



INTERNAL CONTROL

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"We're going to parachute in and do a surprise audit, but I want to keep the whole thing low key."



Understand the relationship between the COSO Framework and the Green Book



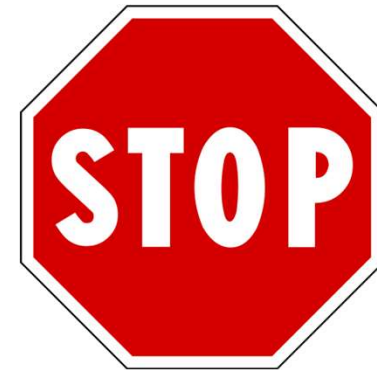
Identify the 5 components and 17 principles of internal control and know the relationship between them



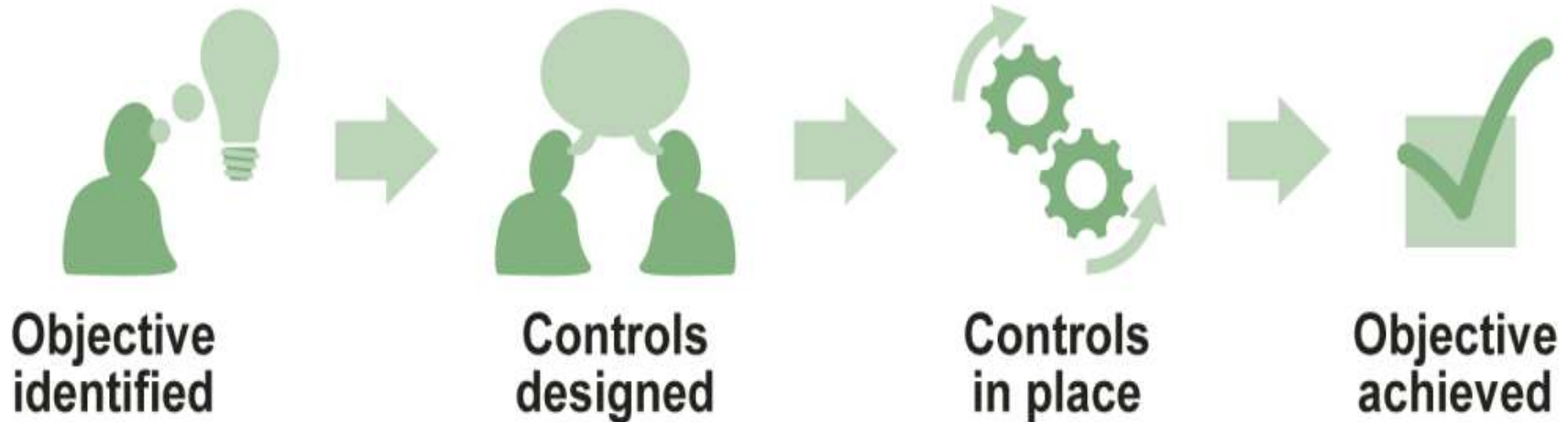
Recognize how to use internal controls in audit work



If you see a



**sign, you
might want
to take
some extra
notes!**



Internal Controls



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

A Brief History of Internal Control



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



fei

financial executives international



ima

The Association of Accountants and Financial Professionals in Business



The Institute of Internal Auditors

COSMO

OVERVIEW

**INTERNAL CONTROL –
INTEGRATED FRAMEWORK**


- ▶ Executive Summary
- ▶ Framework
- ▶ Reporting to External Parties
September 1992
- ▶ Addendum to
"Reporting to External Parties"
May 1994

1992

Committee of Sponsoring
Organizations of the
Treadway Commission

COSO

**Internal Control over Financial Reporting -
Guidance for Smaller Public Companies**
Volume I : Executive Summary




2006

COSO COMMITTEE OF SPONSORING
ORGANIZATIONS OF THE TREADWAY COMMISSION

Internal Control — Integrated Framework


**Guidance on Monitoring
Internal Control Systems**
Volume I : Guidance



2009

COSO
Committee of Sponsoring Organizations of the Treadway Commission

Internal Control — Integrated Framework
Framework and Appendices



2013

May 2013

COSO

Enterprise Risk Management
Integrating with Strategy and Performance



2017

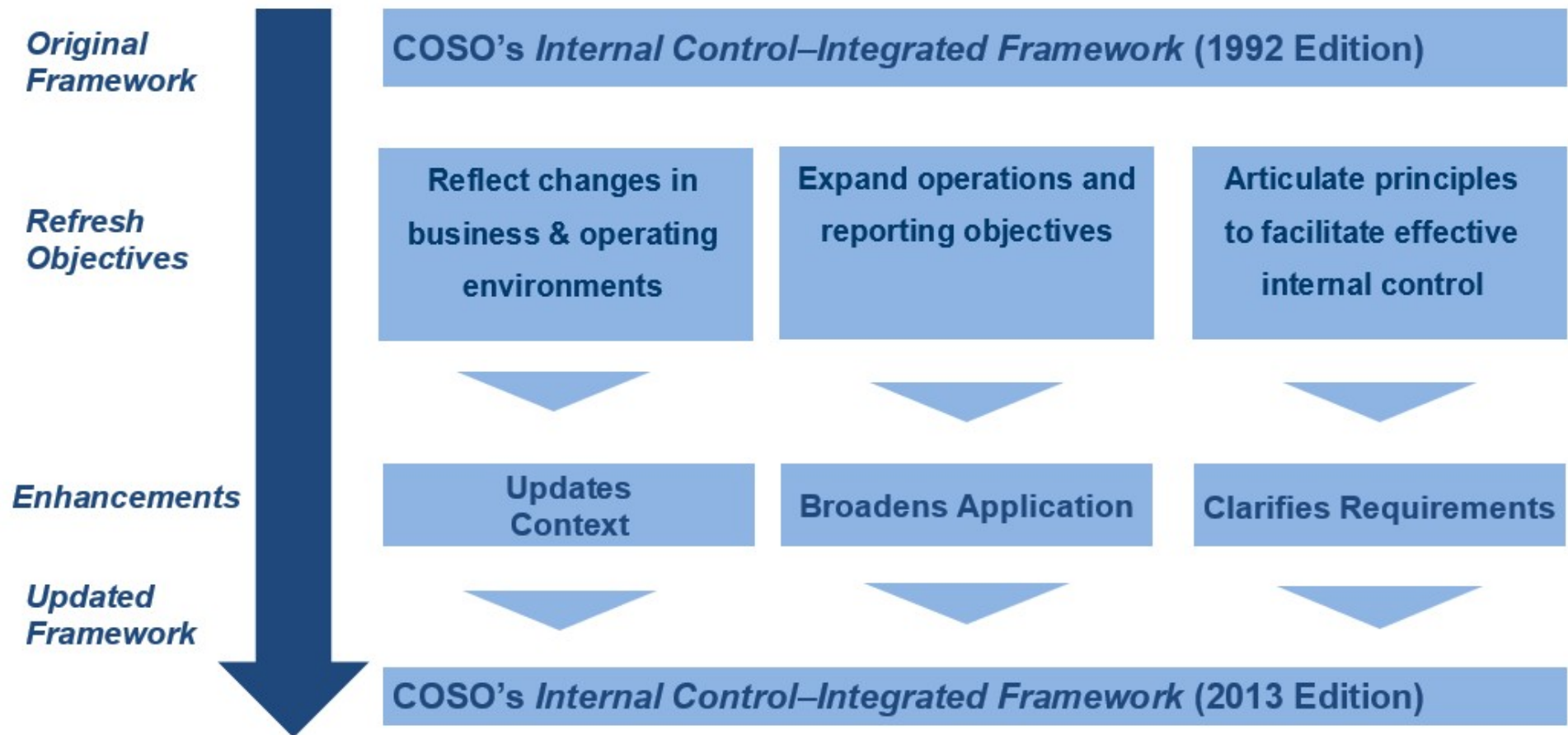
June 2017



Environment changes have driven Framework updates

- 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 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



STOP

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



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

COSO: Control Environment



Component

Control Environment

Principle

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

Controls embedded in other components may affect this principle

Human Resources review employees' confirmations to assess whether standards of conduct are understood and adhered to by staff across the entity

Control Environment

Management obtains and reviews data and information underlying potential deviations captured in Whistle-blower hotline to assess quality of information

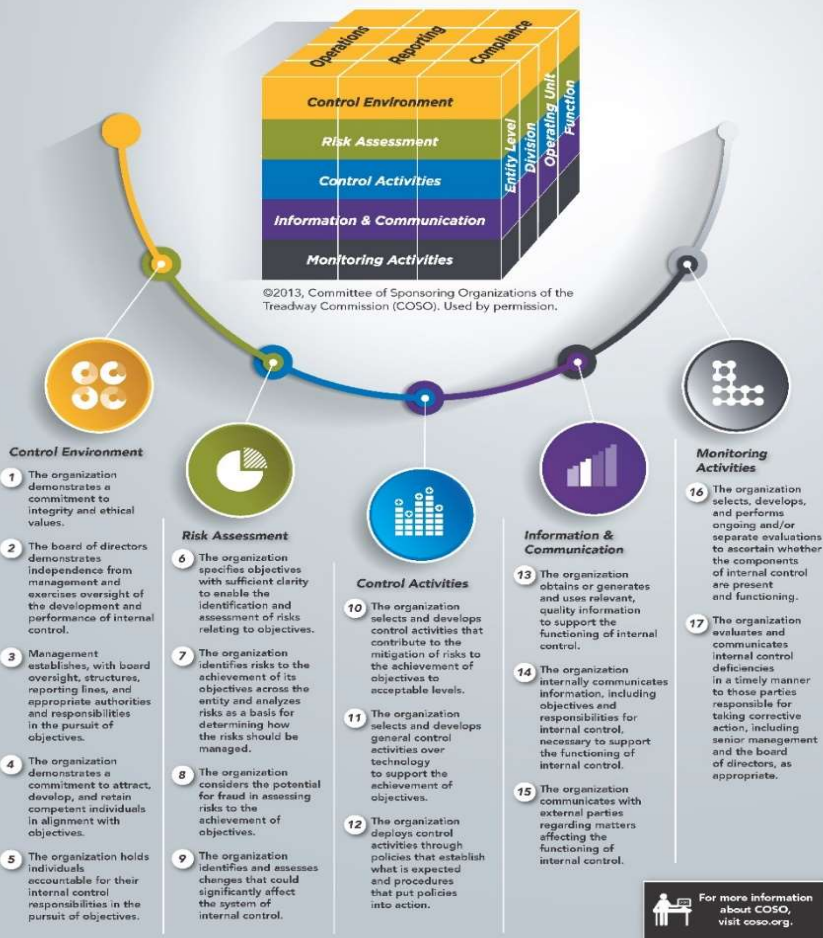
Information & Communication

Internal Audit separately evaluates Control Environment, considering employee behaviors and whistleblower hotline results and reports thereon

Monitoring Activities

COSO & GAO Green Book Comparison

COSO Internal Control — Integrated Framework Principles



GAO

What is the Green Book?

Important facts and concepts related to the Green Book and internal control

RELATED TO GAO-14-704G

What is internal control?

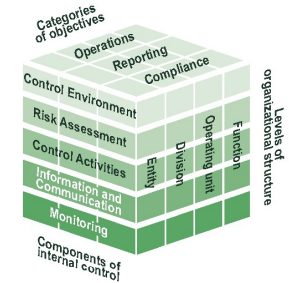
Internal control is a process that helps an entity achieve its objectives. It is the first line of defense in safeguarding public resources.



Standards for Internal Control in the Federal Government, known as the Green Book, is the document that sets internal control standards for federal entities.

How is internal control organized?

Standards for Internal Control in the Federal Government (the Green Book) is organized by the five components of internal control, and apply to staff at all organizational levels and to an entity's operations, reporting, and compliance objectives.

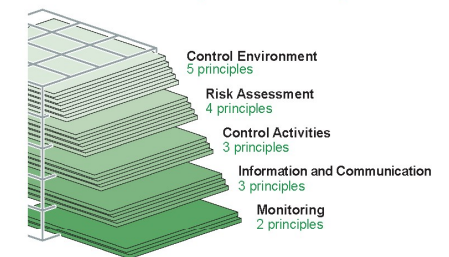


How does internal control work?

Internal control helps an entity



What makes up the 5 components?



Who would use the Green Book?

Here are some of the people who use it

- Someone who manages programs for federal, state, or local government
- Someone conducting a performance audit or a financial audit
- Someone responsible for making sure that personnel follow policies and procedures related to any and all job responsibilities

Principles

Each of the five components contains several principles. Principles are the requirements of each component.

Attributes

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

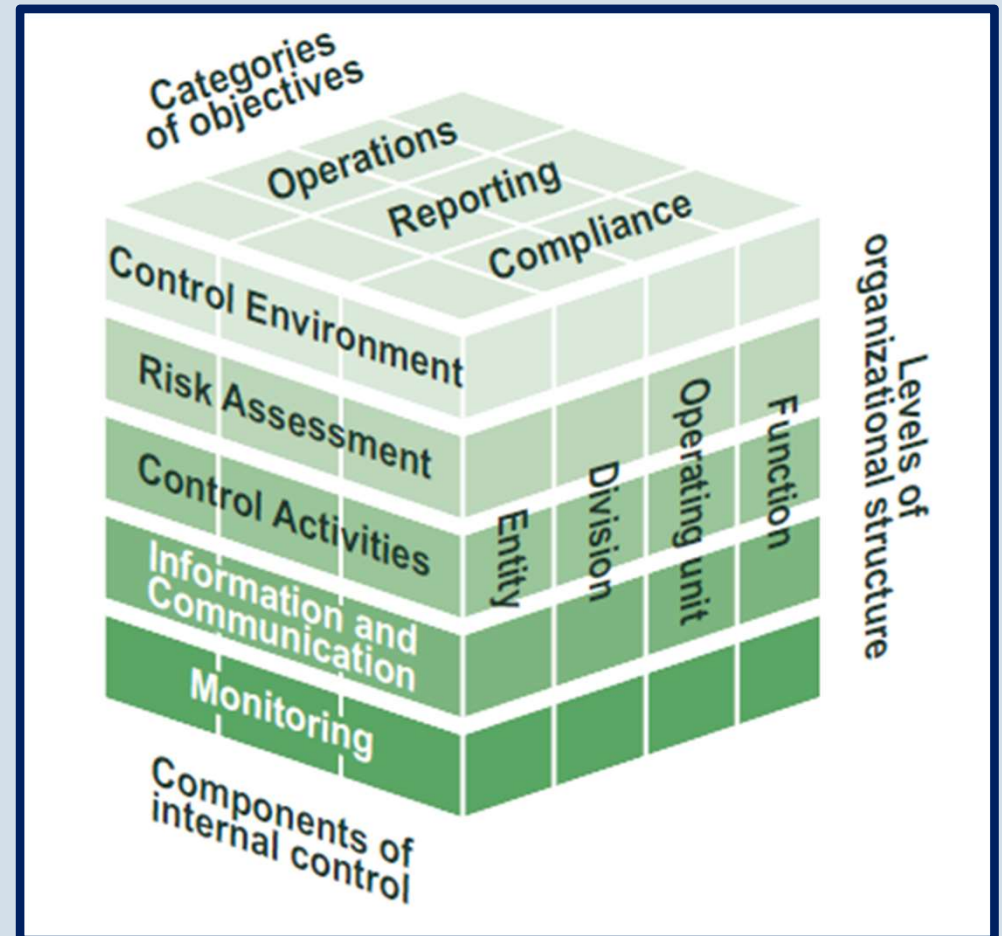
LOOKING FOR MORE INFORMATION? Visit GAO.GOV/GREENBOOK. Read the full report: GAO-14-704G.
This work has been released into the public domain.

GAO

Cube to Cube Comparison



COSO Cube



GAO Green Book Cube



United States Government Accountability Office
By the Comptroller General of the
United States

September 2014

Standards for Internal Control in the Federal Government

1970'S

**Fraud, Waste, and Abuse in
Government**



1982

**Federal Managers' Financial
Integrity Act (FMFIA)**



1983

***Standards for Internal Controls
in the Federal Government***

GAO Green Book



1. Control Environment
2. Risk Assessment
3. Control Activities
4. Information & Communication
5. Monitoring

For each of the five 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

Operations

- What widgets do we make?
- How do we make them well?

Reporting

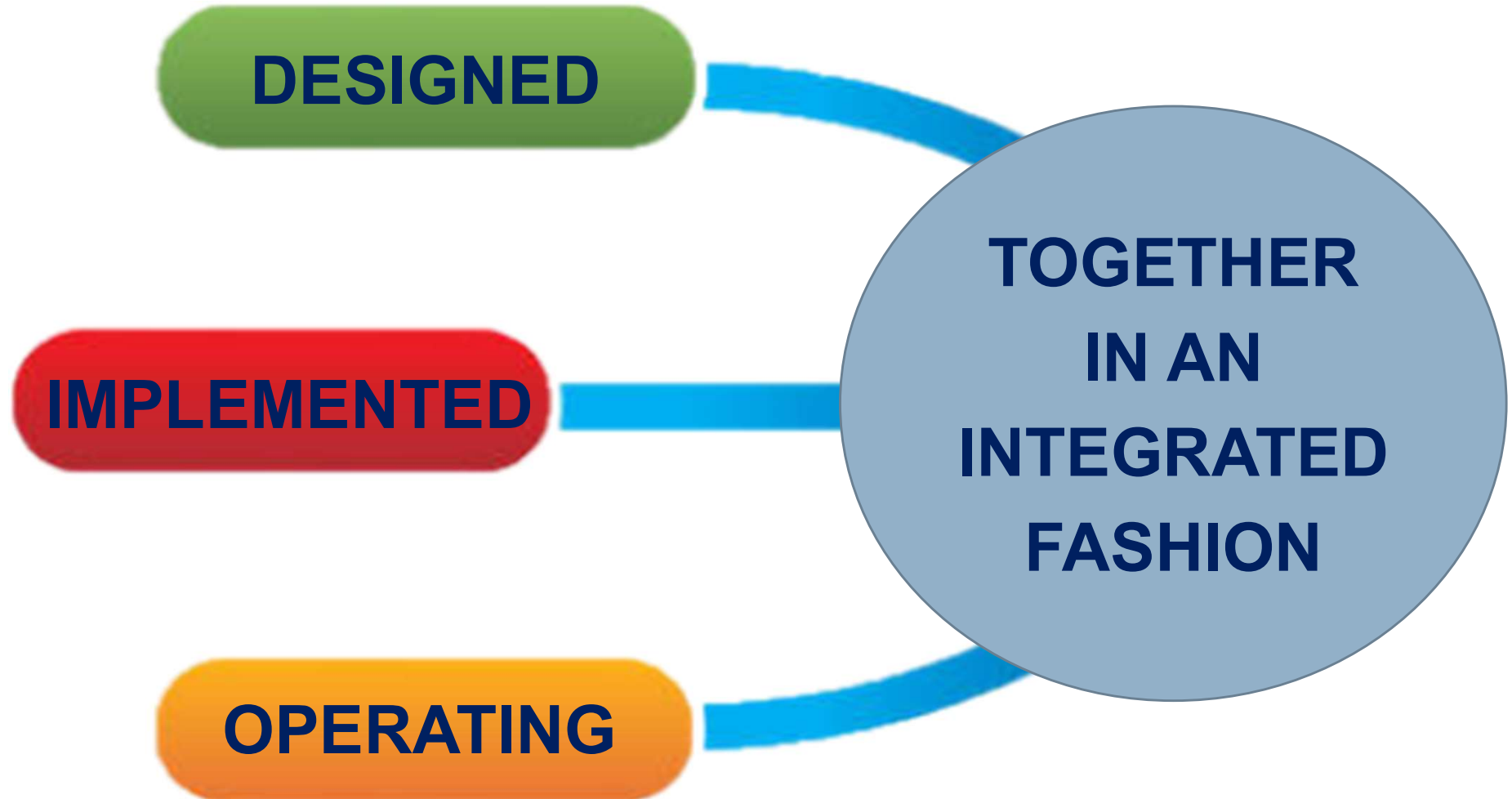
- Who
- When
- Format
- Financial
- Non-financial

Compliance

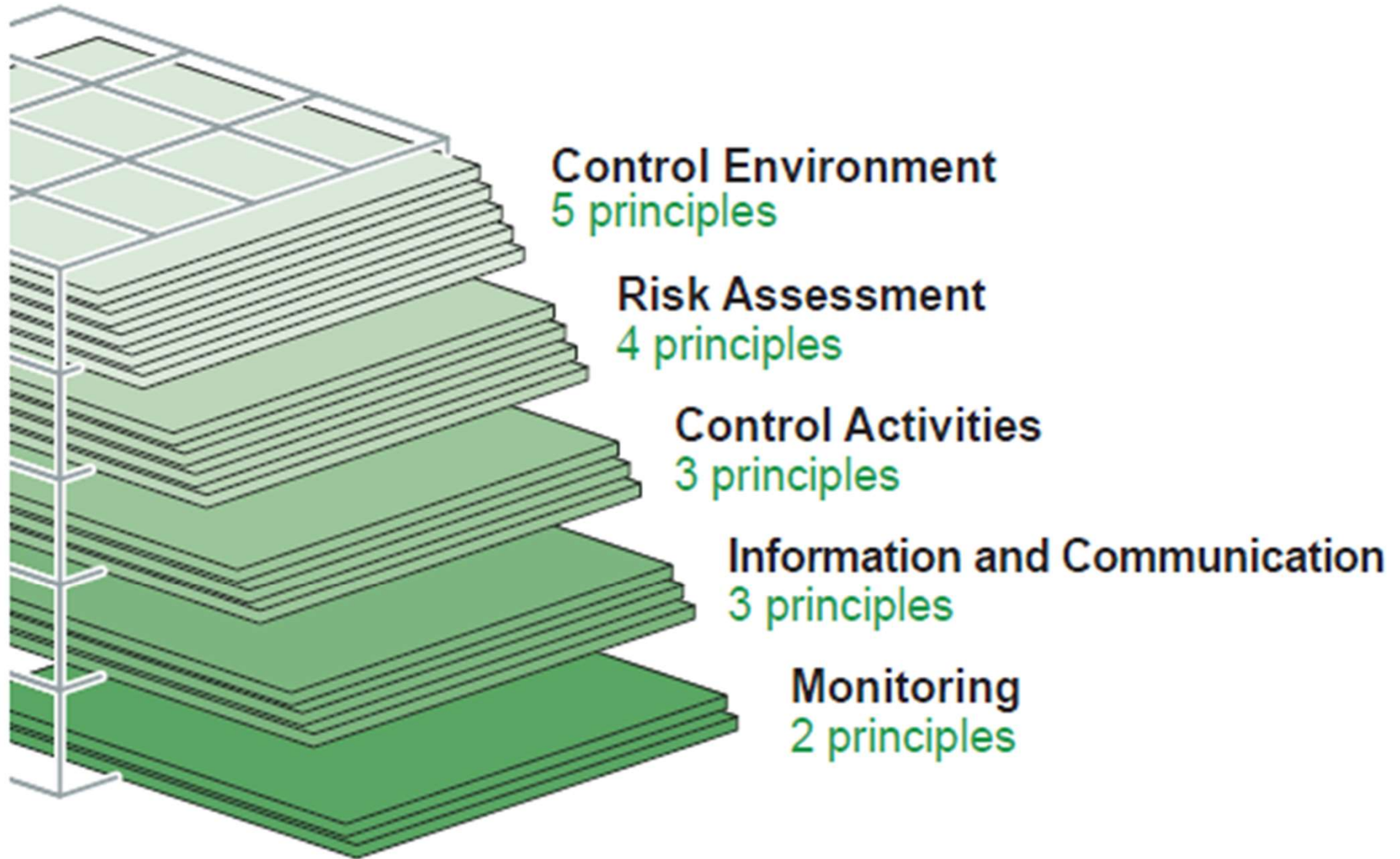
- Laws
- Regulations
- Rules
- Policies

Safeguarding Assets

Controls for Objectives



5 Components & 17 Principles





PRINCIPLES are the requirements of each Component



Each principle has important characteristics, called **ATTRIBUTES**, which explain principles in greater detail



Control Environment

The foundation for an internal control system. It provides discipline and structure to help an entity achieve its objectives.
[OV2.04]



This includes top management's attitude and philosophy regarding internal control.

Control Environment



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

Control Environment

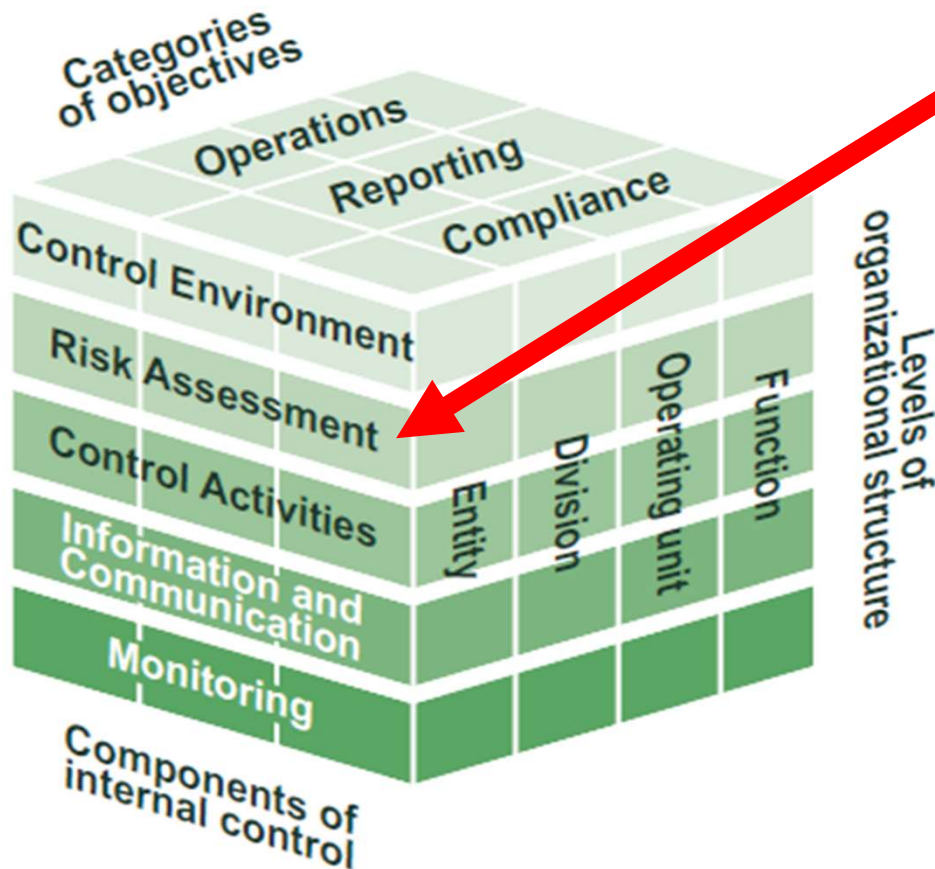
Indicators of an internal control issue / deficiency:



**RED
FLAGS**

- 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.

Risk Assessment



Assesses the risks facing the entity; it seeks to achieve its objectives. This assessment provides the basis for developing appropriate risk responses. [OV2.04]

Risk Assessment



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

Risk Assessment

Indicators of an internal 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.



Risk Assessment (Cont'd)

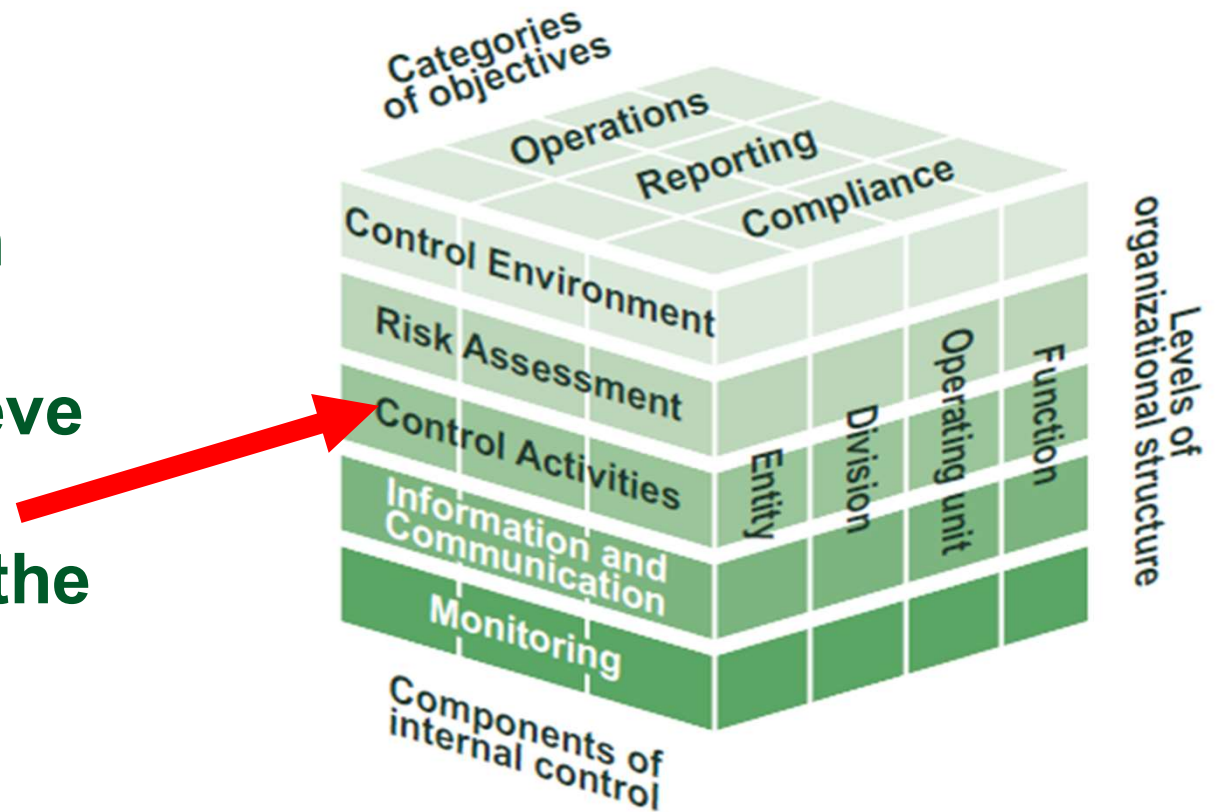
Indicators of an internal control issue / deficiency:

- Undeveloped risk tolerances; agencies unable to design, implement, operationalize, or prioritize anti-fraud controls efficiently or effectively.
- 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.



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. [OV2.04]



Control Activities

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



Control Activities

Indicators of an internal control issue / deficiency, which require further analysis:



**RED
FLAGS**

- 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.

Control Activities (Cont'd)

Indicators of an internal control issue / deficiency, which require further analysis:



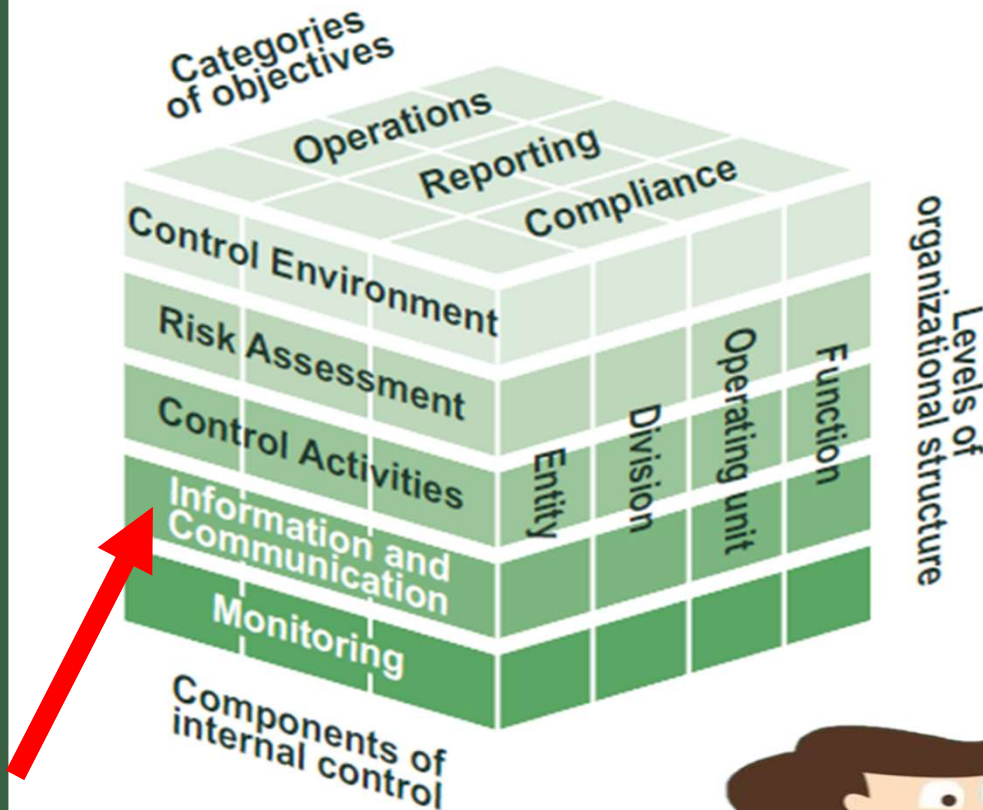
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Control Activities (Cont'd)

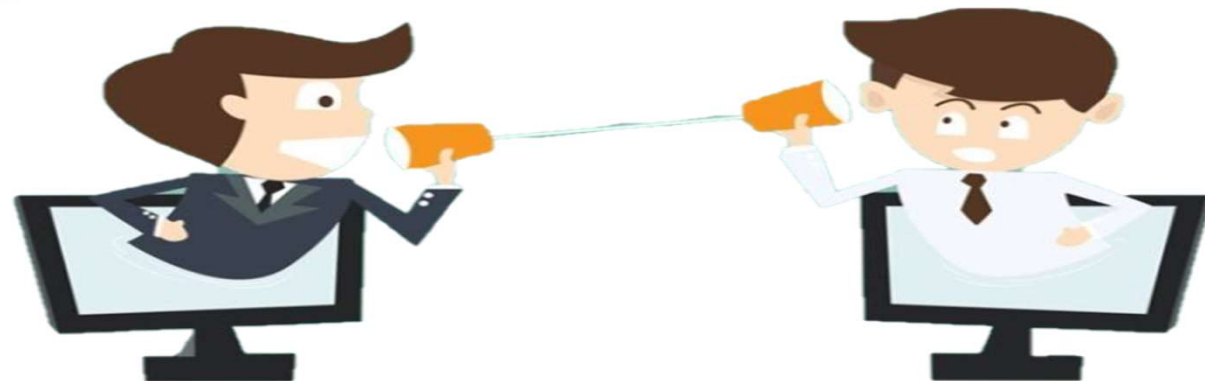
- Segregation of Duties
- Safeguarding of Assets
- Proper Authorization of Transactions
- Proper Documentation



Information & Communication



The quality information management and personnel communicate and use to support the internal control system. [OV2.04]



Information & Communication



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



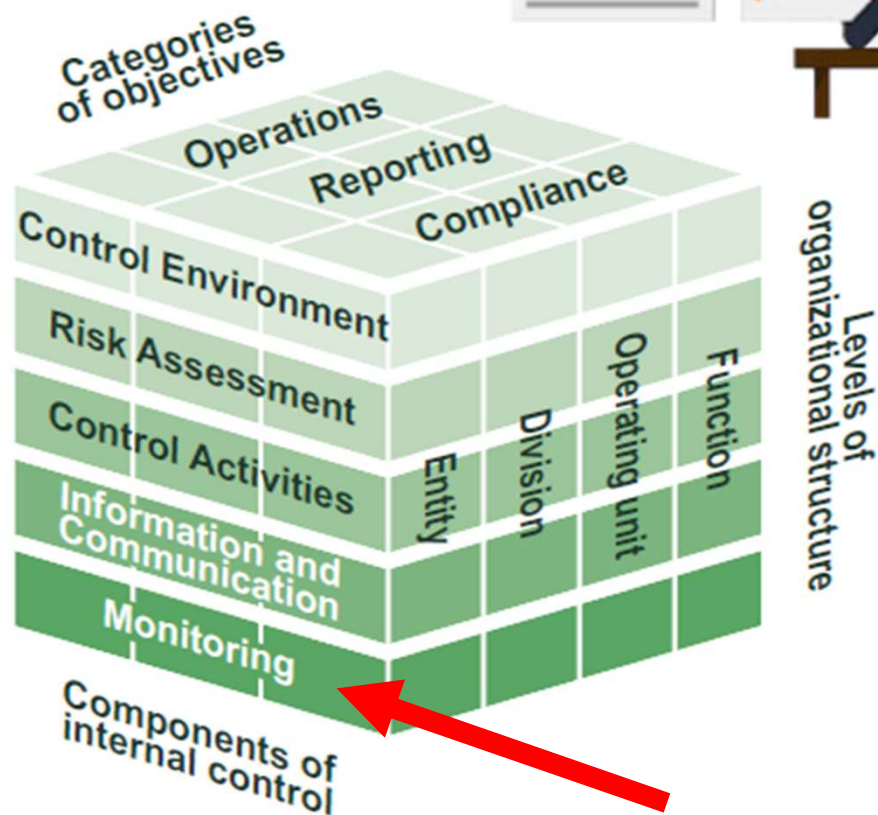
Information & Communication

Indicators of an internal control issue / deficiency:

- 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.



Monitoring



Activities management establishes and operates to assess the quality of performance over time and promptly resolve the findings of audits and other reviews. [OV2.04]

Monitoring

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



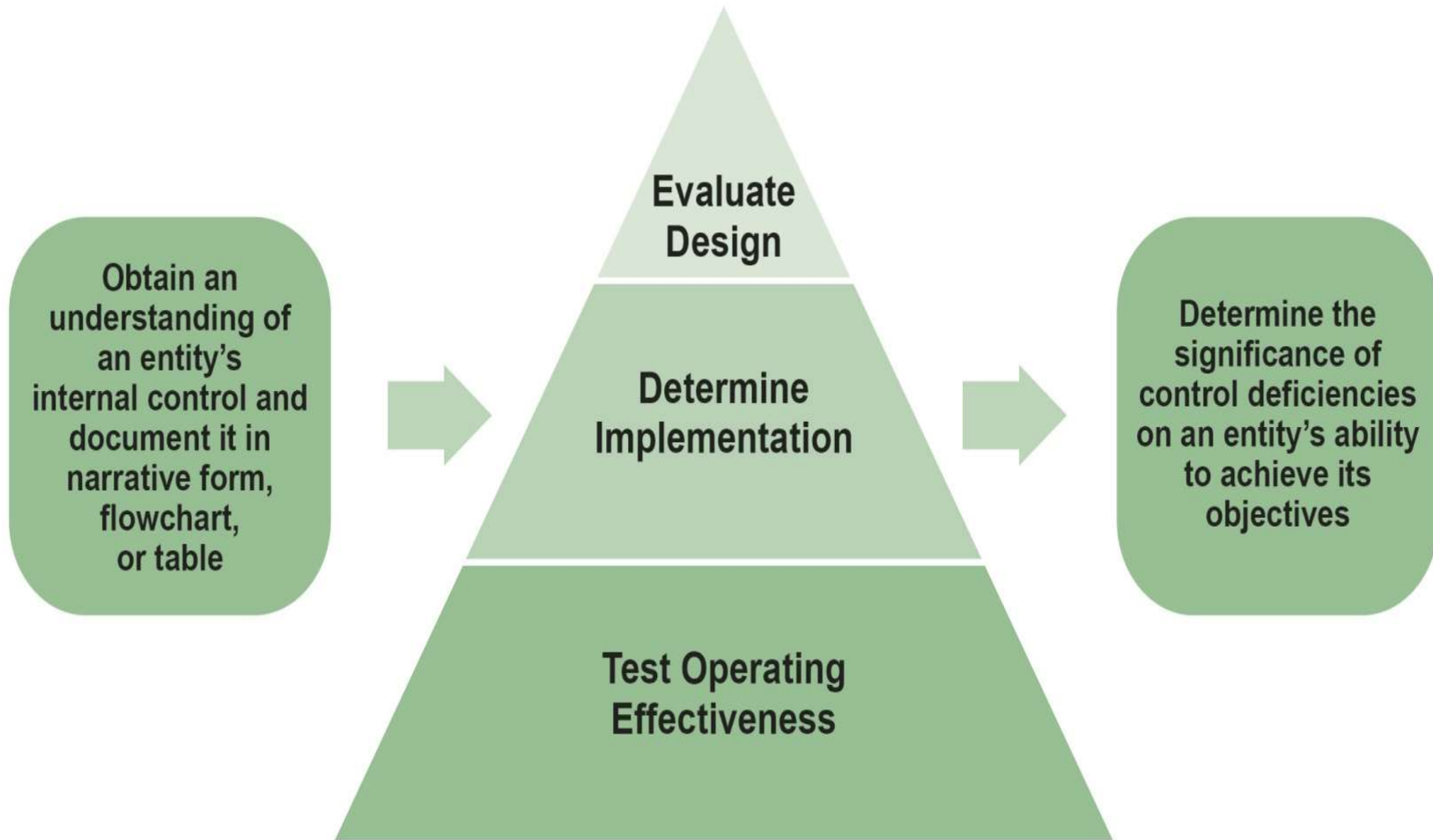
Monitoring

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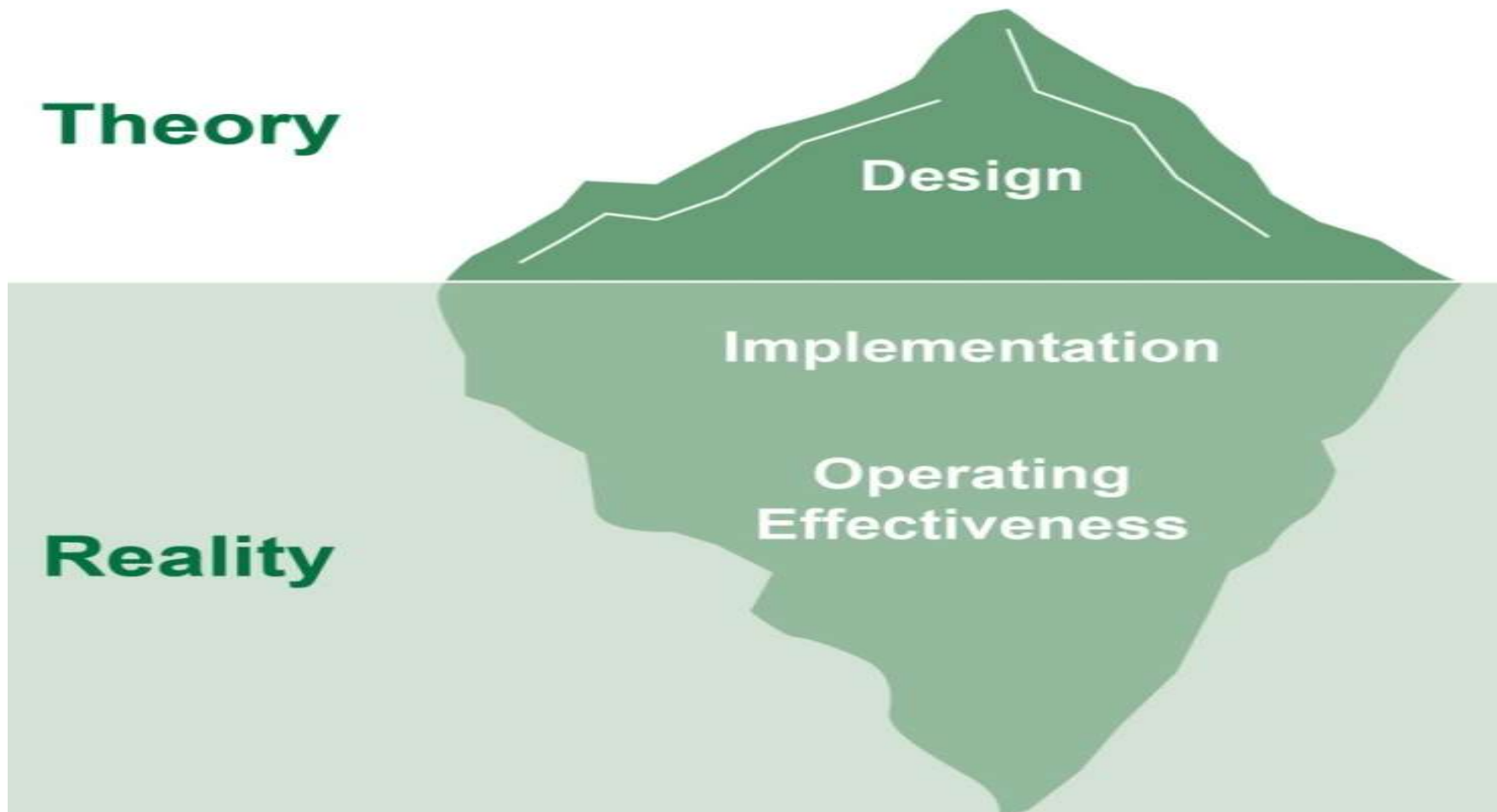
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**RED
FLAGS**



ASSESSING DESIGN, IMPLEMENTATION, AND OPERATIONAL EFFECTIVENESS OF INTERNAL CONTROL



ASSESSING DESIGN, IMPLEMENTATION, AND OPERATIONAL EFFECTIVENESS OF INTERNAL CONTROL

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.)

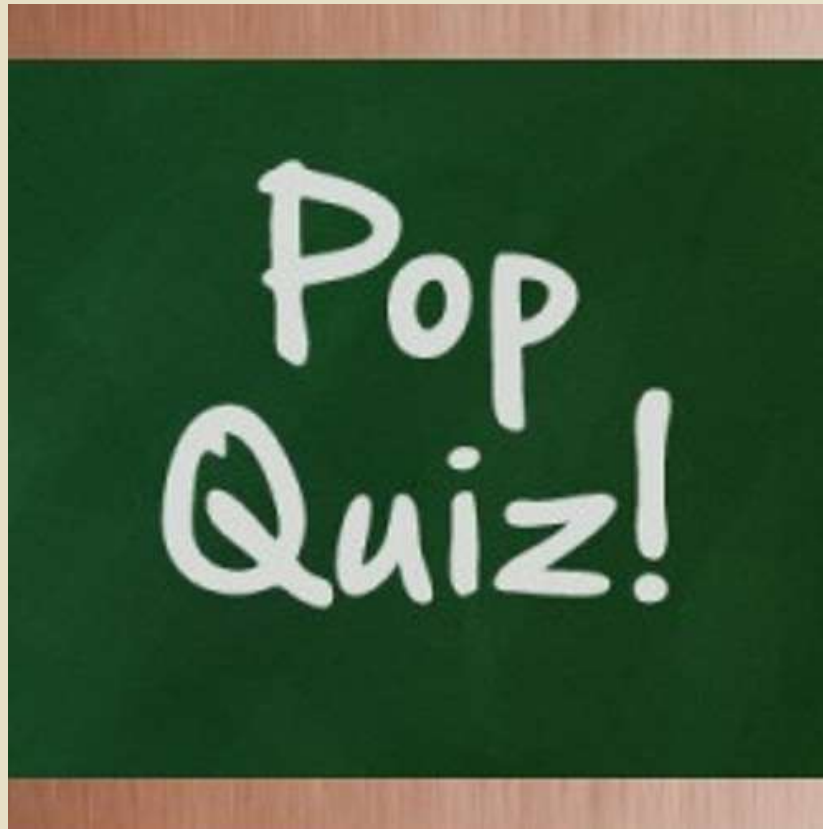
-
- **Evaluating design of controls will not allow you to conclude on internal controls beyond the point of design.**
 - **Determining implementation / operational effectiveness of controls provides reasonable assurance of effective implementation for a point in time when you reviewed documentation / 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. [OV3.06]**

Take a break.

You deserve it!

**10
Minutes**

10 Minute Group Exercise



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What is one Role of Internal Controls?

Prevent and Detect Fraud, Waste, and Abuse

MOTIVE: A reason for doing something. “I don’t make enough money and was injured in an accident.”



OPPORTUNITY: Circumstances that allow fraud to occur. “The office never locks the register, and everyone has access to that room.”



JUSTIFICATION: The individual’s rationalization that it’s okay to commit the fraud or crime. “They don’t pay me enough and they will never know it is missing,” or “I will pay it back next week.”



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.



INTEGRITY

A single lie destroys a whole reputation of integrity.

WHY SHOULD WE CARE?



The plan of organization and all 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.

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.

Internal Control Review



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.

aka "Enterprise-wide Risk Assessment"

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.

- **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.**

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:

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 & 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.





United States Government Accountability Office
By the Comptroller General of the
United States

April 2021

GOVERNMENT AUDITING STANDARDS

2018 Revision

Technical Update April 2021

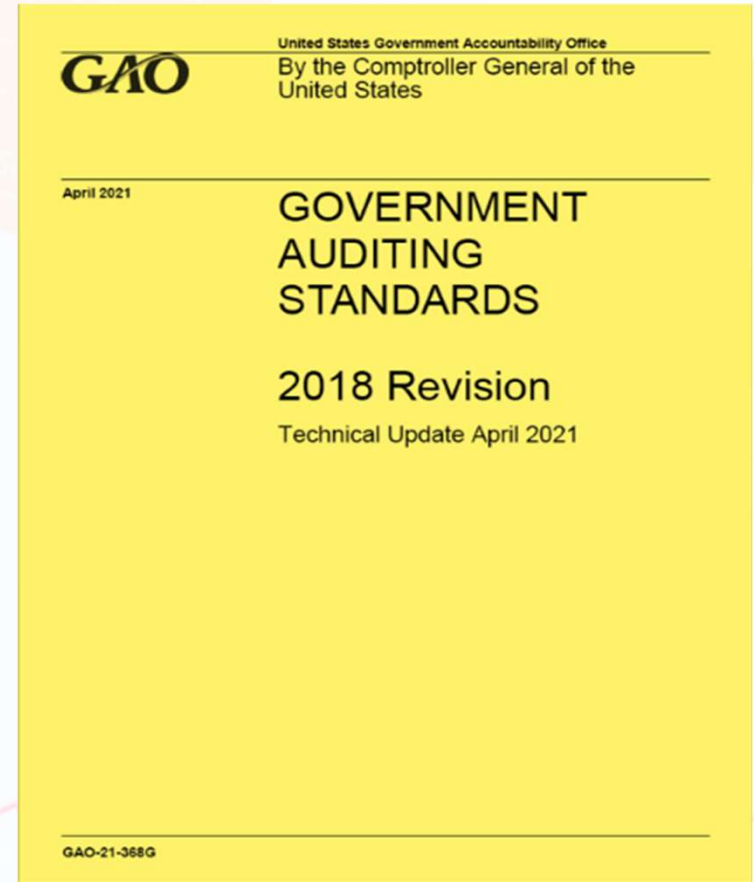
GAO-21-368G

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

GAO

United States Government Accountability Office
By the Comptroller General of the
United States

April 2021

GOVERNMENT
AUDITING
STANDARDS

2018 Revision

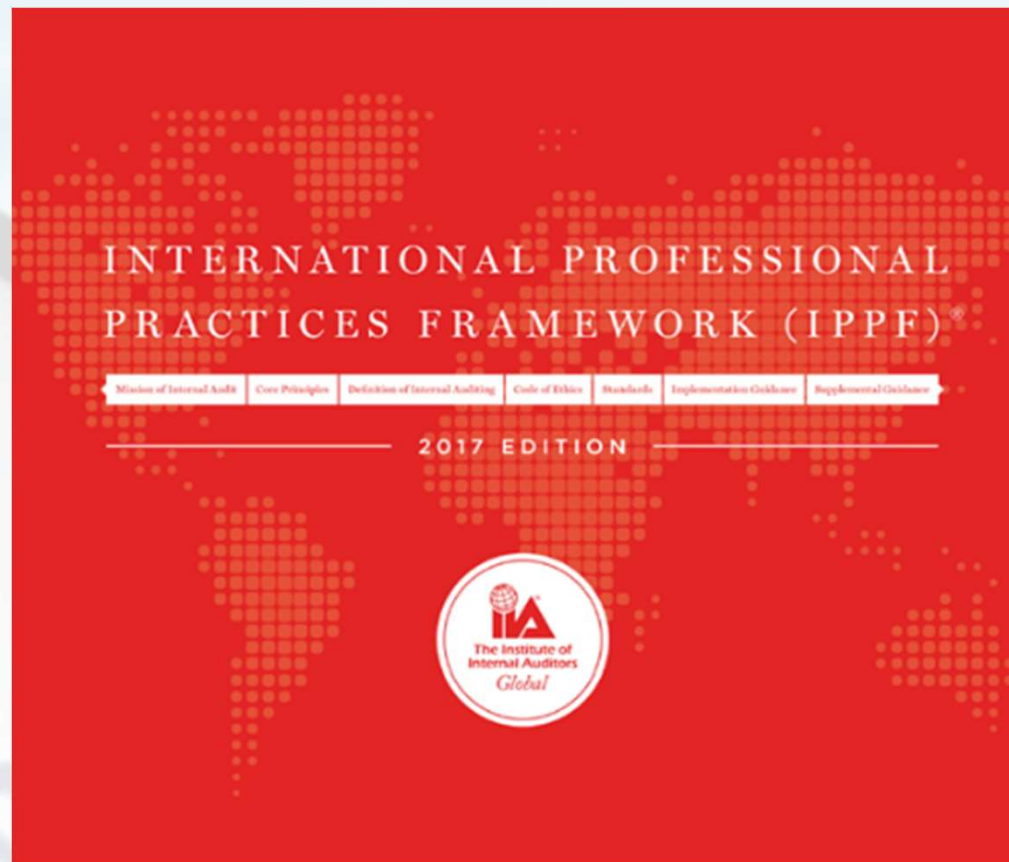
Technical Update April 2021

GAO-21-368G

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)



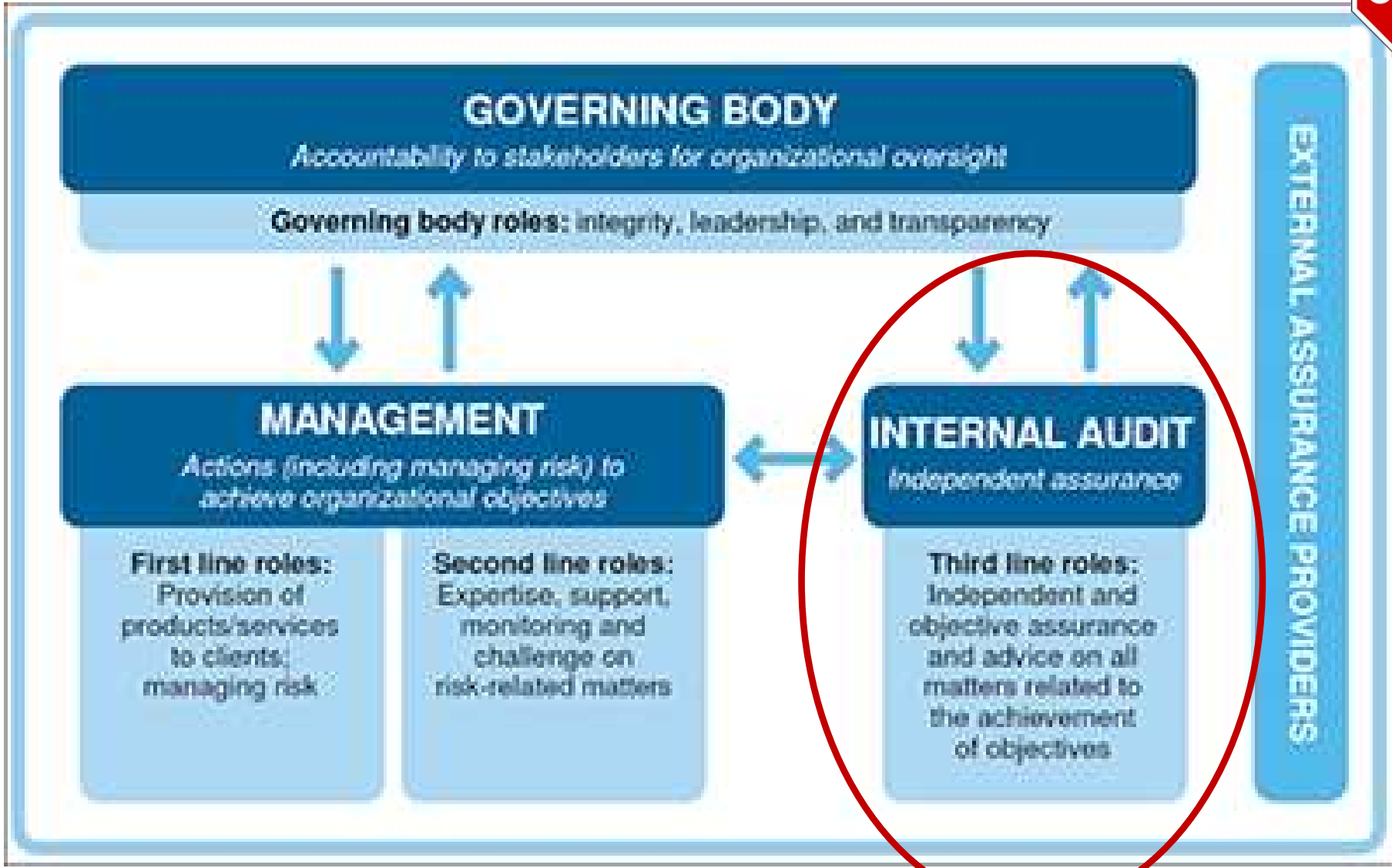
First Line of Defense

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 of Defense



Internal Control Maturity

Built-in component of day-to-day operations



Increases likelihood of achieving objectives



FLASH BACK

- **What are the 5 Components?**
- **What are the 17 Principles?**

**Control
Environment
(5)**

**Risk
Assessment
(4)**

**Control
Activities
(3)**

**Information &
Communication
(3)**

**Monitoring
(2)**

RESOURCES

AIG

<http://inspectorsgeneral.org/>

IIA

www.theiia.org

COSO

www.coso.org

GAO

www.gao.gov



QUESTIONS OR COMMENTS?

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