivers have been using for 10 years. Preliminary tests show that the data is still put into the system the way it was before the imaging.

- As the original documents are destroyed after the imaging process, would this be considered a major change in the accounting system?
- Would you make any changes to your internal control evaluation for data before and after the installation of the imaging system?
- What provisions in the Plan or the Agreement would suggest that the original documents not be destroyed?

During the preliminary study of the internal controls, you are told that much of the fuel is billed monthly through a third party credit account. It is the job of the clerical staff to review the bills and post the receipts to the IFTA account only after the bill is reviewed. After verification, the clerk checks the total against the fuel information captured on a trip-by-trip basis. After the totals are validated, the clerk initials the computer run. However, during the normal course of going through the boxes of fuel receipts you find that two separate statements from the past year are still sealed in their original envelopes from the credit card company. When you question that, Miss Brockawitch states “we can get the totals on-line also, so that must have been what happened in those months”.

- If this was the only question you had during the evaluation, would you discount its importance?
- What if you proceeded to have the clerk open one of the envelopes and found that in fact the totals on the statement were for 500 less gallons than on the computer printout of turned in fuel receipts?
- Does, and should the discovery of a problem like this in one area (fuel accounting) affect your evaluation or confidence in the other areas of record keeping, such as distance accounting?

If you are working with a rather large account and they have data summarized in different manners such as unit totals by week, driver totals by week, trip route summary report by month, etc.

- You see that the different reports all have the same totals for the same time frames (total distance on monthly driver reports and monthly unit reports). Is there any reason to follow the flow of information through the various reports, or since the totals are equal, can you just track through one set of totals?

You are auditing a two-truck operation in which the driver throws all trip sheets into one box and fuel receipts in another. During your initial internal control evaluation (later validated by your sampling of the records) you find that all information is being reported accurately.

- What argument do you make to the registrant to set up a structured system for compiling information?
- Discuss some advantages and disadvantages to setting up a formal system in a small operation.
An IRP account has 3 fleets in different locations in your jurisdiction. When you look at how the information is forwarded to the main office, you are told that while location 1 and 2, can forward documentation for each month, location 3 is habitually late.

- Even though your preliminary tests show that the information is accurate for all 3 locations, would the tardiness cause you to do a more substantive test on location 3, or would you sample each fleet in its proportion to the fleet?

(Presenter reads aloud – Suggests that the audience get a pencil and paper handy. Maybe say that the first table that gets it right can leave.)

You are driving a bus. At the first stop you take on seven people. You go three blocks south, make a right where you drop off two people and pick up three more. The bus travels 6 blocks and then drops off two passengers. At the next light make a right. Go through three traffic signals. At the next signal the bus turns left and lets out 4 passengers. (Got all that? Now, what was the driver’s name? - See if anyone raises their hand. Since you said “you are driving”, the person should give you their name)