



Internal Control

Presented by: Maxene M. Bardwell, CPA, CIA, CFE, CISA, CIGA, CITP,
CRMA

Course Objectives

1

Understand the relationship between the COSO framework and the GAO Green Book (Standards for Internal Control in the Federal Government).

2

Identify the five components and seventeen principles of internal control and know the relationship between them

3

Recognize how to use internal controls in audit work.

Passing the Exam...

Pay close attention and take extra notes wherever this symbol appears!



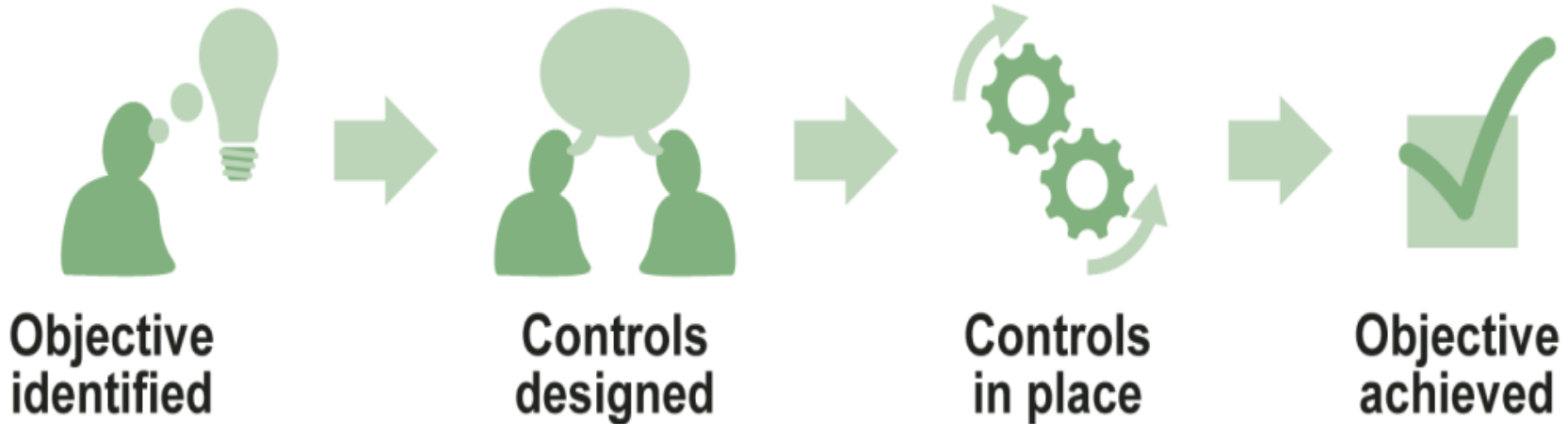
Control



Circa 1990

“Control, to get what I want”

Internal Controls



Source: GAO. | GAO-14-704G

- In short, a process used by management to help achieve agency/program objectives.
- Provides reasonable assurance that the objectives of an entity will be achieved



A Brief History of Internal Control



COMMITTEE OF SPONSORING
ORGANIZATIONS OF THE TREADWAY COMMISSION

1970s corrupt practices

1977 Foreign Corrupt Practices
Act

1985 Treadway Commission

1992 *Internal Control—
Integrated Framework*



American
Accounting
Association

Thought Leaders in
Accounting



AICPA

American Institute of
Certified Public Accountants



financial executives
international

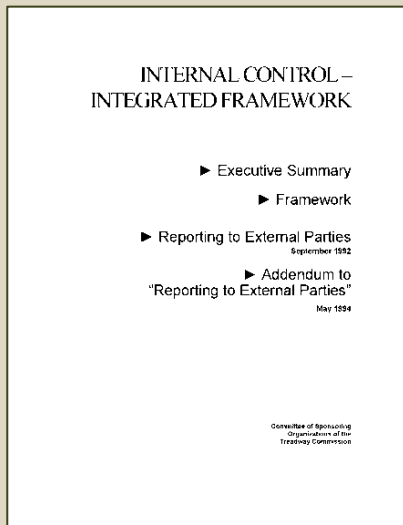


The Association of Accountants
and Financial Professionals
in Business



The Institute of
Internal Auditors

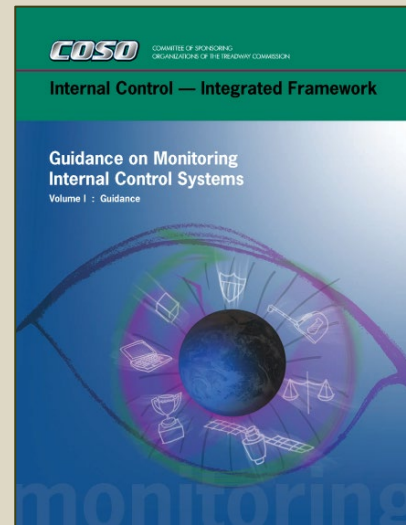
COSO Overview



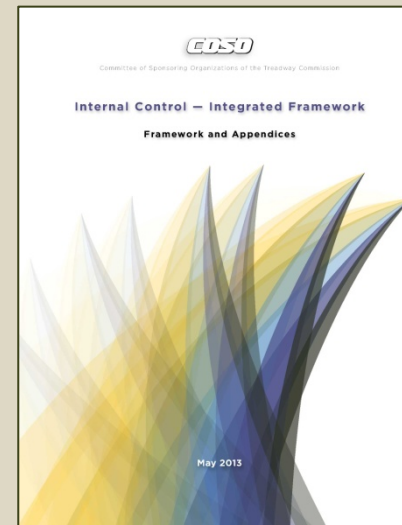
1992



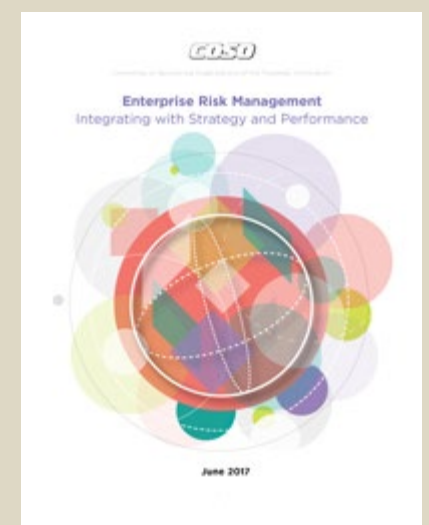
2006



2009




2013

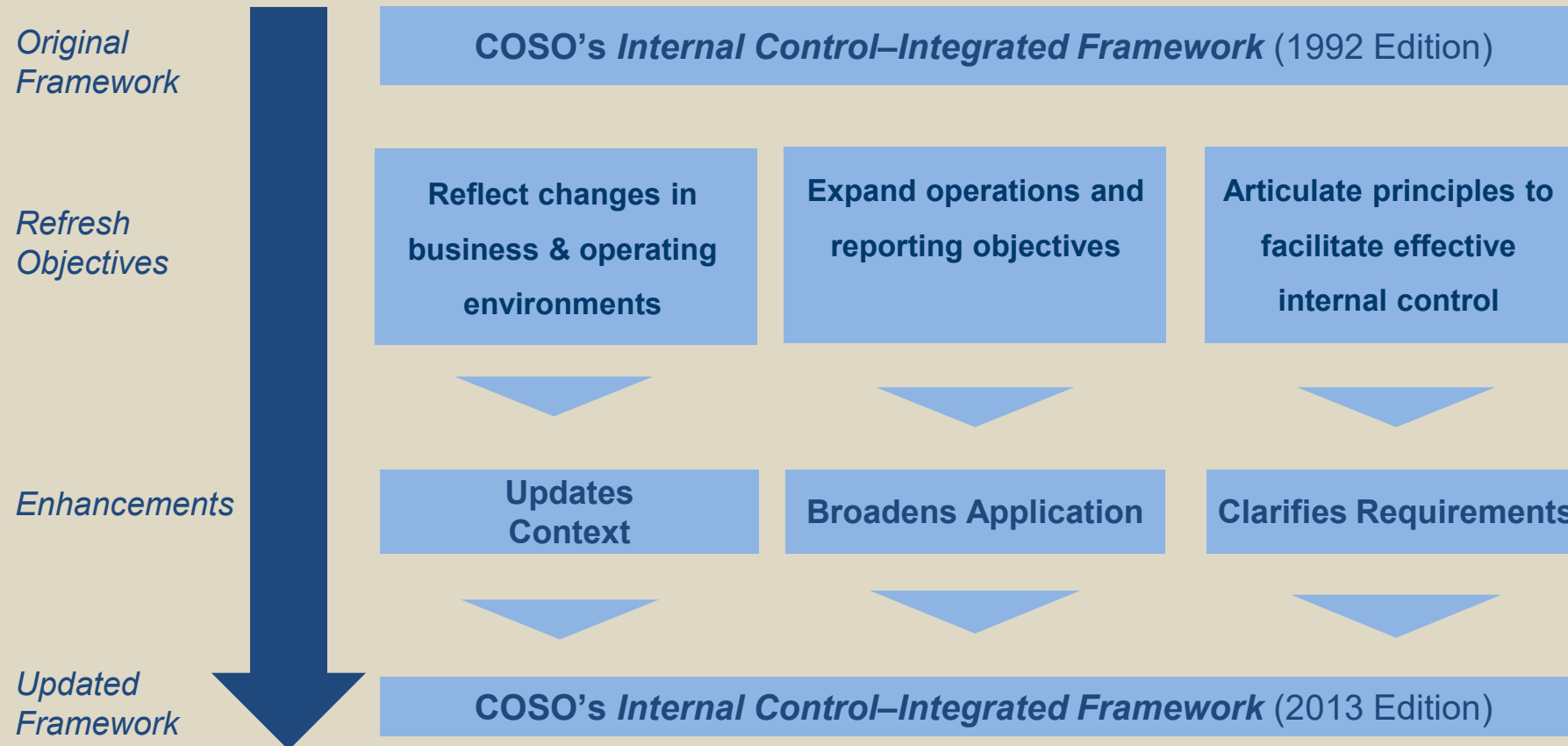


2017

COSO Overview (Cont'd.)

<i>Environments changes...</i>	<i>...have driven Framework updates</i>
Expectations for governance oversight	
Globalization of markets and operations	
Changes and greater complexity in business	
Demands and complexities in laws, rules, regulations, and standards	
Expectations for competencies and accountabilities	
Use of, and reliance on, evolving technologies	
Expectations relating to preventing and detecting fraud	

COSO Overview (Cont'd.)



COSO Internal Control Components



Control Environment

1. Demonstrates commitment to integrity and ethical values
2. Exercises oversight responsibility
3. Establishes structure, authority and responsibility
4. Demonstrates commitment to competence
5. Enforces accountability

Risk Assessment

6. Specifies suitable objectives
7. Identifies and analyzes risk
8. Assesses fraud risk
9. Identifies and analyzes significant change

Control Activities

10. Selects and develops control activities
11. Selects and develops general controls over technology
12. Deploys through policies and procedures

Information & Communication

13. Uses relevant information
14. Communicates internally
15. Communicates externally

Monitoring Activities

16. Conducts ongoing and/or separate evaluations
17. Evaluates and communicates deficiencies

COSO – Control Environment Example

Control Environment

1. The organization demonstrates a commitment to integrity and ethical values.

Points of Focus:

- Sets the Tone at the Top
- Establishes Standards of Conduct
- Evaluates Adherence to Standards of Conduct
- Addresses Deviations in a Timely Manner

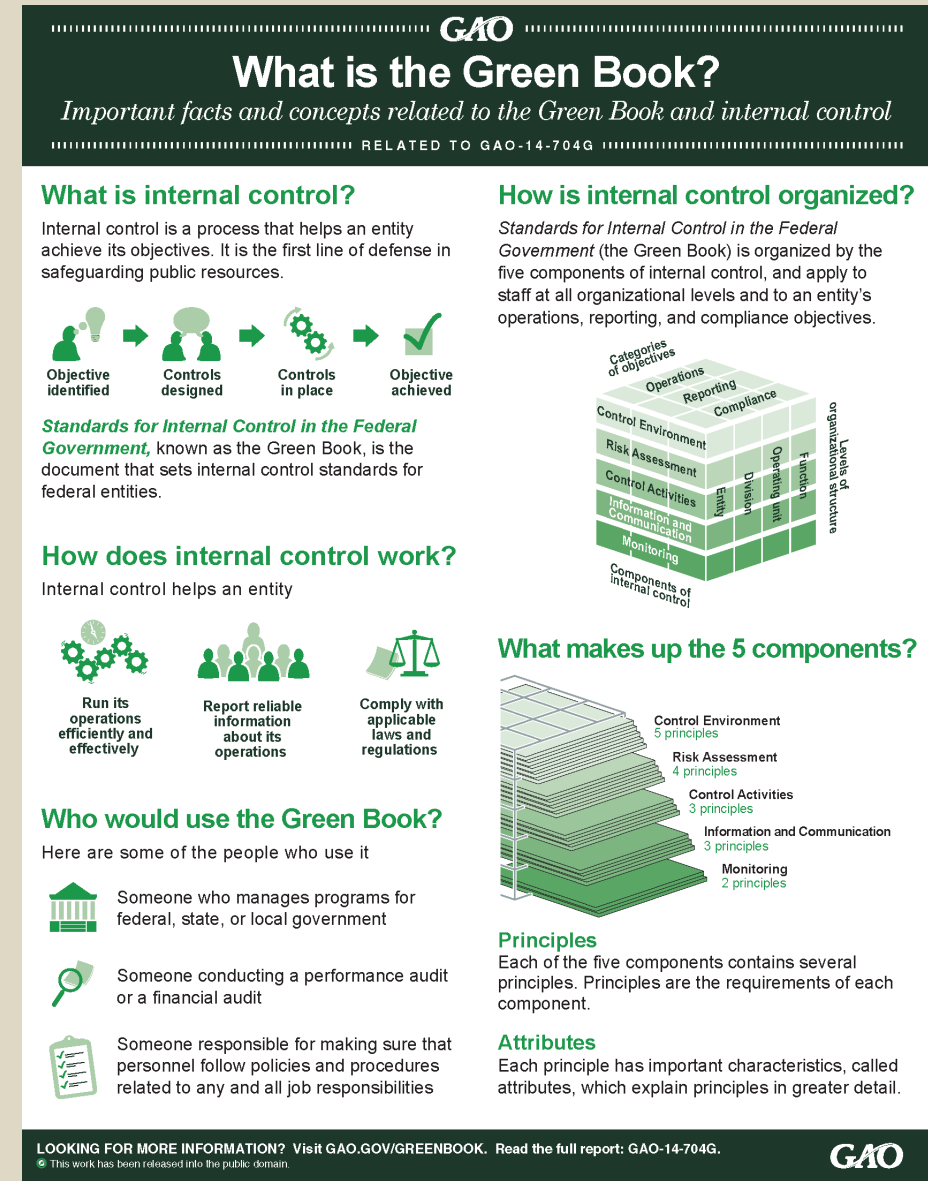
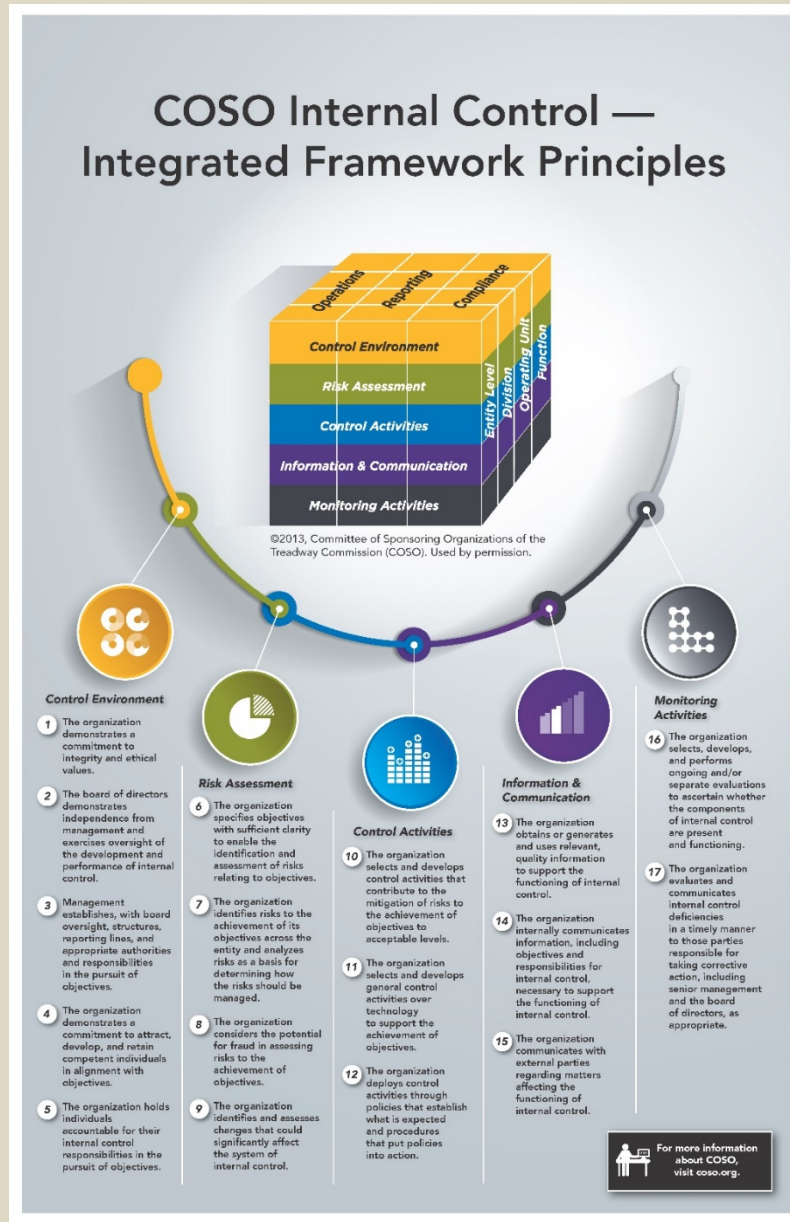


- Points of focus may not be suitable or relevant, and others may be identified
- Points of focus may facilitate designing, implementing, and conducting internal control
- There is no requirement to separately assess whether points of focus are in place

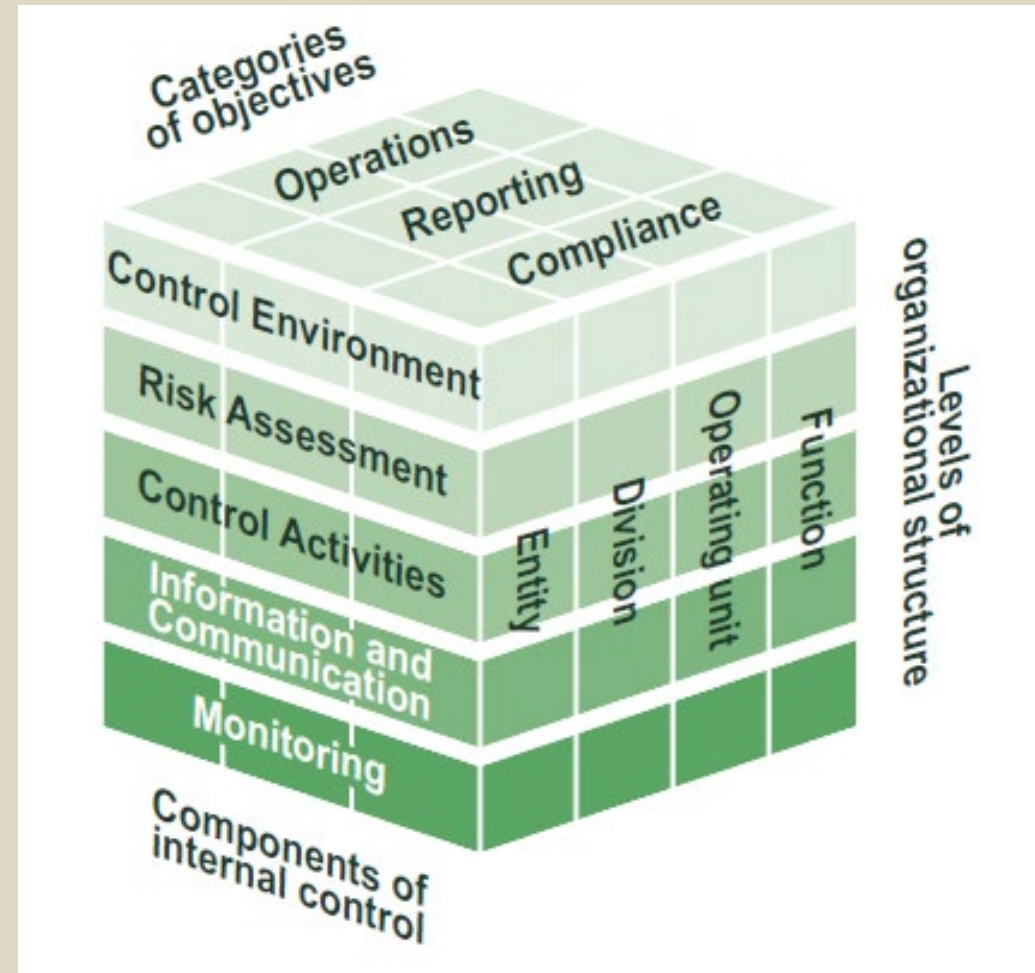
COSO – Control Environment (Cont'd.)

Component	Control Environment		
Principle	1. The organization demonstrates a commitment to integrity and ethical values.		
Controls embedded in other components may effect this principle	Human Resources review employees' confirmations to assess whether standards of conduct are understood and adhered to by staff across the entity <i>Control Environment</i>	Management obtains and reviews data and information underlying potential deviations captured in whistleblower hot-line to assess quality of information <i>Information & Communication</i>	Internal Audit separately evaluates Control Environment, considering employee behaviors and whistleblower hotline results and reports thereon <i>Monitoring Activities</i>

COSO & GAO Green Book Comparison



Cube to Cube Comparison



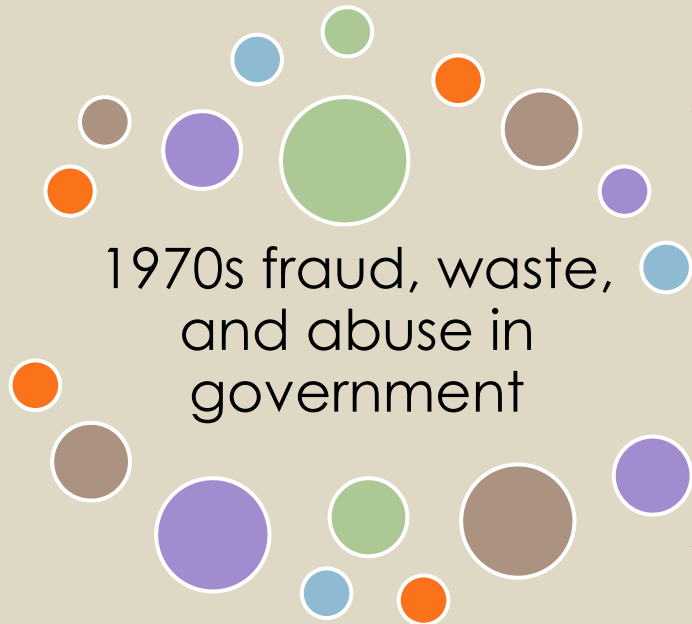


United States Government Accountability Office

By the Comptroller General of the
United States

September 2014

Standards for Internal Control in the Federal Government



1970s fraud, waste,
and abuse in
government



1982 Federal
Managers' Financial
Integrity Act (FMFIA)



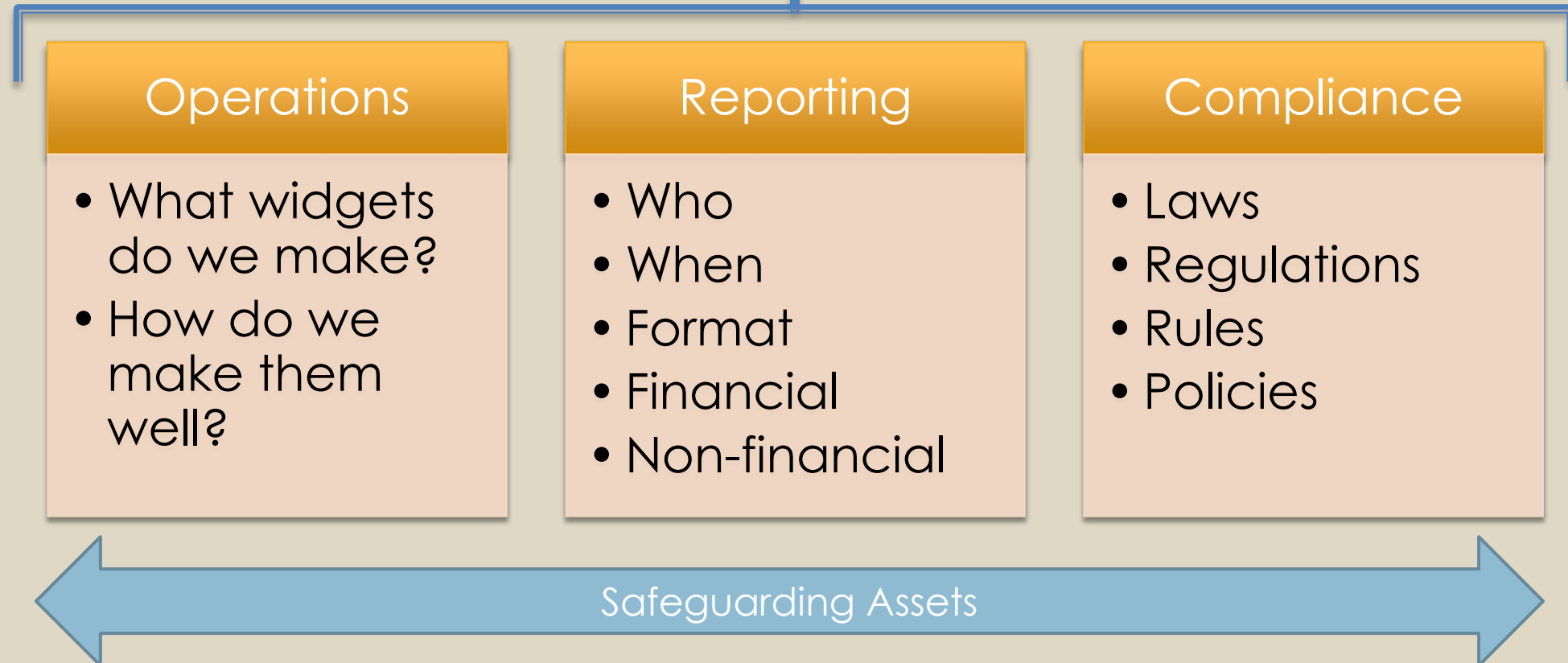
1983
*Standards for
Internal
Controls in
the Federal
Government*

Green Book

For each of the 5 components of internal control, obtain and document a sufficient understanding of the (a) internal control system or (b) key controls at the:

- entity level; or
- program level

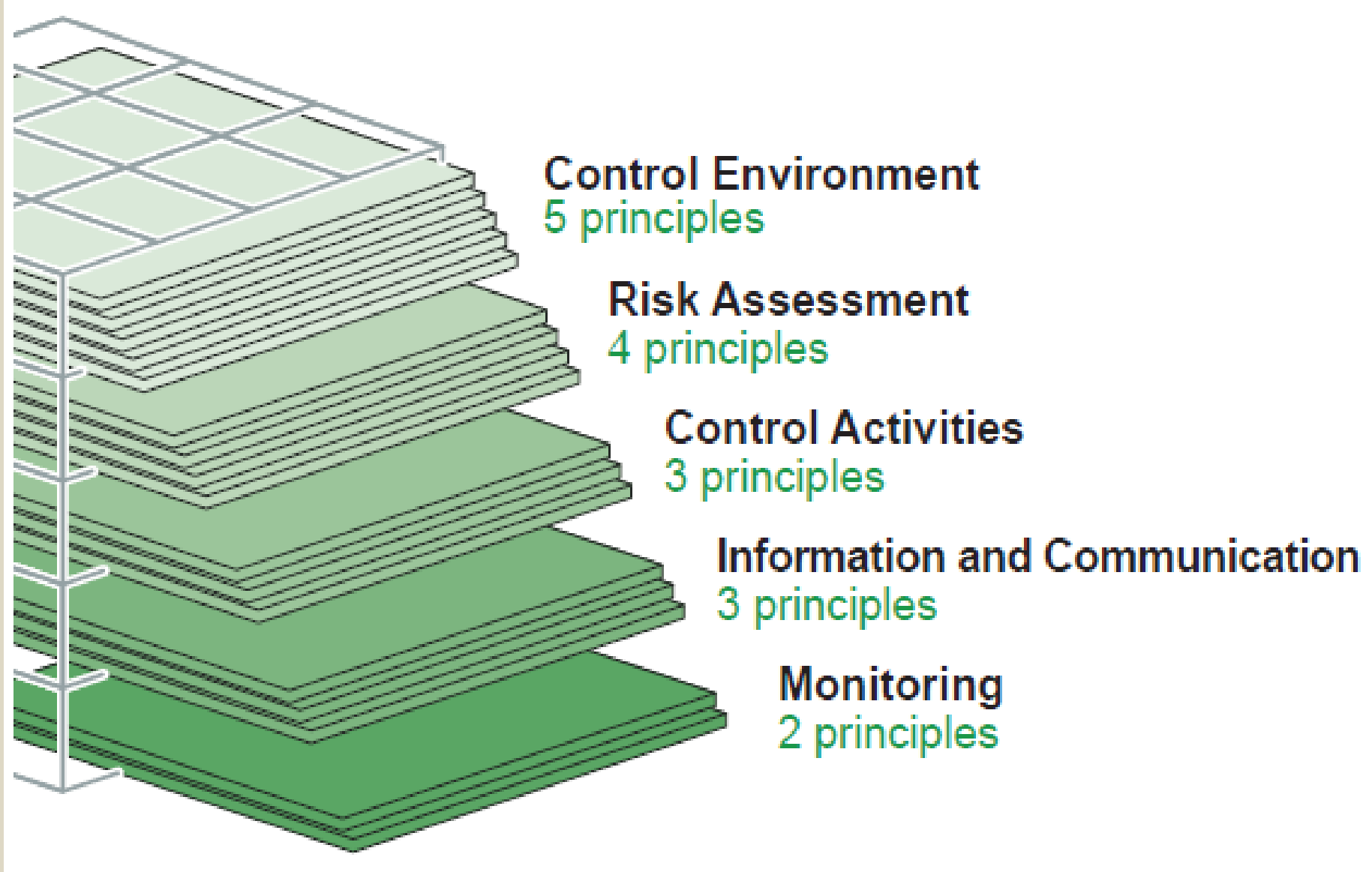
Green Book - 3 Categories of Objectives



Controls for Objectives



5 Components & 17 Principles



Principles Vs. Attributes

Principles

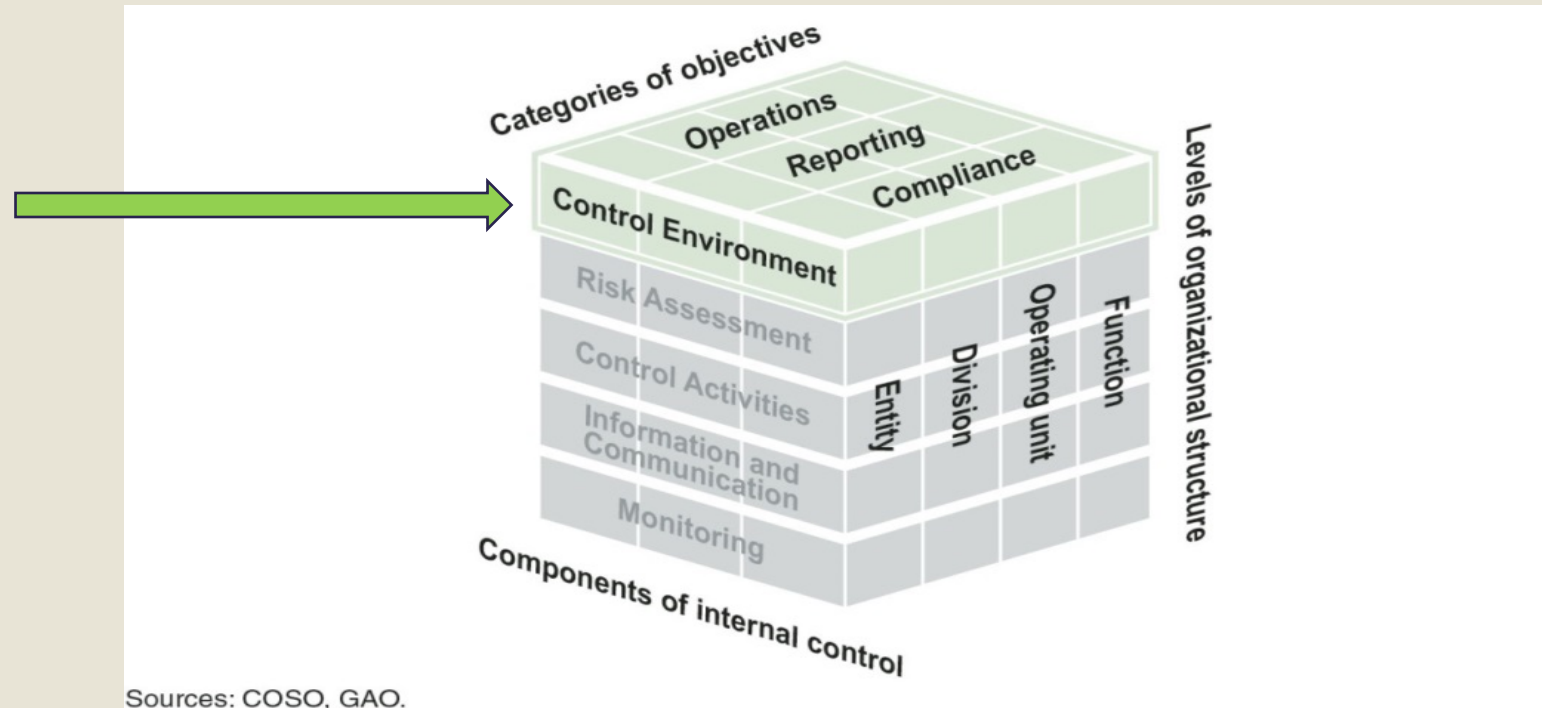
- Principles are the requirements of each component

Attributes

- Each principle has important characteristics, called attributes, which explain principles in greater detail.

Green Book

- Control Environment - The foundation for an internal control system. It provides discipline and structure to help an entity achieve its objectives. (Para. OV2.04)
- Includes top management's attitude and philosophy regarding internal control



Green Book - Control Environment 5 Principles

1. Oversight body and management should demonstrate a commitment to integrity and ethical values. (Para. 1.01)
2. Oversight body should oversee the entity's internal control system. (Para. 2.01)
3. Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives. (Para. 3.01)
4. Management should demonstrate commitment to recruit, develop, and retain competent individuals. (Para. 4.01)
5. Management should evaluate performance and hold individuals accountable for their internal control responsibilities. (Para. 5.01)

Green Book - Control Environment Red Flags

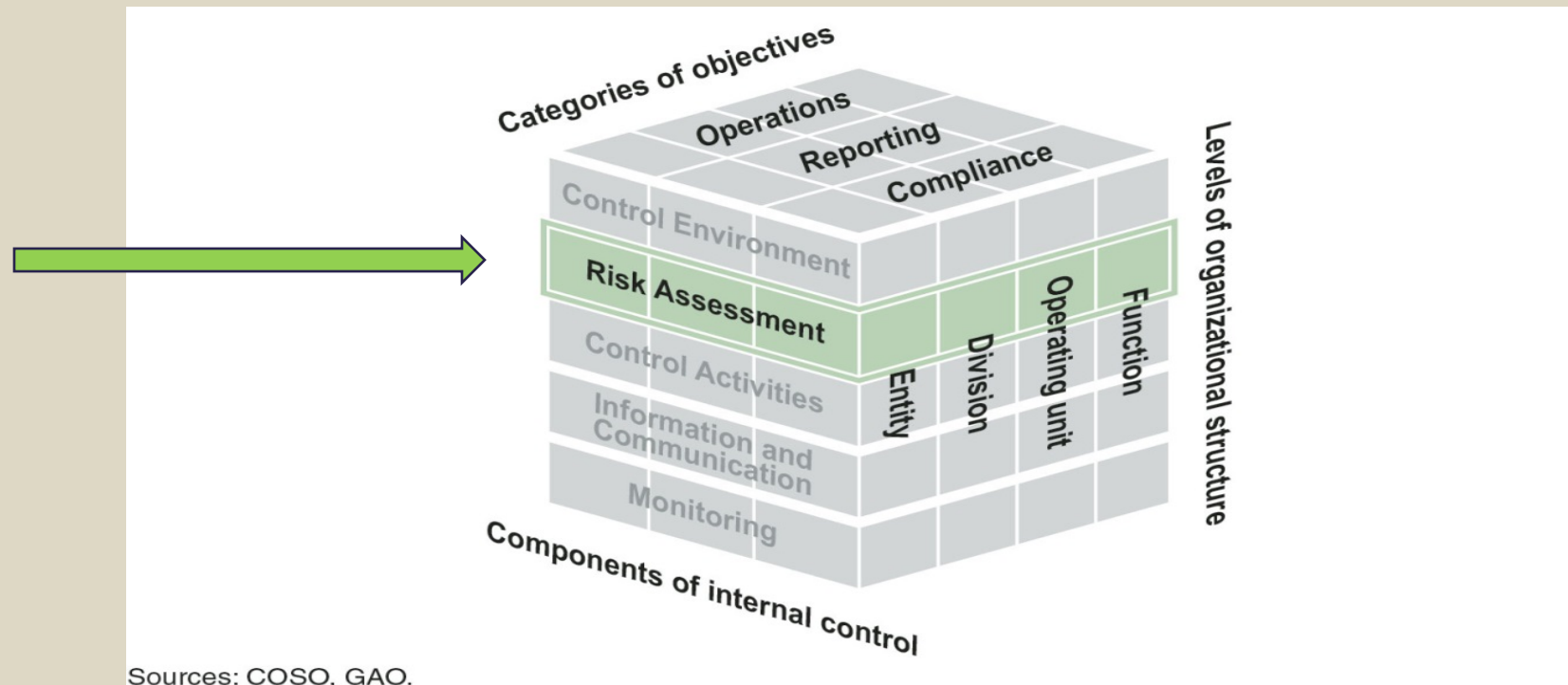
Indicators of an internal control issue/deficiency:

- Personnel do not understand acceptable behavior.
- Top management unaware of actions taken at the lower level.
- It is difficult to determine the entities or individuals that have responsibility for programs or particular parts of a program. The entity's organizational structure is inefficient or dysfunctional.
- Management displays a lack of concern for internal control and is unresponsive to internal control deviations or recommendations to improve internal control.



Green Book – Risk Assessment

Risk Assessment - Assess the risks facing the entity; it seeks to achieve its objectives. This assessment provides the basis for developing appropriate risk responses. (Para. OV2.04)



Green Book – Risk Assessment 4 Principles

Management should:

1. Define objectives clearly to enable the identification of risks and define risk tolerances. (Para. 6.01)
2. Identify, analyze, and respond to risks related to achieving objectives. (Para. 7.01)
3. Consider the potential for fraud when identifying, analyzing, and responding to risks. (Para. 8.01)
4. Identify, analyze, and respond to significant changes that could impact the internal control system. (Para. 9.01)

Green Book – Risk Assessment Red Flags

Indicators of control issue/deficiency:

- Management has not reassessed the risk related to recent major changes (e.g., new responsibilities, reorganization, cuts in funding, and expansion of programs).
- Agency or program does not have well-defined, specific, or measurable objectives and thus has no documented strategy for assessing risks, including fraud risks.
- Management has not considered previous risks of fraud, waste, or abuse in the agency's documented risk assessment and relies on OIG instead to conduct.
- Undeveloped risk tolerances; agencies unable to design, implement, operationalize, or prioritize antifraud controls efficiently or effectively.



Green Book – Risk Assessment Red Flags (Cont'd.)

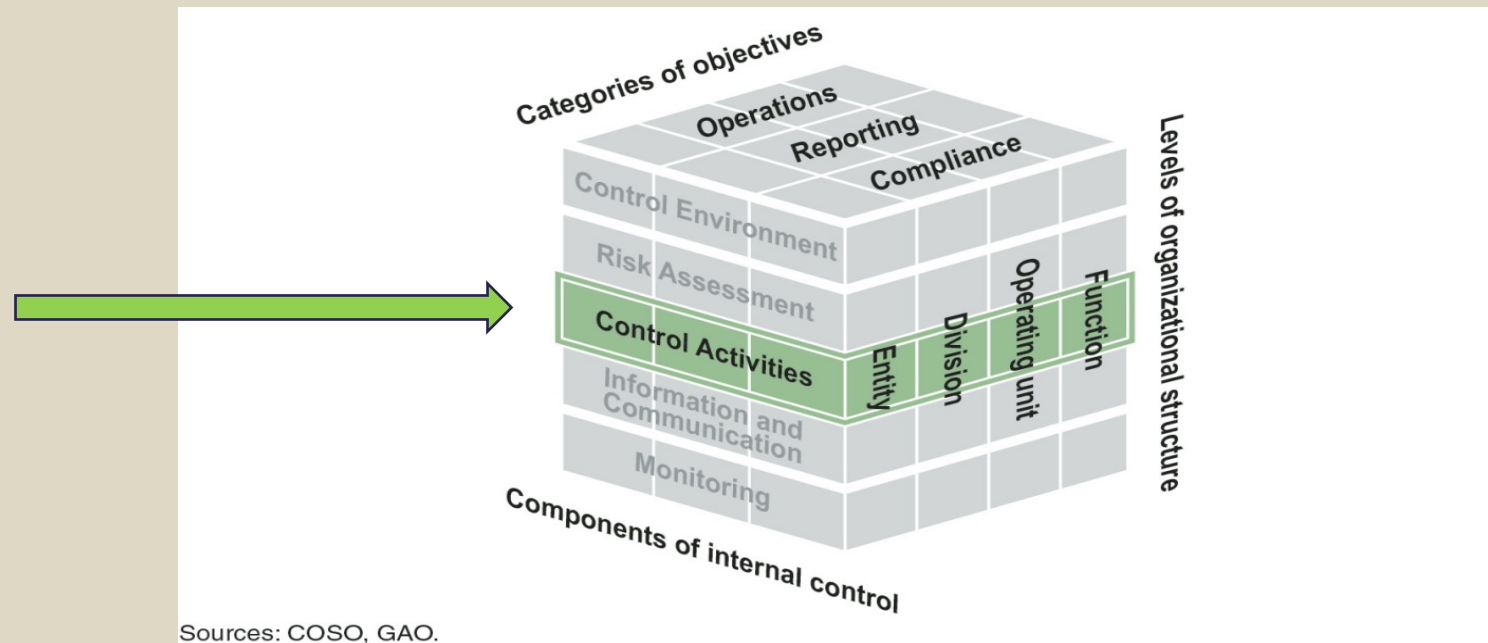
Indicators of control issue/deficiency:

- Agency has not developed fraud risk tolerances when assessing fraud risks
- Agency has conducted a fraud risk assessment, but has not documented their assessment
- Agency staff are frustrated by requests for data and contracts because they are time-consuming and items requested are difficult to locate



Green Book – Control Activities

Control Activities - The actions management establishes through policies and procedures to achieve objectives and respond to risks in the internal control system, which includes the entity's information system. (Para. OV2.04)



Sources: COSO, GAO.

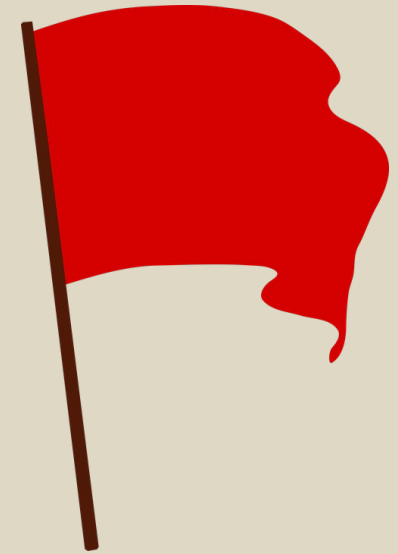
Green Book – Control Activities 3 Principles:

1. Management should design control activities to achieve objectives and respond to risks. (Para. 10.01)
2. Management should design the entity's information system and related control activities to achieve objectives and respond to risks. (Para. 11.01)
3. Management should implement control activities through policies. (Para. 12.01)


Green Book – Control Activities Red Flags

Indicators of an internal control issue or deficiency and require further analysis:

- Employees are unaware of policies and procedures, or they are aware, but do things the way “they have always been done,” “others do it that way,” or because of limited resources or time and goal pressures
- Operating policies and procedures have not been developed or are outdated.
- Key documentation is often lacking or does not exist.
- Key steps in a process are not being performed.
- Personnel and management are uncertain why processes are being performed or how processes are related to and support program goals.

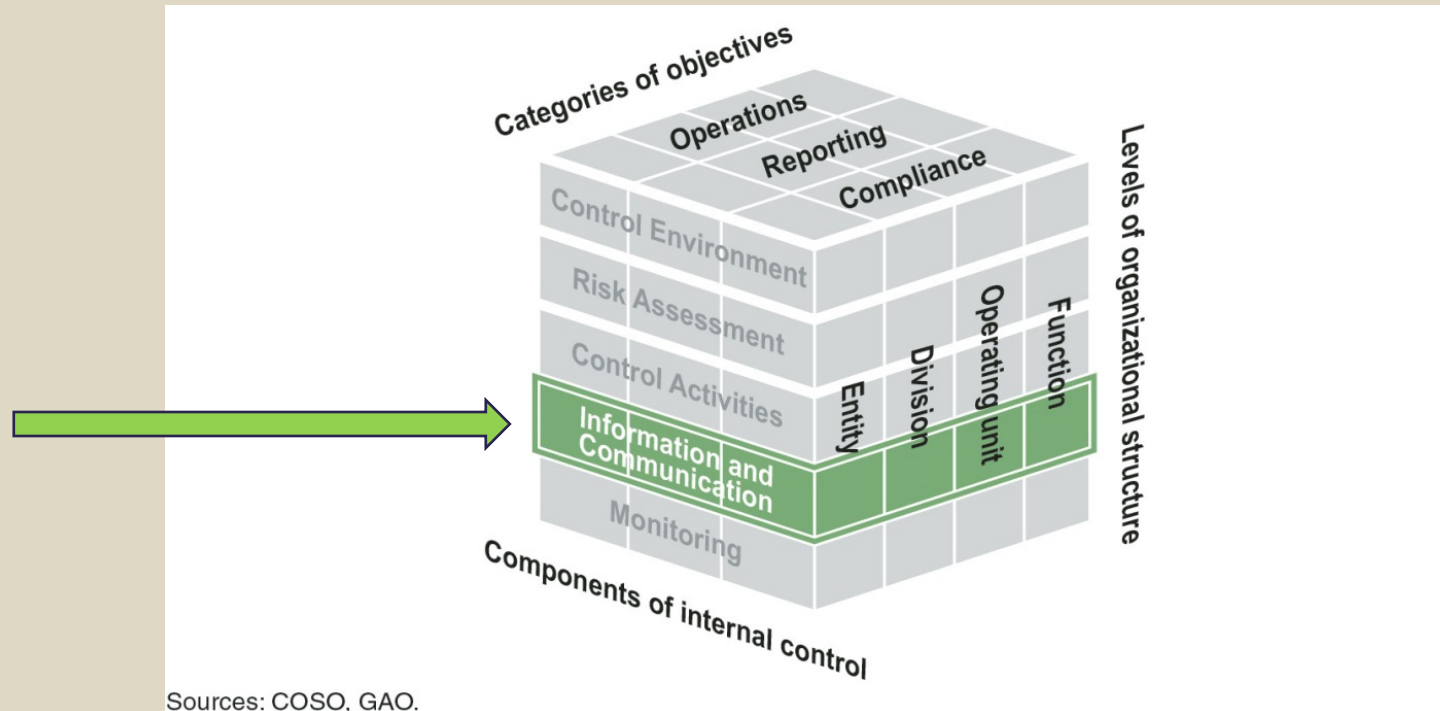


Green Book – Control Activities (Cont'd.)

- Segregation of Duties 
- Safeguarding of Assets
- Proper Authorization of Transactions
- Proper Documentation

Green Book – Information & Communication

Information and Communication – The quality information management and personnel communicate and use to support the internal control system. (Para. OV2.04)



Green Book – Information & Communication

3 Principles

1. Management should use quality information to achieve the entity's objectives. (Para. 13.01)
2. Management should internally communicate necessary quality information to achieve the entity's objectives. (Para. 14.01)
3. Management should externally communicate necessary quality information to achieve the entity's objectives. (Para. 15.01)



Green Book – Information & Communication

Red Flags

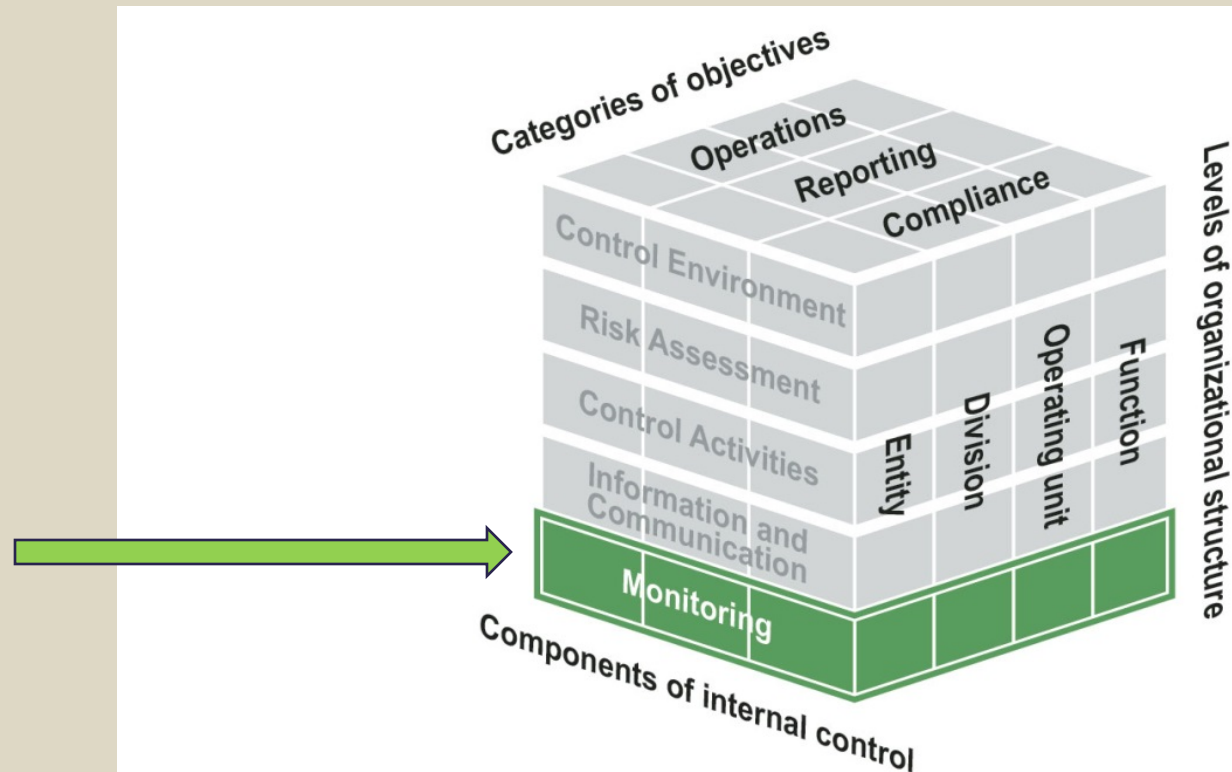
Indicators of control issues/deficiencies:

- When top management needs information, there is an excessive rush to assemble the information, or the process is handled through ad hoc mechanisms (e.g., the information was not readily available).
- Key information requests for basic information on the status of operations from external stakeholders (e.g., Congress or GAO) are difficult for the agency to respond to and require extra resources or special efforts.
- Staff frustrated by requests for information because it is time-consuming and difficult to provide information.
- Management does not have reasonable assurance that the information it is using is accurate.



Green Book – Monitoring

Monitoring - Activities management establishes and operates to assess the quality of performance over time and promptly resolve the findings of audits and other reviews. (Para. OV2.04)



Sources: COSO, GAO.

Green Book – Monitoring 2 Principles

1. Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results. (Para. 16.01)
2. Management should remediate identified internal control deficiencies on a timely basis. (Para. 17.01)

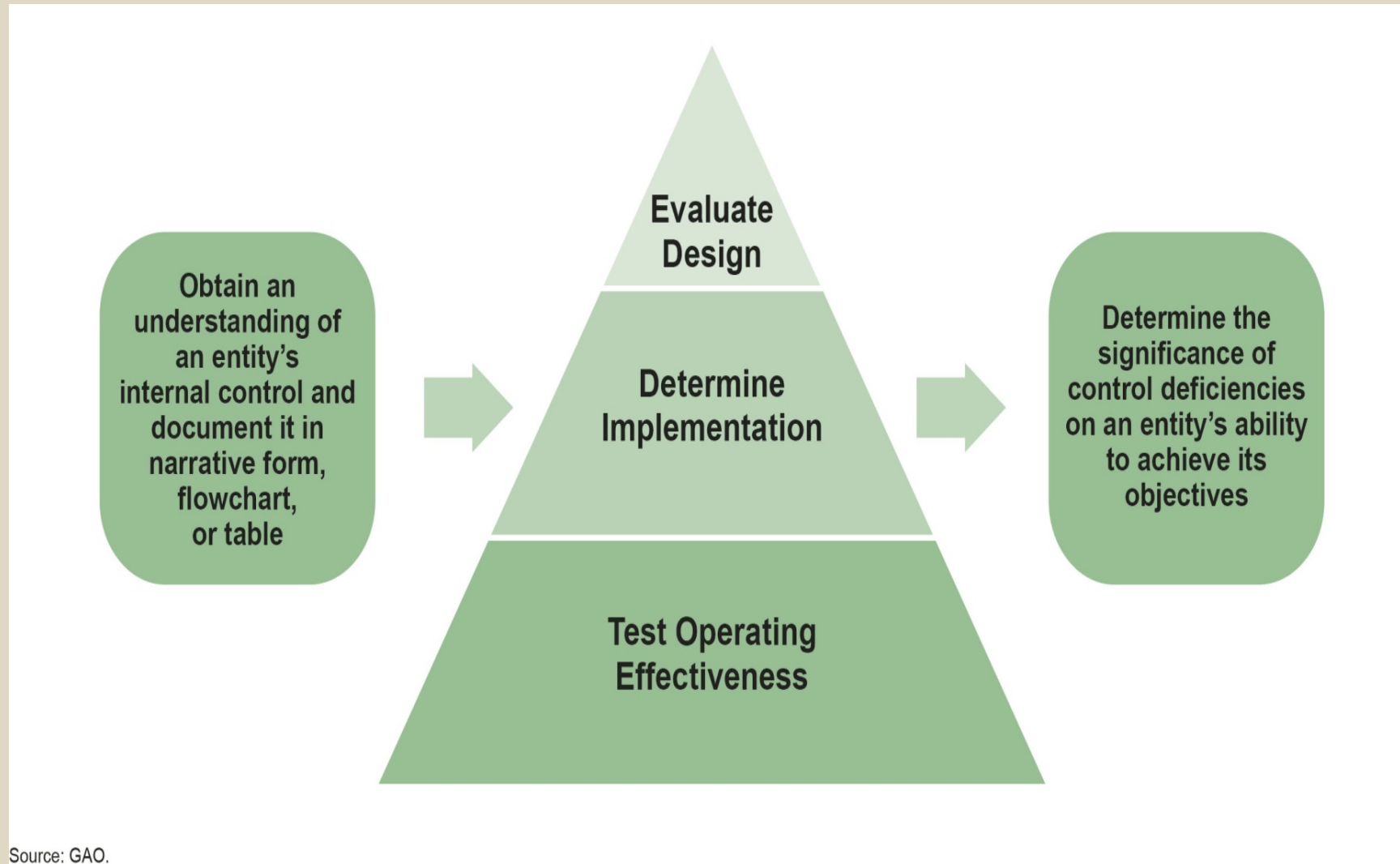
Green Book – Monitoring Red Flags

Indicators of an internal control issue/deficiency:

- Management does not evaluate a program on an ongoing basis.
- Significant problems exist in controls and management was not aware of those problems until a big problem occurred or until an outside party brought it to its attention.
- There are unresolved problems with the other components: control environment, risk assessment, control activities, and information and communications.
- Previously identified engagement findings are not being resolved adequately or timely.
- Management misses key deadlines and was not aware that it would not be able to meet deadlines.



Assessing Design, Implementation, and Operational Effectiveness of Internal Control



Assessing Design, Implementation, and Operational Effectiveness of Internal Control (Cont'd.)



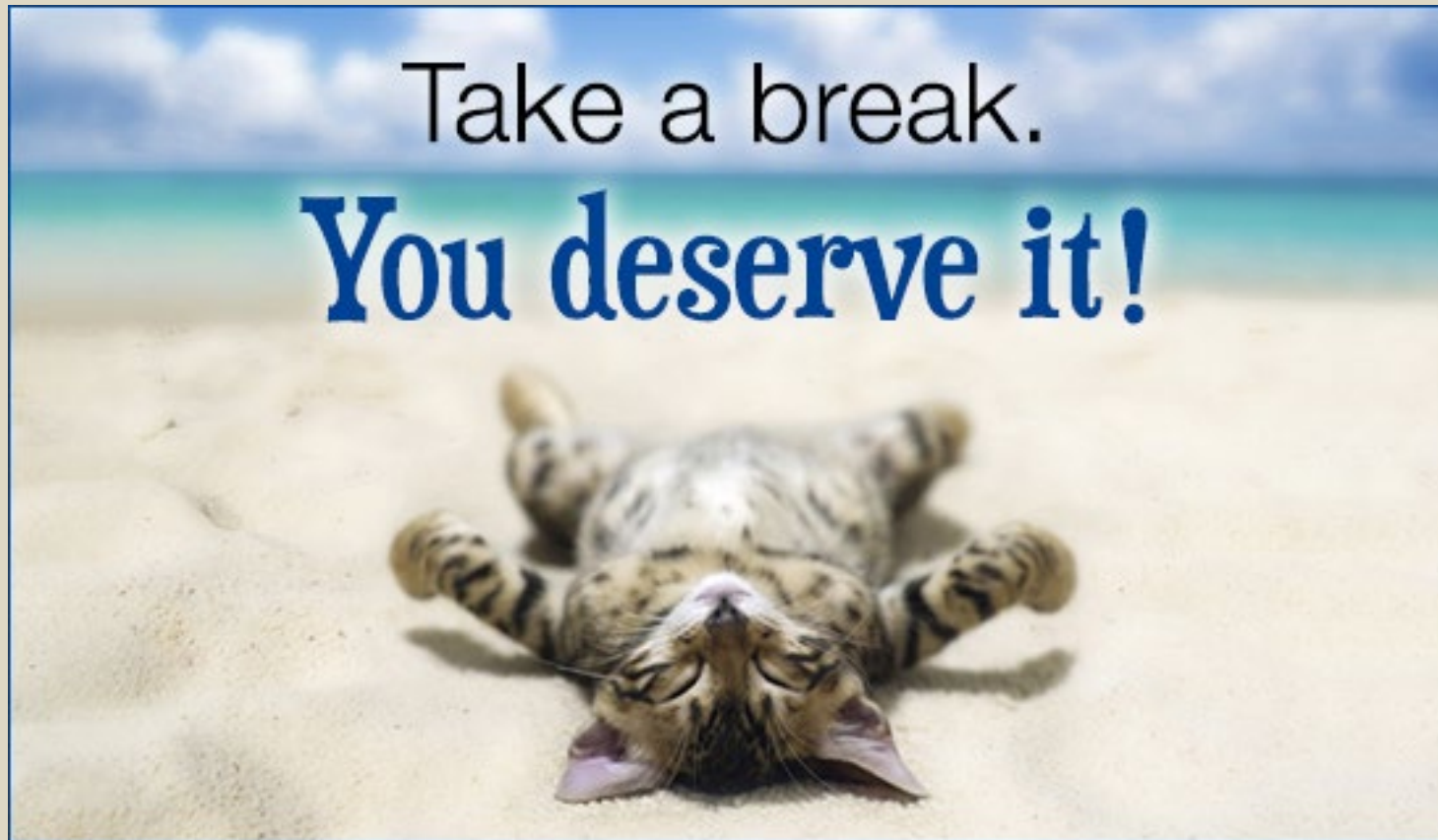
Assessing Design, Implementation, and Operational Effectiveness of Internal Control (Cont'd.)

- Should you test implementation or operational effectiveness/efficiency of a control if it's not effectively designed (e.g., agency says it assesses risks, but does not document these assessments)? Why?
- What if the control is effectively designed and documented? Should we test whether it has been implemented or operating effectively/efficiently? Why?

Assessing Design, Implementation, and Operational Effectiveness of Internal Control (Cont'd.)

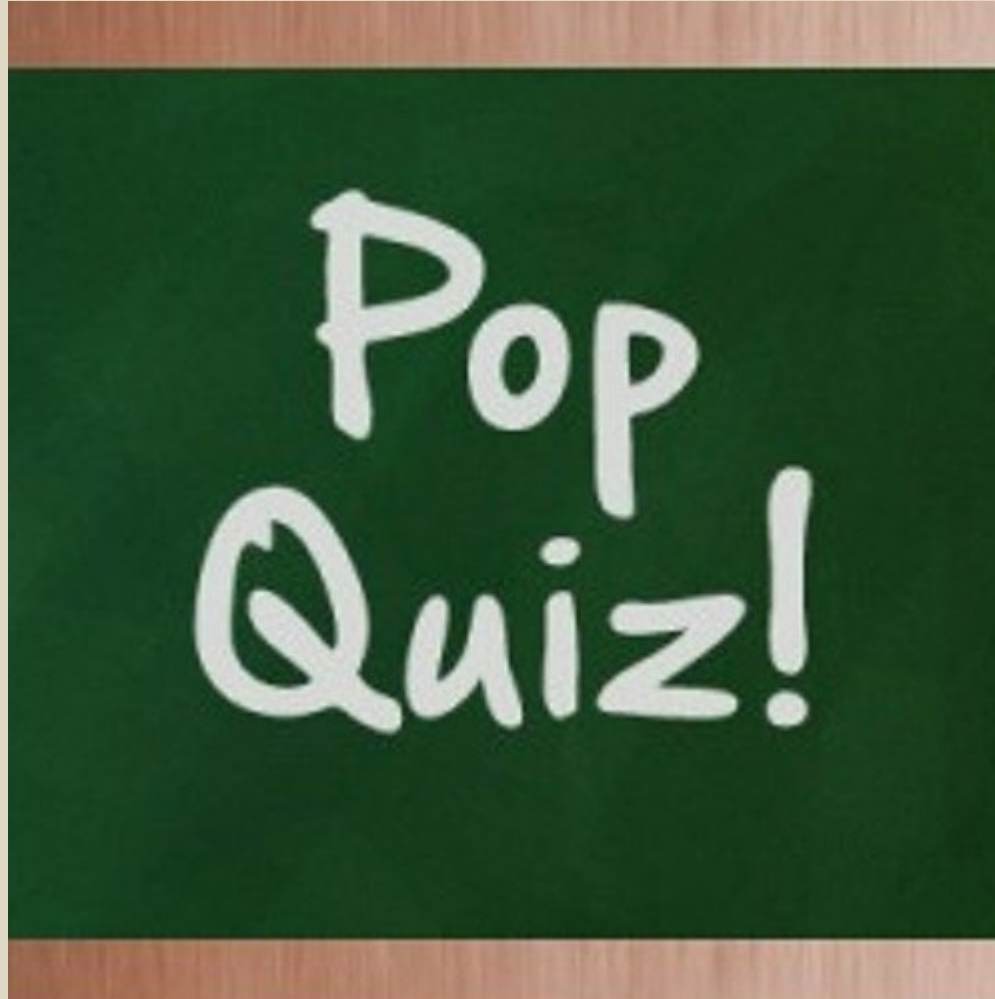
- Evaluating design of controls will not allow you to conclude on internal controls beyond the point of design.
- Determining implementation/operational effectiveness of controls provides reasonable assurance of effective implementation for a point in time when you reviewed documentation/tested controls (e.g., extent to which agency flagged our 50 bogus applications from CY17 to CY18).
- An internal control cannot be effectively operating if it was not effectively designed or implemented. (Para. OV3.06)

10 MINUTES



[This Photo](#) by Unknown Author is licensed under [CC BY-NC-ND](#)

10 Minute Group Exercise

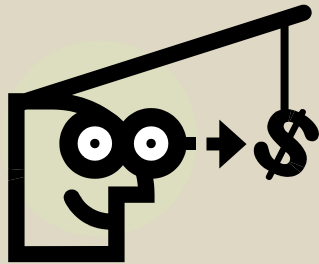


[This Photo](#) by Unknown Author is licensed under [CC BY](#)

What is one Role of Internal Controls?

To Prevent and Detect Fraud, Waste & Abuse

MOTIVE + OPPORTUNITY + JUSTIFICATION



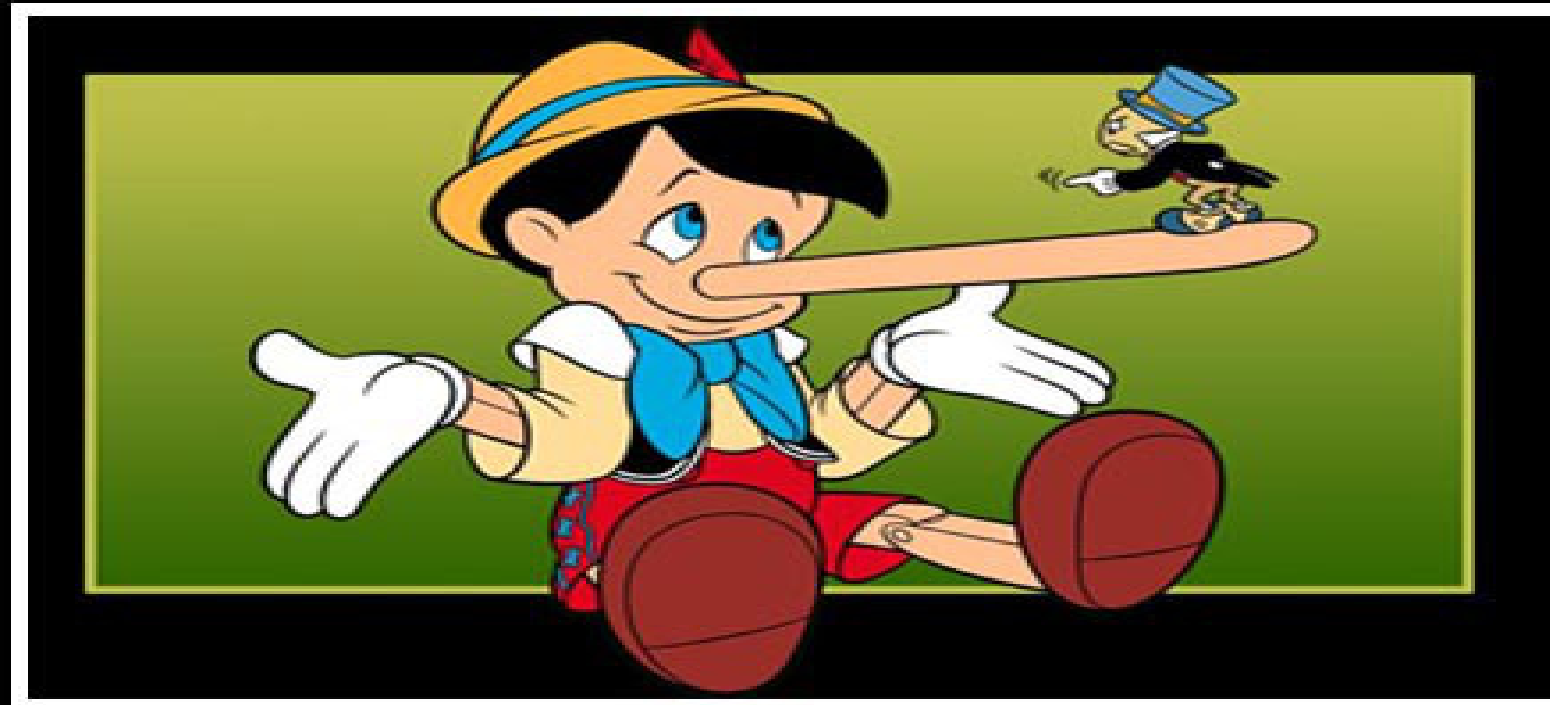
= FRAUD



Benefits of Internal Controls

- Ensure internal business is properly transacted.
- Reduce the opportunity for fraud.
- Protect elected officials and employees from personal liability.
- Provide a positive public image by reducing errors, fraud, and mismanagement.

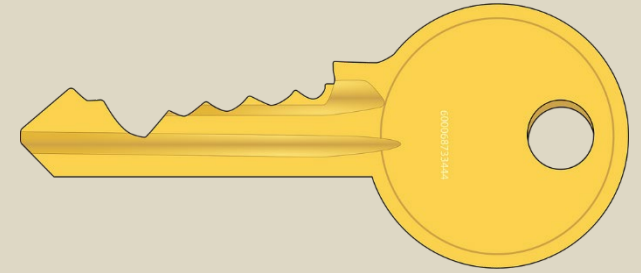
Why Should We Care?



INTEGRITY

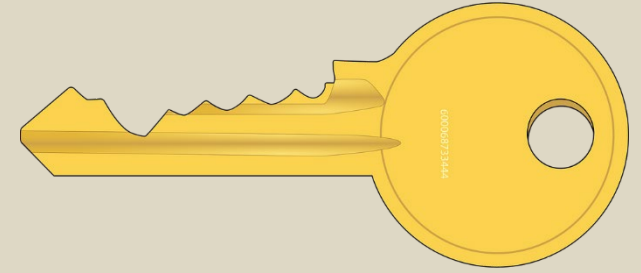
A single lie destroys a whole reputation of integrity.

Key Definitions



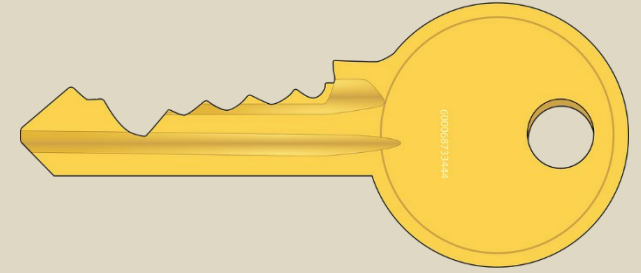
- **Internal Controls:** The plan of organization and all of the **methods** and **measures** adopted within an agency to safeguard its resources, assure that accuracy and reliability of its information, assure adherence to applicable laws, regulations and policy, and promote operational economy and efficiency.

Key Definitions (Cont'd.)



- **Vulnerability Assessment:** A review of the **vulnerability** of an agency or program to **loss or unauthorized** use of resources, errors in reports and information, illegal or unethical acts, and/or adverse or unfavorable public opinion.

Key Definitions (Cont'd.)



Internal Control Review (Enterprise-wide Risk Assessment): A detailed examination of an agency's or component's system of internal controls to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost-effective manner.

Administrative Controls

Includes but is not limited to the plan of organization and the **procedures and records** that are concerned with the **decision processes** leading to **management's authorization** of transactions. Such authorization is a management function directly associated with the responsibility for achieving the objectives of the organization and in the starting point for establishing accounting control of transactions.

Accounting Controls

Comprises the plan of organization and the procedures and records that are concerned with the safeguarding of assets and the reliability of financial records and consequently are designed to produce reasonable assurance that:

- Transactions are executed in accordance with management's general or specific authorization.**
- Transactions are recorded as necessary in conformity with Generally Accepted Accounting Principles (GAAP) and to maintain accountability for assets.**
- Access to assets is permitted only in accordance with management's authorization.**

Standards/Guidance

- COSO Report
Committee of Sponsoring Organizations of the Treadway Commission
- Standards for Internal Control in the Federal Government (2014)
- OMB Circular No. A-123, July 2016 Revision: Management's Responsibility for Enterprise Risk Management and Internal Control
- Government Auditing Standards (Yellow Book)
- International Standards for the Professional Practice of Internal Auditing (Red Book)

Sarbanes-Oxley Act of 2002

Management's Responsibilities

Section 404 requires management of all **public companies** to issue an internal control report that includes the following:

- A statement that management is responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting.
- An assessment of the effectiveness of the internal control structure and procedures for financial reporting as of the end of the company's fiscal year.

OMB Circular No. A-123

Management's Responsibility for Enterprise Risk Management and Internal Control

Circular A-123 provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal control. The Circular provides *specific requirements*, based on the Green Book, for conducting management's assessment of the effectiveness of internal control.

OMB Circular No. A-123 (Cont'd.)

Internal Control Components

- Control Environment
 - Risk Assessment
 - Control Activities
- Information and Communications
 - Monitoring

OMB Circular No. A-123 (Cont'd.)

Management's Responsibilities

Federal leaders and managers are responsible for establishing and achieving goals and objectives, seizing opportunities to improve effectiveness and efficiency of operations, providing reliable reporting, and maintaining compliance with relevant laws and regulations. They are also responsible for implementing management practices that effectively identify, assess, respond, and report on risks.

Agency managers must continuously monitor, assess, and improve the effectiveness of internal control associated with those internal control objectives identified as part of their risk profile.

OMB Circular No. A-123 (Cont'd.)

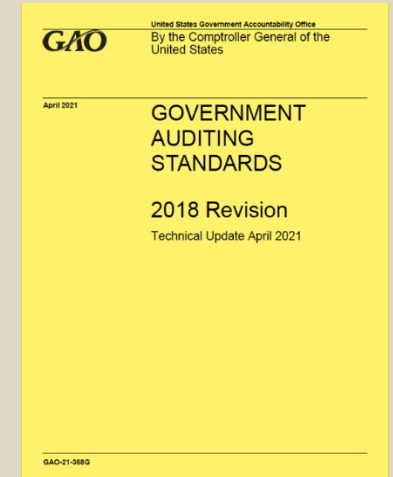
Culture

Successful implementation of this Circular requires Agencies to establish and foster an open, transparent culture that encourages people to communicate information about potential risks and other concerns with their superiors without fear of retaliation or blame. Similarly, agency managers, Inspectors General (IG) and other auditors should establish a new set of parameters encouraging the free flow of information about agency risk points and corrective measure adoption. An open and transparent culture results in the earlier identification of risk, allowing the opportunity to develop a collaborative response, ultimately leading to a more resilient government.

Yellow Book

Financial Audits

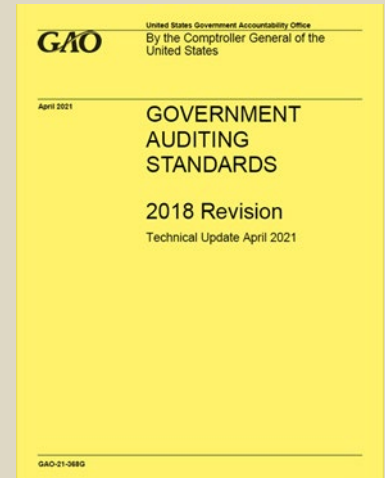
- When providing an opinion or a disclaimer on financial statements, auditors should report as findings any significant deficiencies or material weaknesses in internal control over financial reporting that the auditors identified based on the engagement work performed. (GAS 6.40)
- Auditors should include either in the same or in separate report(s) a description of the scope of the auditors' testing of internal control over financial reporting and of compliance with provisions of laws, regulations, contracts, and grant agreements. Auditors should also state in the report(s) whether the tests they performed provided sufficient, appropriate evidence to support opinions on the effectiveness of internal control and on compliance with provisions of laws, regulations, contracts, and grant agreements. (GAS 6.42)



Yellow Book

Performance Audits

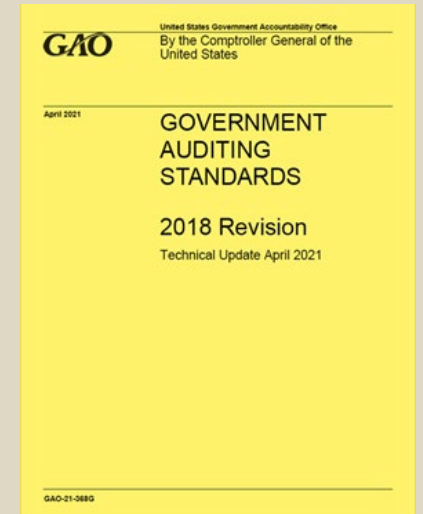
- Auditors should determine and document whether internal control is significant to the audit objectives. (GAS 8.39) If it is determined that internal control is significant to the audit objectives, auditors should obtain an understanding of such internal control.(GAS 8.40)
- If internal control is determined to be significant to the audit objectives, auditors should plan and perform audit procedures to assess internal control to the extent necessary to address the audit objectives. (GAS 8.49)
- Auditors should evaluate and document the significance of identified internal control deficiencies within the context of the audit objectives. (GAS 8.54)



Yellow Book

Attestation Engagements and Reviews of Financial Statements

Auditors should include in the examination report all internal control deficiencies, even those communicated early, that are considered to be significant deficiencies or material weaknesses that the auditors identified based on the engagement work performed. (GAS 7.42)



Red Book

The internal audit activity must evaluate the adequacy and effectiveness of controls in responding to risks within the organization's governance, operations, and information systems regarding the:

- Achievement of the organization's strategic objectives.
- Reliability and integrity of financial and operational information.
- Effectiveness and efficiency of operations and programs.
- Safeguarding of assets.
- Compliance with laws, regulations, policies, procedures, and contracts. (IIA 2130.A1)



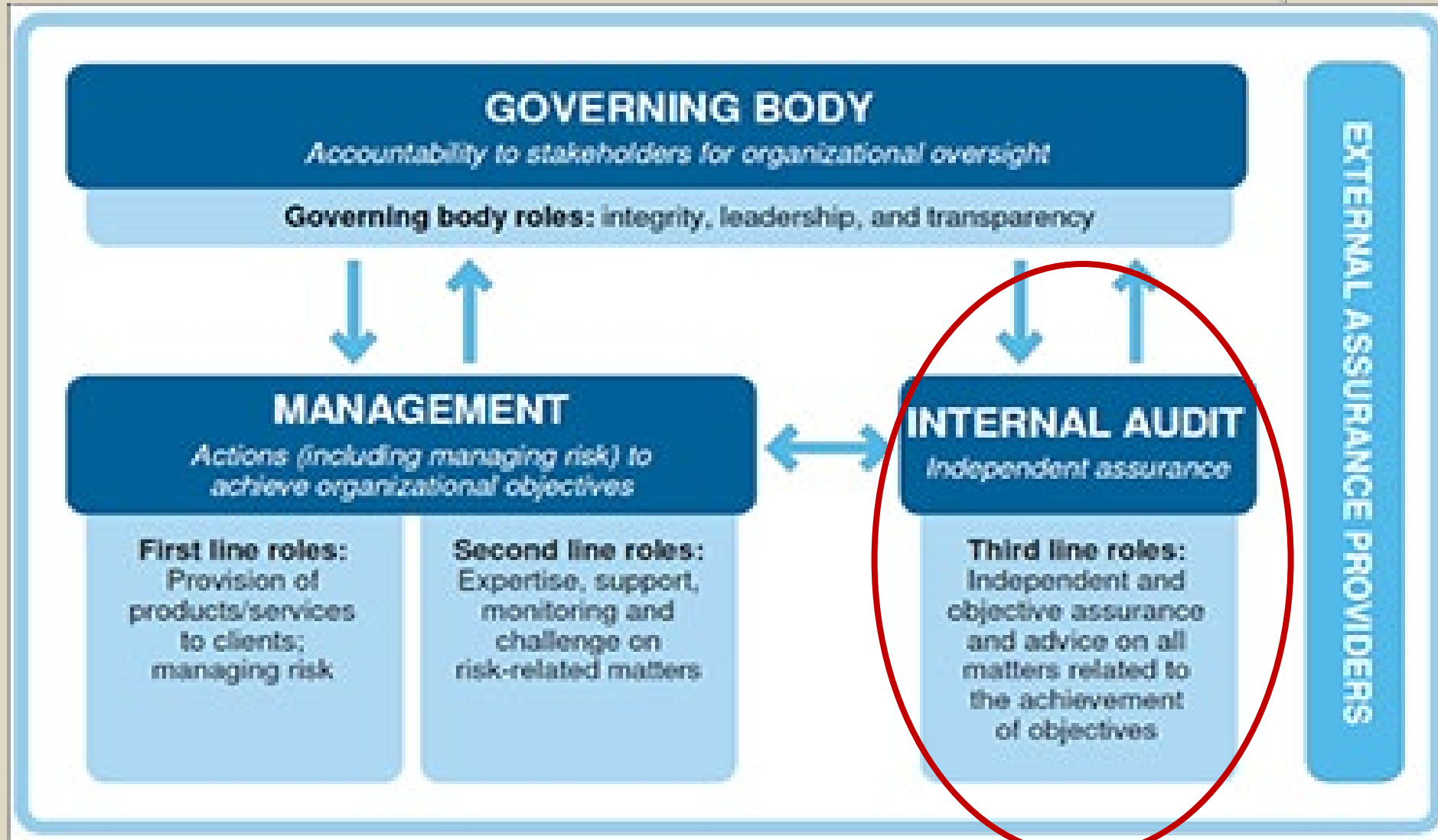
First Line



- “Internal control serves as the first line of defense in safeguarding assets. In short, internal control helps managers achieve desired results through effective stewardship of public resources.” (OV1.03)

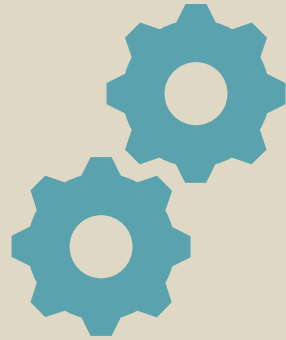


Internal Audit – Third Line



Source: IIA, Lake Mary, Fla. (July 20, 2020)

Internal Control Maturity



Built-in component of day-to-day operations



Increases **likelihood** of achieving objectives

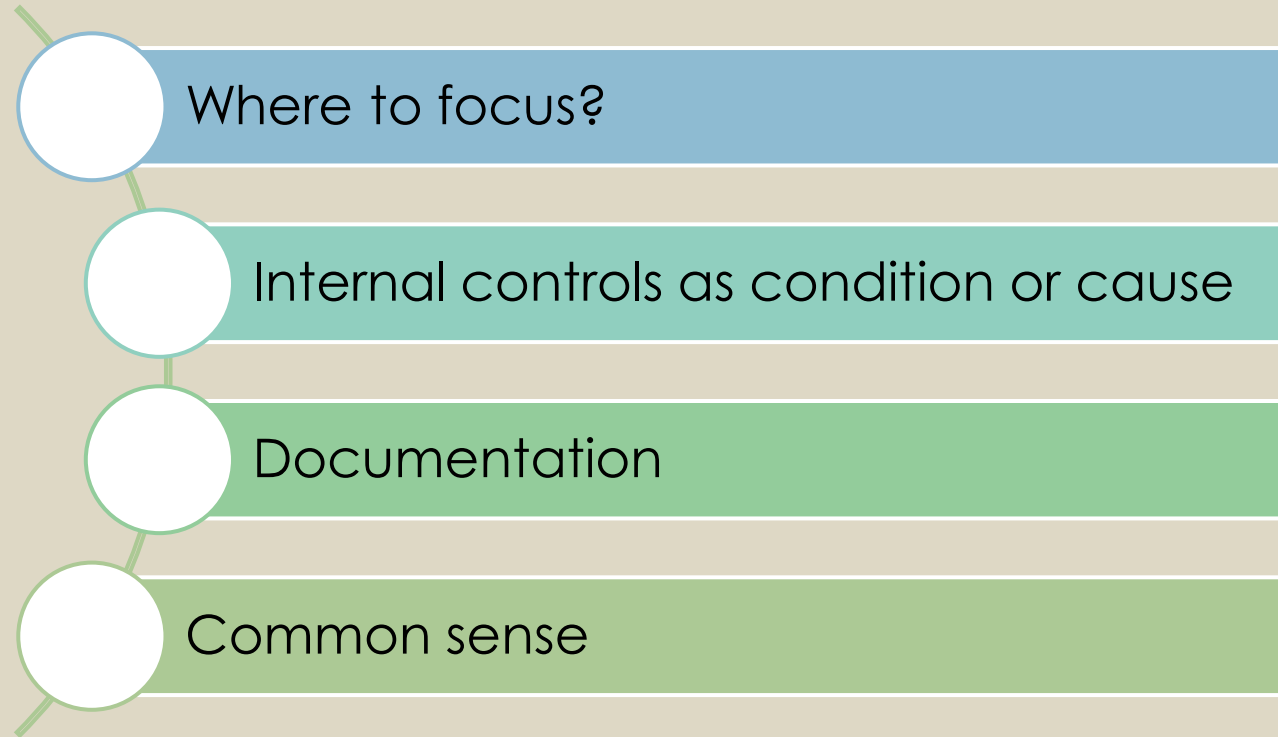
Flashback! Summary

What are the...

- 5 Components?
- 17 Principles?



Internal Control and Auditing



Resources

- The IIA – www.theiia.org
- AIG – <http://inspectorsgeneral.org/>
- COSO – www.coso.org
- GAO – www.gao.gov



Questions? Comments?

Presented by:

Maxene M. Bardwell, CPA, CIA, CFE, CISA, CIGA, CRMA, CITP

Assistant Inspector General for Audit

WSSC Water Office of the Inspector General

Maxene.Bardwell@wsscwater.com

(301) 206-8300