

2019 Internal Control Training

Ethan Draves, Roni Harlan, & Justin Powell



Agenda

Welcome from the Controller

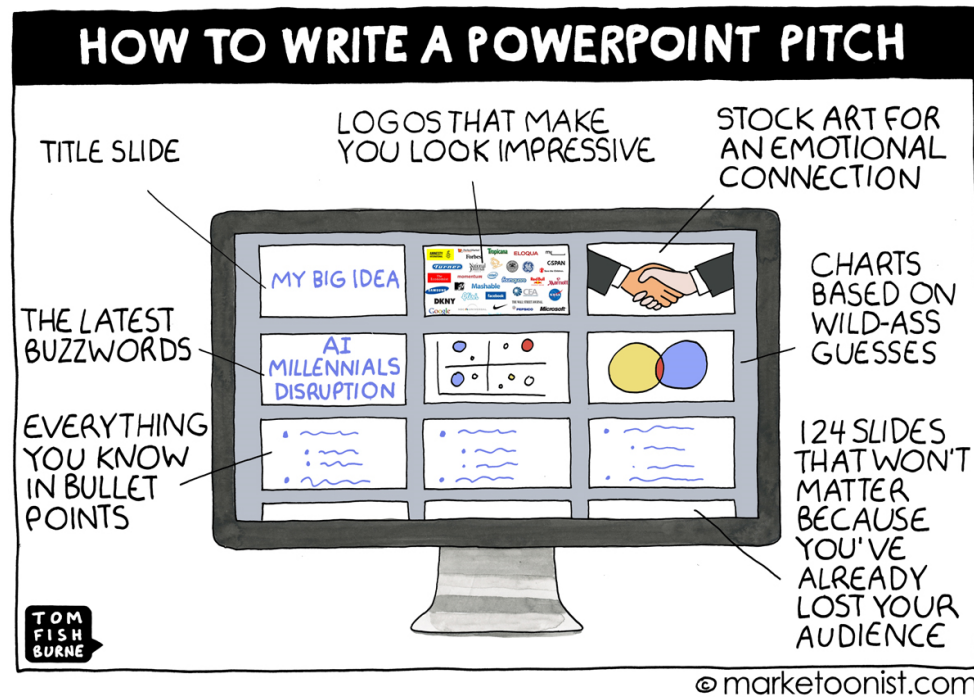
What are Internal Controls and Why are They Important?

The COSO Framework

Control Environment

Monitoring Activities

Questions or comments are welcome!



What are
internal controls?

And why are they
important?

Internal Controls: Mitigate & Eliminate Threats



SCO website – Accounting – Internal Controls

Internal Control Resources

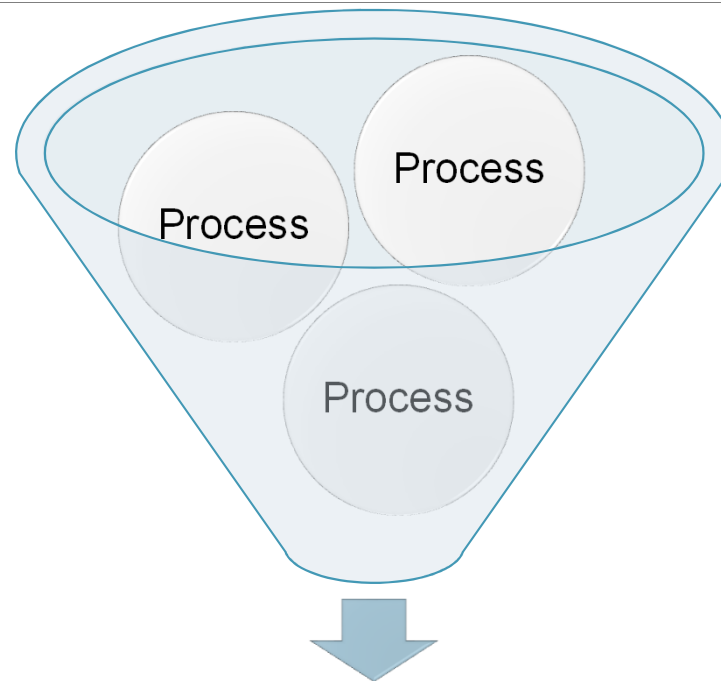
en conducting internal control evaluations within your organizations. Usage of these specific checklists is not ma

File Type	Title	Pub. Date	Size
▼	Internal Controls		
▼	Financial Management Controls Checklists		
	Accounting System (NASACT)	05/17/2013	315k
	Budgets & Planning (NASACT)	05/17/2013	354k
	Buy America Act (NASACT)	05/17/2013	234k
	Capital Assets (NASACT)	05/17/2013	307k
	Cash (NASACT)	05/17/2013	542k
	Civil Rights (NASACT)	05/17/2013	193k
	Control Environment (NASACT)	05/17/2013	297k
	Davis-Bacon Act (NASACT)	05/17/2013	90k
	Drug-Free Workplace (NASACT)	05/17/2013	254k
	Financial Reporting (NASACT)	05/17/2013	447k
	Grant Administration (NASACT)	05/17/2013	1015k
	Investments (NASACT)	05/17/2013	282k
	Payables (NASACT)	05/17/2013	341k
	Personnel & Payroll (NASACT)	05/17/2013	465k
	Receivables (NASACT)	05/17/2013	367k
	Risk Assessment (NASACT)	05/17/2013	253k
▼	Other Internal Control Evaluation Resources		
	AGA Toolkits	05/17/2013	1k
▼	Systems Management Controls Checklists		
	Information Systems & Technology (NASACT)	05/17/2013	679k
	System Interfaces w/ STARS (NASACT)	05/17/2013	231k

Internal Controls Defined

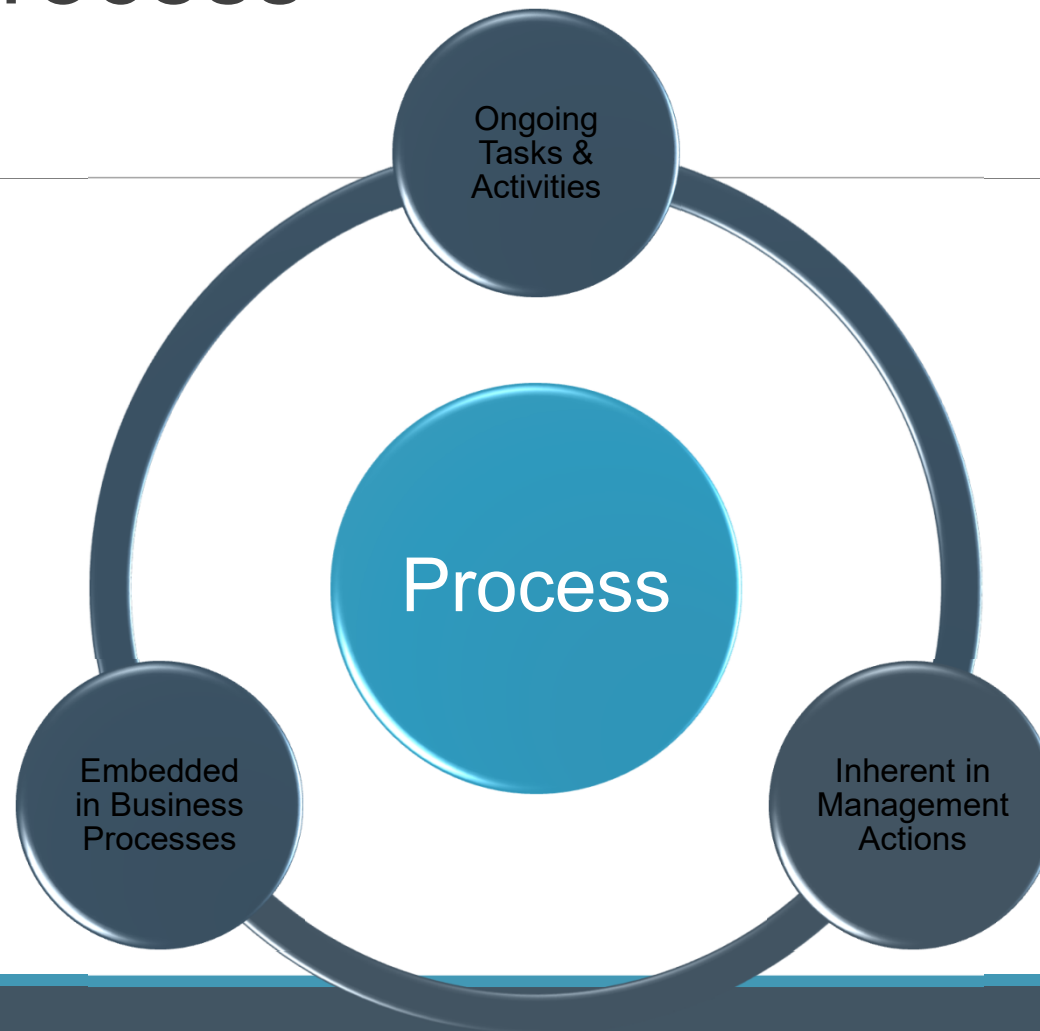
Internal controls is a { *Process* },
effected by { *People* },
designed to provide { *Reasonable* } { *Assurance* }
regarding the achievement of
objectives relating to
{ *Operations* }, { *Reporting* }, and { *Compliance* }.

Process

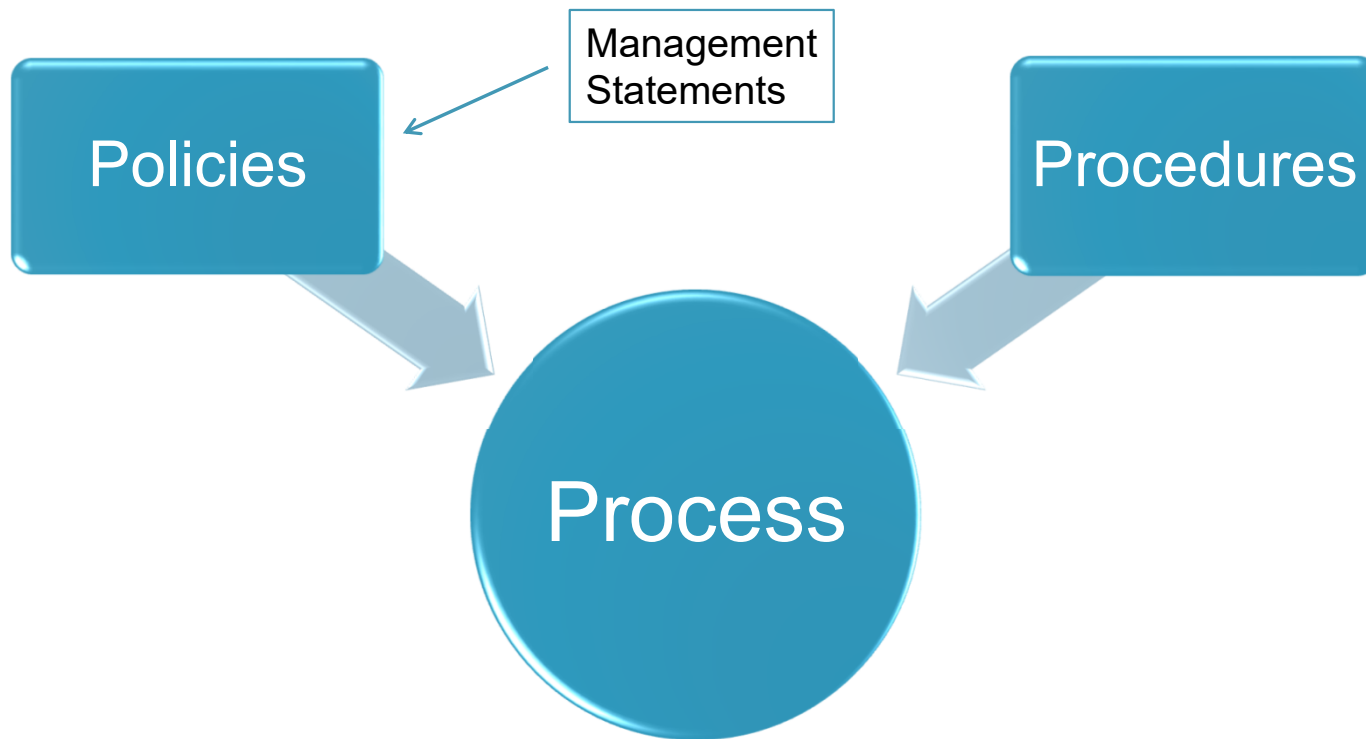


Internal Controls

Process



Process



Effected by People

Director-level

- Provides oversight
- Sets the tone
 - The ethical atmosphere in the workplace created by the organization's leadership

Management implements controls

Other personnel

- Learn responsibilities
- Understand limits of authority



Reasonable Assurance

Reasonable assurance to management

Limitations in all systems

- Human error
- Misjudgment
- External events

Circumvention

- Collusion
- Management overrides

Even effective systems can fail

Objectives of Internal Control



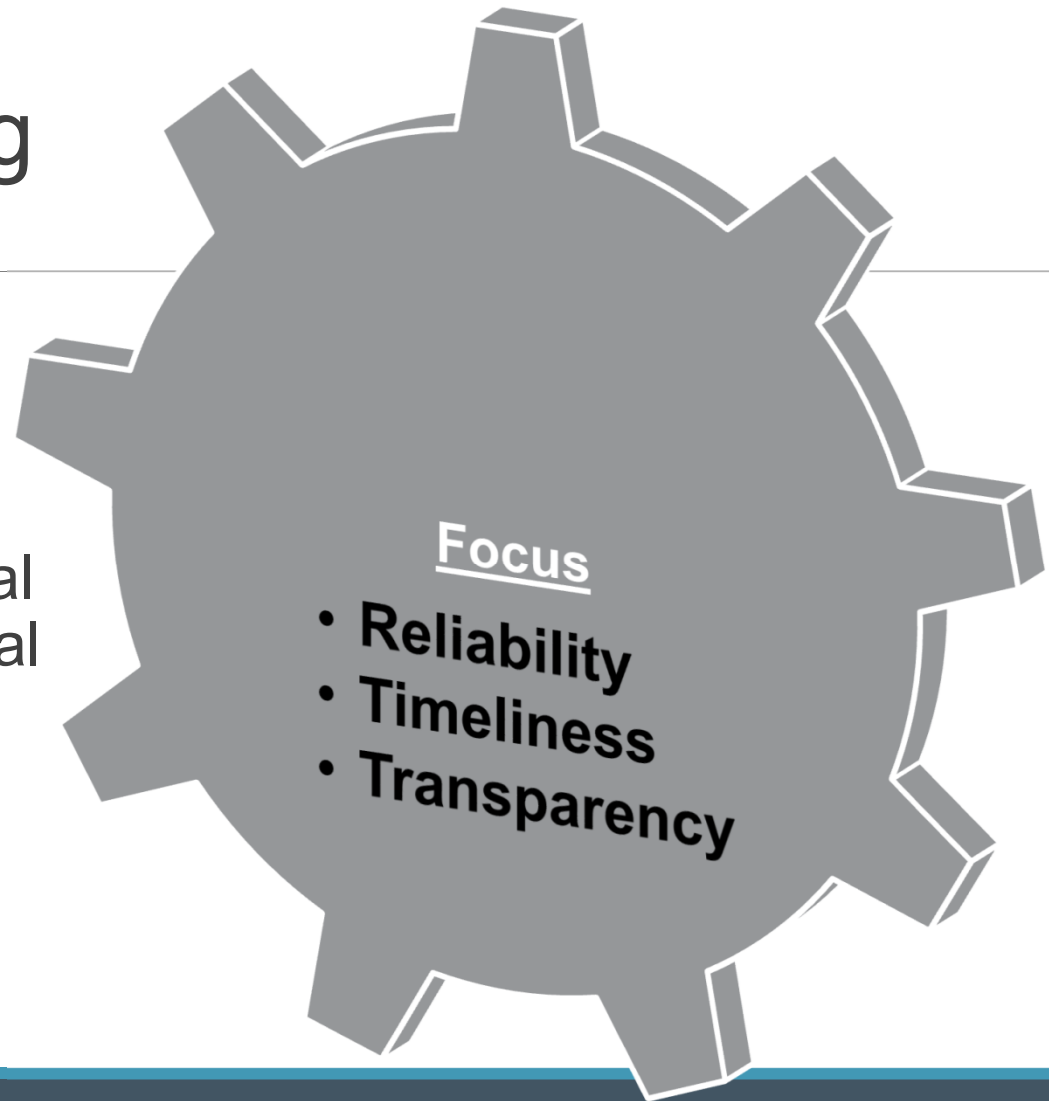
Operations

Relate to the achievement of an organization's basic mission and vision



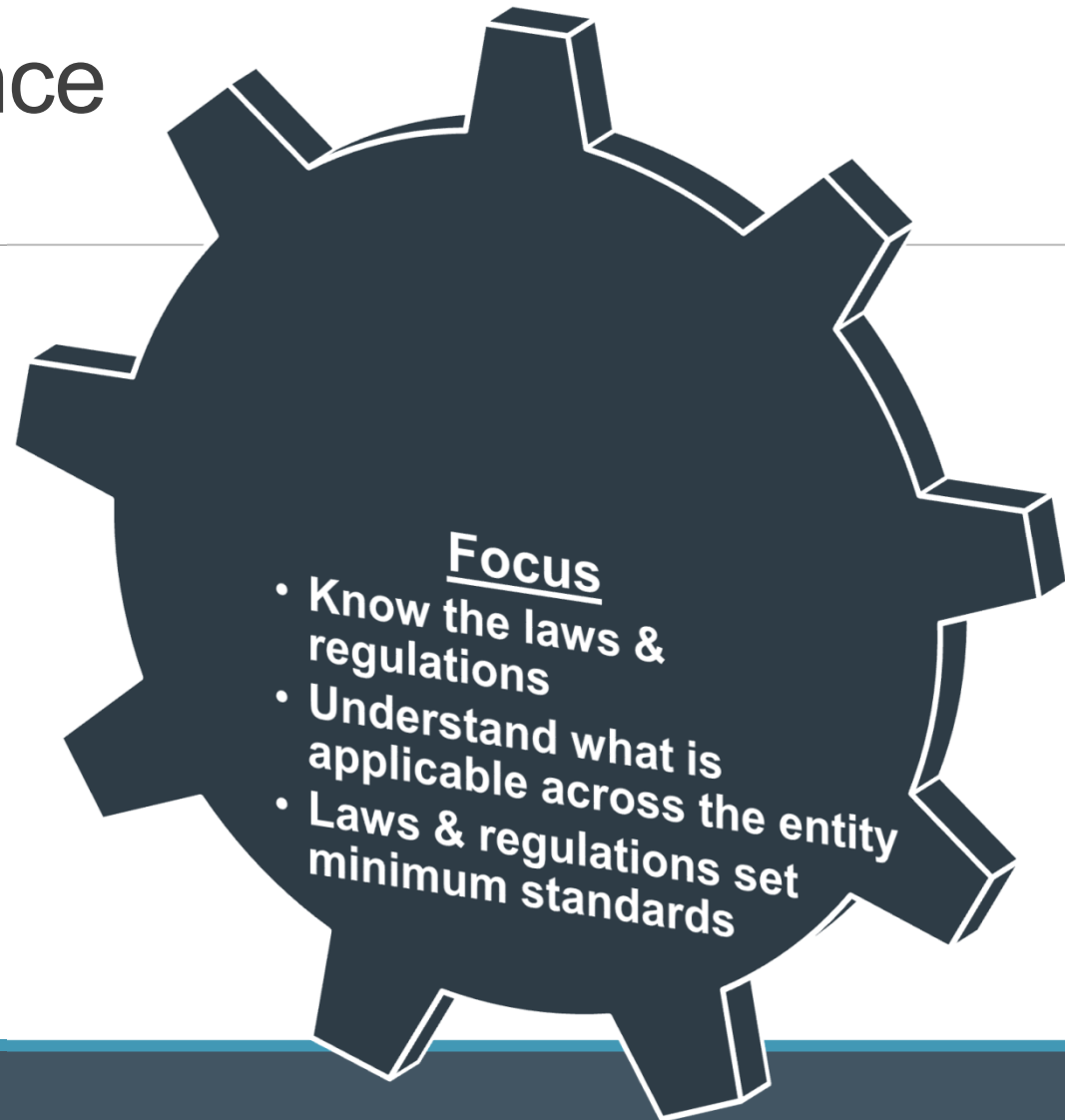
Reporting

Internal and
external financial
and non-financial
reporting



Compliance

Adherence to laws and regulations



Application in Job

Cash or cash-like transactions

Inventory process

Payroll process

Purchase requisition

Sensitive or proprietary information

E-mail

Computer Security Access

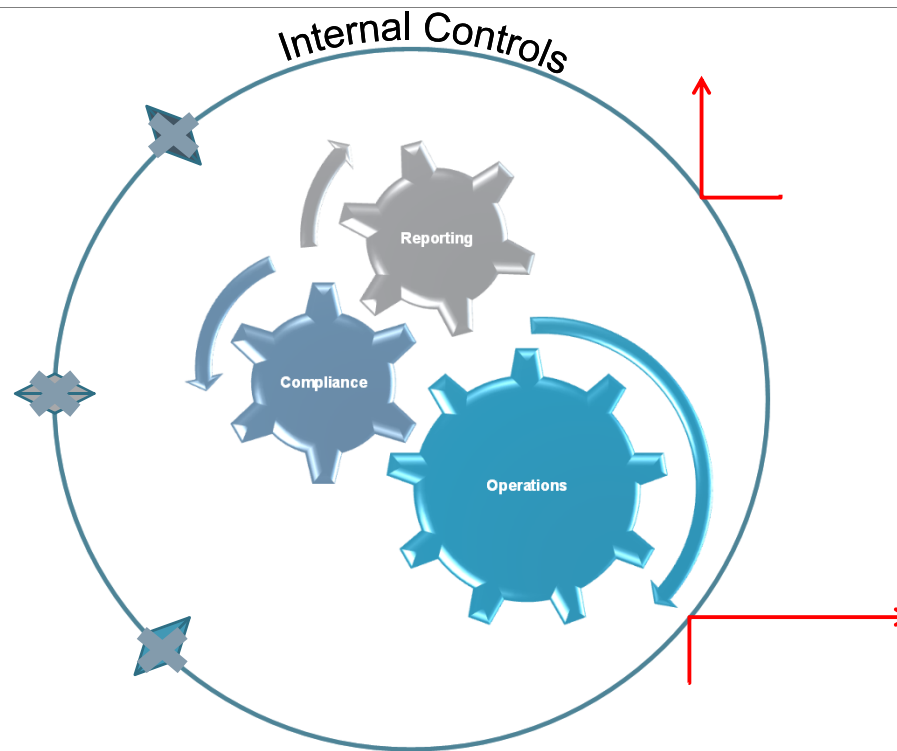
Firewalls

Grants/Federal and State funds

Loan issuance



Bottom Line: Mitigate & Eliminate Threats



The COSO Framework

http://www.coso.org/

 COMMITTEE OF SPONSORING
ORGANIZATIONS OF THE TREADWAY COMMISSION

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ERM Integrated Framework Update

[Learn More](#)

SPONSORING ORGANIZATIONS:

 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

Welcome to COSO

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) is a joint initiative of the five private sector organizations listed on the left and is dedicated to providing thought leadership through the development of frameworks and guidance on enterprise risk management, internal control and fraud deterrence. We hope you will find the information on this site to be helpful and we welcome your input.

2017 ERM Framework Update

The 2017 update to the *Enterprise Risk Management — Integrated Framework* addresses the evolution of enterprise risk management and the need for organizations to improve their approach to managing risk to meet the demands of an evolving business environment. The updated document, *Enterprise Risk Management — Integrating with Strategy and Performance*, highlights the importance of considering risk in both the strategy-setting process and in driving performance. For more information or to purchase the updated *Framework*, [click here](#).



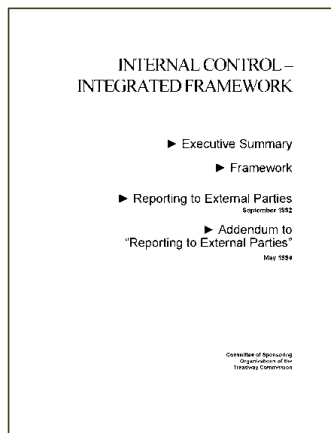
HOW TO PURCHASE

University Professor/Student Discounts

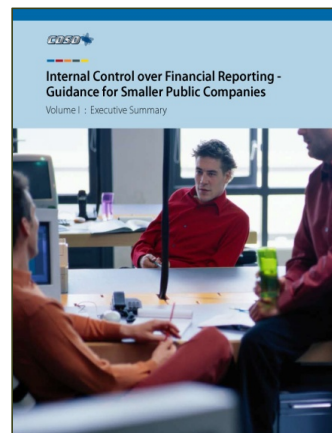
For information on discounts available to qualified university professors and their students, please contact Joanna Dabrowska at jdabrow1@depaul.edu.

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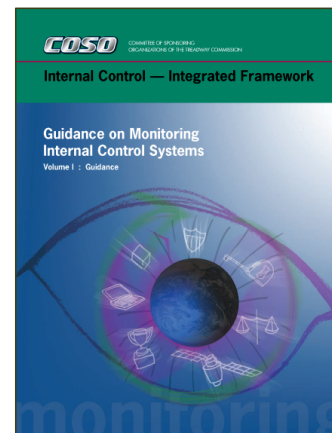
COSO Internal Control Publications



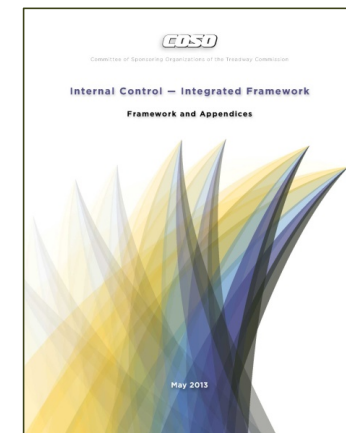
1992



2006



2009



2013

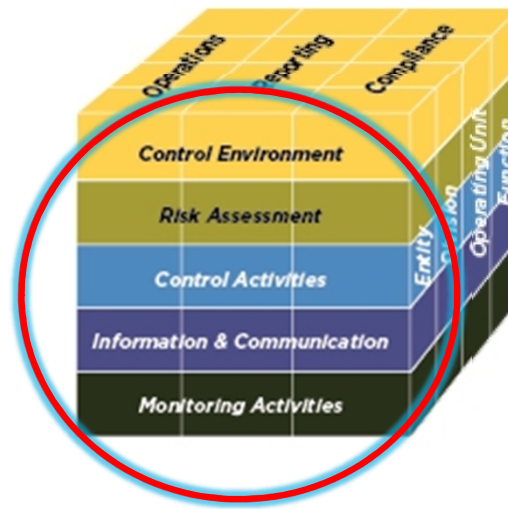
COSO Framework

- Framework consists of:
 - Objectives
 - ✦ Operations
 - ✦ Reporting
 - ✦ Compliance



COSO Framework

- Framework consists of:
 - Objectives
 - Components
 - ✦ Control Environment
 - ✦ Risk Assessment
 - ✦ Control Activities
 - ✦ Information & Communication
 - ✦ Monitoring Activities



COSO Framework

- Framework consists of:

- Objectives
- Components
- Entity Structure
 - ✧ Entity
 - ✧ Division
 - ✧ Operating Unit
 - ✧ Function



COSO 17 Principles

Control Environment

- Demonstrate Commitment to Integrity and Ethical Values
- Exercise Oversight Responsibility
- Establish Structure, Authority, and Responsibility
- Commitment to Competence
- Enforce Accountability

Risk Assessment

- Specify Suitable Objectives
- Identify and Analyze Risks
- Assess Fraud Risk
- Identify and Analyze Significant Change

Control Activities

- Select and Develop Control Activities
- Select and Develop General Controls over Technology
- Deploy through Policy and Procedures

Information and Communication

- Use Relevant Information
- Communicate Internally
- Communicate Externally

Monitoring Activities

- Conduct Ongoing and/or Separate Evaluations
- Evaluates and Communicates Deficiencies

Effective Internal Controls

- Adherence to Policies and Procedures
- Judgment
 - How much?
 - Which controls?
 - How effective are the internal controls?
- Internal control components and principles
- Risk Management
 - Need strong internal control environment

Common Threats to Good Judgement

- Rush to Solve
- Overconfidence
- Confirmation
- Anchoring
- Availability



Review Questions

1 - 3

Review Question #1

Internal Controls eliminate all threats to an organization

- a) True
- b) False

Review Question #2

Which departments are involved in internal controls

- a) Accounting
- b) Administration
- c) Information Technology
- d) All of the Above

Review Question #3

External auditors are considered part of the in the internal control system

- a) True
- b) False

3 Lines of Defense

<https://www.coso.org/Documents/COSO-2015-3LOD.pdf>



1st Line

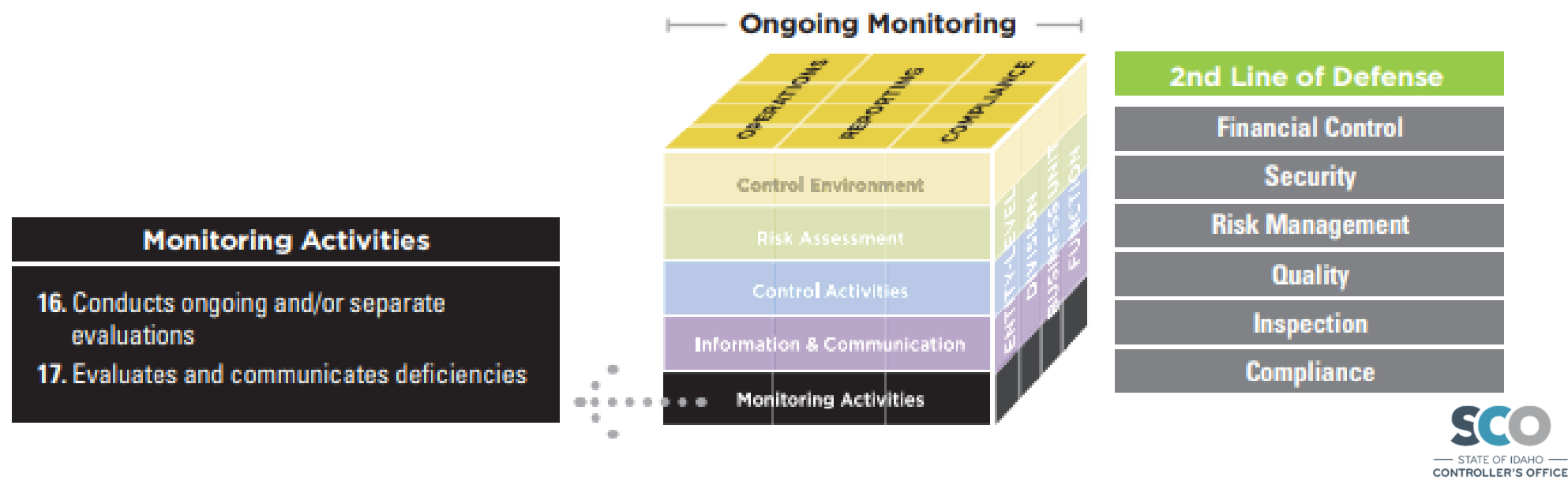
Figure 4. COSO and the 1st Line of Defense

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 IT 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



2nd Line

Figure 5. COSO and the 2nd Line of Defense



3rd Line

Figure 6. COSO and the 3rd Line of Defense

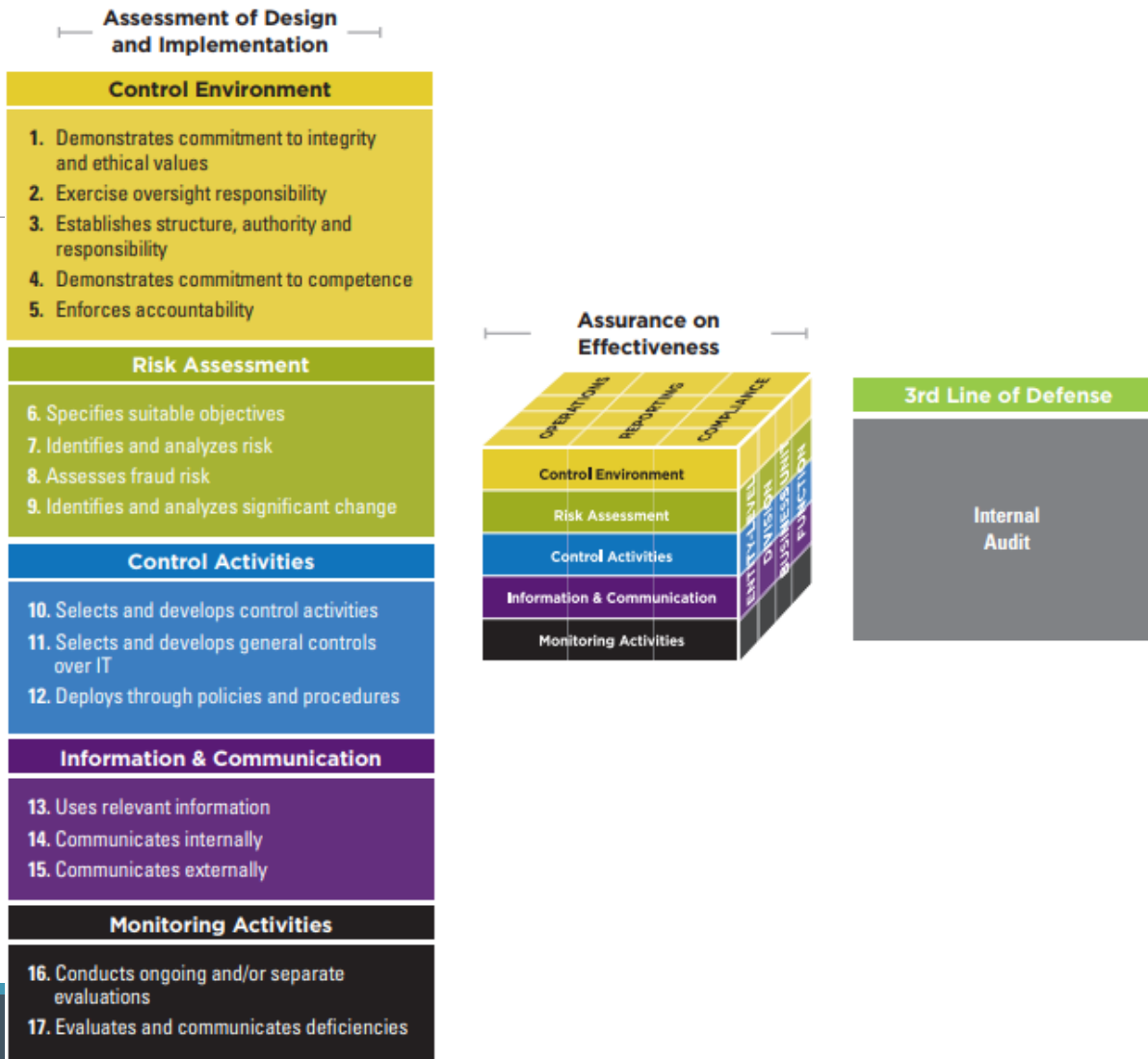


Figure 7. Differences Between the Three Lines of Defense

Management Functions		Assurance
1st Line of Defense	2nd Line of Defense	3rd Line of Defense
Operating Management	Limited Independence Reports Primarily to Management	Internal Audit Greater Independence Reports to Governing Body

Small Offices

Two-person office

Clerk/Administrative Employee	Executive Director/Chief Executive
<ul style="list-style-type: none"> ✧ Write checks ✧ Mail checks ✧ Receive cash ✧ Reconcile bank statements ✧ Disburse petty cash ✧ Record accounts receivable and general ledger entries ✧ Approve payroll ✧ Authorize purchase orders ✧ Authorize check requests ✧ Authorize invoices for payment 	<ul style="list-style-type: none"> ✧ Sign checks ✧ Complete deposit slips ✧ Review bank reconciliations ✧ Perform inter-bank transfer ✧ Reconcile petty cash ✧ Process vendor invoices ✧ Approve employee timesheets ✧ Distribute payroll

Three-person office

Bookkeeper	Clerk/Admin Assistant	Executive Director/Chief Executive
<ul style="list-style-type: none"> ✧ Write checks ✧ Record accounts receivable entries and general ledger journal entries ✧ Reconcile petty cash ✧ Record general ledger entries ✧ Reconcile bank statements 	<ul style="list-style-type: none"> ✧ Authorize purchase orders ✧ Approve and process vendor invoices ✧ Disburse petty cash ✧ Receive cash ✧ Mail checks ✧ Authorize employee timesheets ✧ Approve payroll ✧ Distribute payroll 	<ul style="list-style-type: none"> ✧ Sign checks ✧ Complete deposit slips ✧ Review bank reconciliations ✧ Perform inter-bank transfers

Four-person Office

Bookkeeper	Clerk	Office Manager	Executive Director/Chief Executive
<ul style="list-style-type: none"> ✧ Write checks ✧ Reconcile petty cash ✧ Reconcile bank statements ✧ Record accounts receivable entries ✧ Record general ledger entries 	<ul style="list-style-type: none"> ✧ Receive cash ✧ Disburse petty cash ✧ Authorize purchase orders ✧ Authorize check requests ✧ Mail checks ✧ Distribute payroll 	<ul style="list-style-type: none"> ✧ Complete deposit slips ✧ Process vendor invoices ✧ Approve payroll 	<ul style="list-style-type: none"> ✧ Sign checks ✧ Review bank reconciliations ✧ Perform inter-bank transfers ✧ Approve employee timesheets

Review Questions

4 - 5

Review Question #4

There are 3 lines of defense?

- a) True
- b) False

Review Question #5

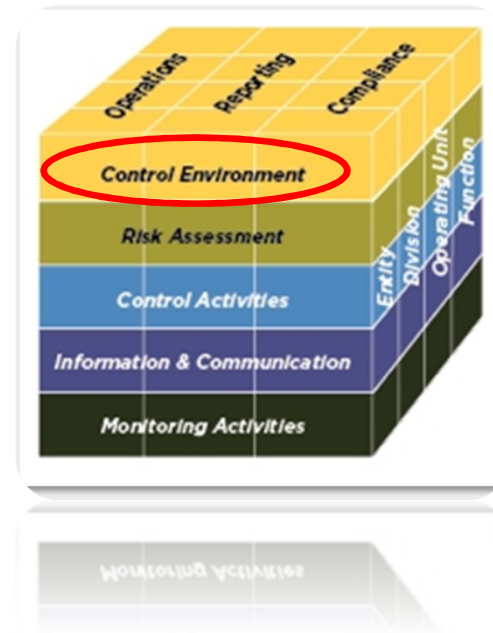
Which is a common threat to good judgement?

- a) Overconfidence
- b) Confirmation
- c) Availability
- d) All of the Above

10 Minute Break!

Control Environment

Is the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization.



Principle 1

“DEMONSTRATES COMMITMENT TO INTEGRITY AND ETHICAL VALUES.”

Principle 1

Demonstrates commitment to integrity and ethical values

- Set the tone at the top
- Establish standards of conduct
- Evaluate adherence to the standards of conduct
- Address deviations in a timely manner



Principle 2

“EXERCISES OVERSIGHT RESPONSIBILITY.”

Principle 2

Exercises Oversight Responsibility

- Establish oversight responsibilities
- Apply relevant expertise
- Operate independently
- Provide oversight for the system of internal controls



Principle 3

“MANAGEMENT ESTABLISHES STRUCTURES, REPORTING LINES, AND APPROPRIATE AUTHORITIES AND RESPONSIBILITIES IN THE PURSUIT OF AN OBJECTIVE.”

Principle 3

Management establishes structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of an objective

- Consider all structures of the entity
- Establish reporting lines
- Define, assign, and limit authorities and responsibilities

Principle 4

“THE ORGANIZATION DEMONSTRATES A COMMITMENT TO ATTRACT, DEVELOP, AND RETAIN COMPETENT INDIVIDUALS IN ALIGNMENT WITH OBJECTIVES.”

Principle 4

The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives

- Establish policies and practices
- Evaluate competence and address short comings
- Attract, develop, and retain individuals
- Plan and prepare for succession

Principle 5

“THE ORGANIZATION HOLDS INDIVIDUALS ACCOUNTABLE FOR THEIR INTERNAL CONTROL RESPONSIBILITIES IN THE PURSUIT OF OBJECTIVES.”

Principle 5

The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives

- Establish accountability through structures, authorities, and responsibilities
- Establish performance measures, incentives, and rewards
- Evaluate performance measures, incentives, and rewards for ongoing relevance

CONTROL ENVIRONMENT

<i>Major Control Weaknesses at WorldCom</i>	<i>Corresponding Fraud Exposure</i>
<p>Extreme Pressure on Top Management Self-induced pressure on top management (CEO: "Our goal is not to capture market share or be global, our goal is to be the No. 1 stock on Wall Street."), but obviously also extreme pressure from investors, analysts, banks, other stakeholders, and Wall Street. Also, private pressure on top management, for example, on CEO Ebbers by banks (citing margin calls from the bank because WorldCom's stock was half its all-time high).</p>	<p>Fraud risk increases if: Extreme or unrealistic business targets are combined with overblown bonus schemes (for example, 20 percent fixed, 80 percent variable salary, or huge number of stock options), which might possibly motivate management to do something to reach corporate targets and personal bonuses. Pressure is one of the three fraud drivers in the well-known Fraud Triangle.</p>
<p>Top-down Pressure on Employees Top management thrust pressure on employees by exploiting their trust and loyalty. To hit the numbers, top management asked employees to wrongly record journal entries, explaining the company must be saved or saying that irregular entries would be a one-time occurrence and in the next quarter everything would be OK.</p>	<p>Fraud risk increases if:</p> <ul style="list-style-type: none"> • Management forwards pressure top-down. (Manager to internal accountant: "Use any accounts that would make the current quarter's expenses look like the prior quarter's expenses.") • Employees are indirectly or even directly forced by management into misconduct.
<p>No Whistle-blower Process Implemented Employees, business partners or other stakeholders of former WorldCom didn't have the possibility to report questionable findings because there was no whistle-blower function. (According to SOX Section 301, that's now mandatory.) Neither an internal process nor an external ethics hotline existed. Also, the audit committee didn't effectively support internal auditors during their detection of irregular accounting entries.</p>	<p>Fraud risk increases if: There's no independent, neutral, and formal mechanism for reporting questionable matters because statistics prove that companies experience lower losses due to fraud when they organize a whistle-blower function the No.1 detection method for fraud is anonymous tipoffs.</p>
<p>Rapid Growth by Acquisition Within two decades, WorldCom grew from a local telecom provider to a global player with \$38 billion annual revenue and 70 acquisitions in more than 65 countries.</p>	<p>Fraud risk increases, if:</p> <ul style="list-style-type: none"> • An organizational structure is difficult to manage. • Anonymity, demotivation and fear (especially in newly acquired companies) exist. • Comparability of reported data is limited.

Review Questions

6 - 10

Review Question #6

Which of the following is NOT part of the (5) components of the COSO framework:

- a) Monitoring
- b) Transparency
- c) Risk Assessment
- d) Control Environment

Review Question #7

True or False, organizational culture is influenced by the control environment and other components of internal control, and vice versa.

- a) True
- b) False

Review Question #8

The way the people in a company, organization etc are organized, with particular people managing other people is called:

- a) Monitoring
- b) Control Environment
- c) Reporting lines
- d) Micromanaging

Review Question #9

This is defined by the standards, processes, and structures that guide people at all levels in carrying out their responsibilities for internal control and making decision.

- a) Tone at the top
- b) Monitoring
- c) Control Environment
- d) COSO

Review Question #10

_____ is the qualification to carry out assigned responsibilities. It requires relevant skills and expertise, which are gained largely from professional experience, training and certifications.

- a) Competence
- b) Due diligence
- c) Risk assessment
- d) Tone at the top

Monitoring Activities



"I accept. But there may be some monitoring for quality assurance."

What are Monitoring Activities?

- Monitoring activities assess whether each of the five components of internal control and relevant principles are present and operating efficiently.
- Monitoring can be done through ongoing evaluations, separate evaluations, or some combination of the two.



Kevin had a funny feeling that his boss was monitoring his emails

Why do we perform Monitoring Activities?

- To identify and correct internal control problems on a timely basis
- To produce more accurate and reliable information for use in decision-making
- To prepare accurate and timely financial statements
- To be in a position to provide periodic certifications or assertions on the effectiveness of internal control.



How are Monitoring Activities performed?

Ongoing evaluations:

- Generally defined, routine operations, built into business processes and performed on a real-time basis

Separate evaluations:

- Should be conducted periodically by objective management personnel, internal audit, and/or external parties



Elements

Establishing a foundation

- Proper tone at the top
- Effective organizational structure
- Starting point/baseline



Elements

Designing and executing procedures

- Persuasive information



**"Welcome to the Weight Loss Forum.
To lose one pound, double-click
your mouse six million times."**

Elements

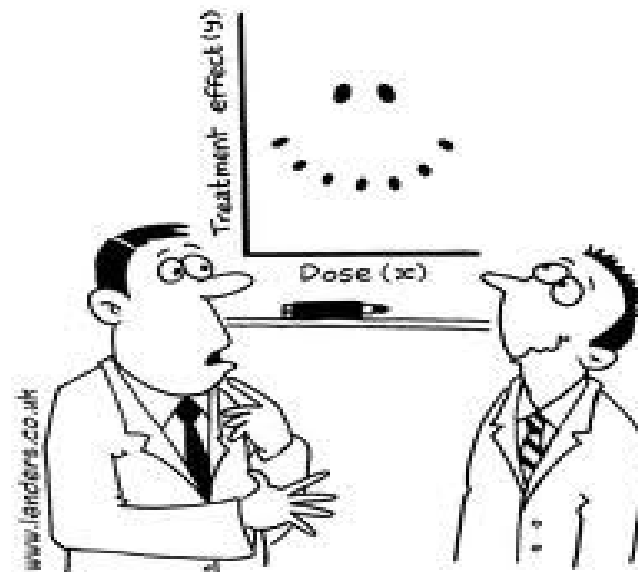
Assessing and reporting results

- Evaluating identified deficiencies
- Reporting results



Detecting and Preventing Fraud with Data Analytics

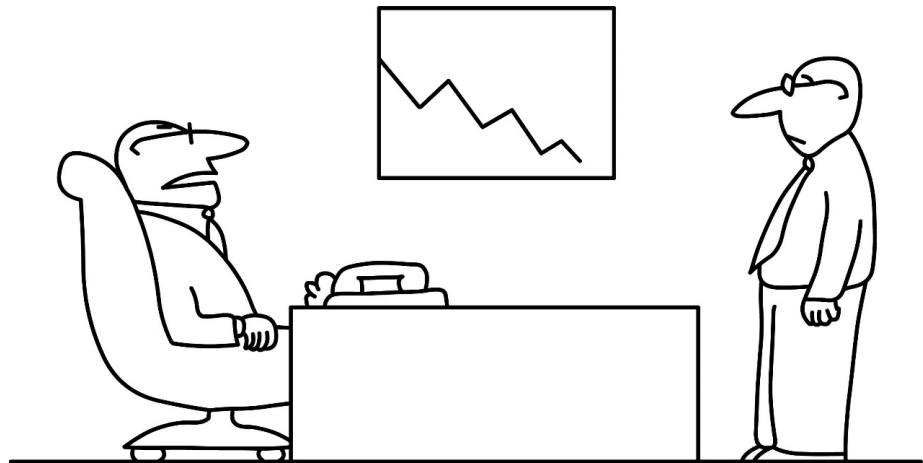
- Are internal controls enough?
- How can we use data analysis?



"It's a non-linear pattern with outliers.....but for some reason I'm very happy with the data."

Detecting and Preventing Fraud with Data Analytics

- Fraud Monitoring Plan
 - Define objectives
 - Define indicators
 - Identify required data sources
 - Obtain and safeguard data
 - Determine extent of reliance
 - Test the integrity
 - Describe analytics tests



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"It would appear, Hopkins, that your gut feel was only indigestion"

Analytical Procedures

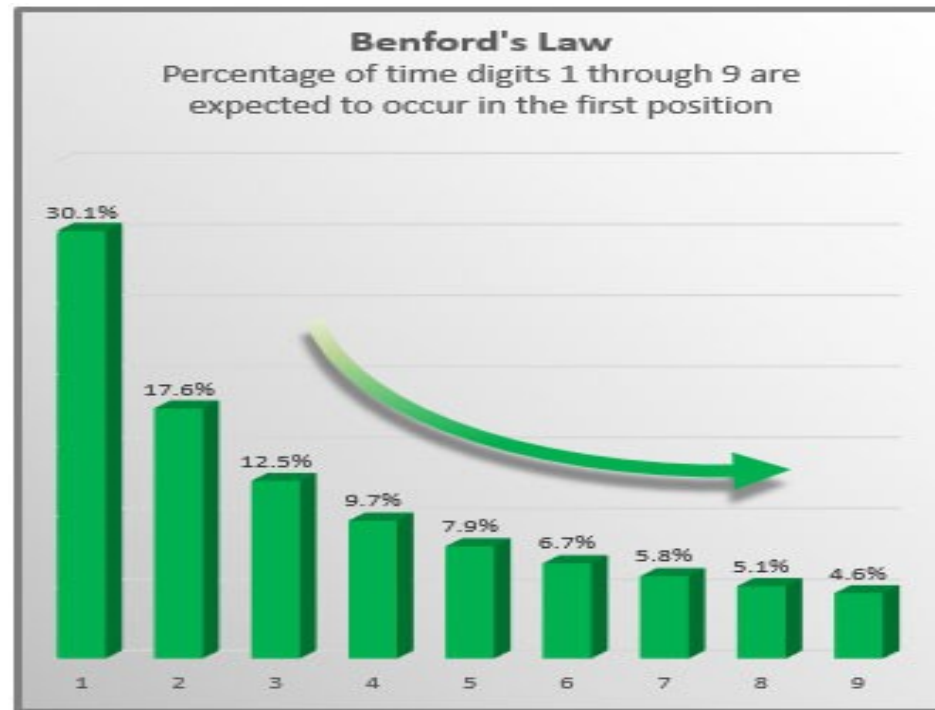
- Repetitive or Continuous Analysis



**“Let’s shrink Big Data into Small Data ...
and hope it magically becomes Great Data.”**

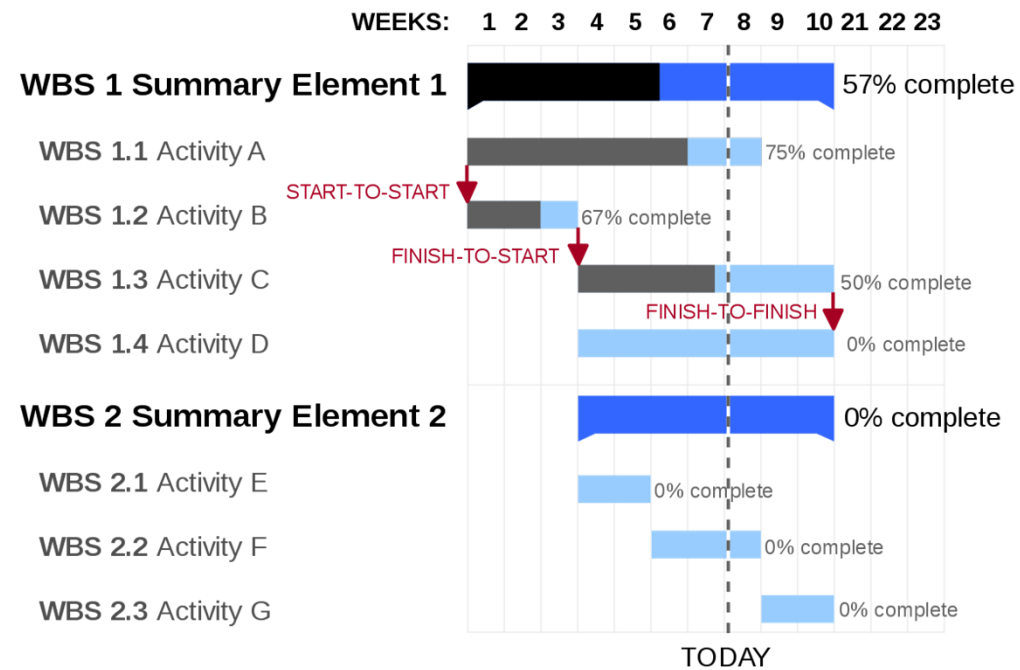
Analytical Procedures

- Benford's Law



Analytical Procedures

- Gantt Chart



Analytical Procedures

- Thresholds



Case Study - WorldCom

MONITORING

<i>Major Control Weaknesses at WorldCom</i>	<i>Corresponding Fraud Exposure</i>
<p>Internal Monitoring Wrongly Directed WorldCom's internal monitoring process was wrongly organized and incapable of informing top management with proper direction and business guidance. Examples:</p> <ul style="list-style-type: none"> • Sales and external growth by acquisitions and the image at Wall Street dominated all. Monitoring of cost containment and budget deviations, especially in material areas, were seriously underrepresented or not in place. • Ebbers persistently complained about someone who was \$500 over budget or spending \$900 for a plane ticket instead of \$600, but ignored \$200 million in capital being spent. 	<p>Fraud risk increases if: Monitoring processes are of poor quality because of:</p> <ul style="list-style-type: none"> • missing risk orientation/materiality • inconsequent follow-up • unorganized, nontransparent reporting
<p>Lack of Risk Orientation in Audit Planning Material and risk-oriented business aspects, such as capital expenditures or "prepaid capacity" with billions in value, should have received a stronger prioritization during internal and external audit planning (for example, higher frequency of audit activities in those fields).</p>	<p>Fraud risk increases if: Internal and external audit planning lacks risk orientation and materiality.</p>
<p>Understaffed Internal Audit Department Cynthia Cooper had only 35 internal auditors for a globally operating telecom group with \$38 billion annual revenue and some 100,000 employees. Based on the telecom industry average of one auditor for every 1,000 employees, WorldCom should have had at least 100 internal auditors.</p>	<p>Fraud risk increases if: The internal audit department is permanently understaffed (missing manpower, qualifications, equipment, and budget).</p>

Review Questions

Review Question #11

Monitoring activities assess whether each of the five components of internal control and relevant principles are present and operating efficiently.

- a) True
- b) False

Review Question #12

Separate evaluations are generally defined, routine operations, built into business processes and performed on a real-time basis.

- a) True
- b) False

Review Question #13

Which of the following are part of the 'Establishing a foundation' element of the monitoring process?

- a) Proper tone at the top
- b) Effective organizational structure
- c) Starting point/baseline
- d) All of the above

Review Question #14

By using data analytics, we can find root issues, identify trends, and provide detailed results to those across the organization.

- a) True
- b) False

Review Question #15

A _____ chart is a beneficial tool that can be used in any agency to track how long certain tasks take over a period of time.

- a) Lebowski
- b) Bueller
- c) Gantt
- d) Dobler

Wrap-Up Questions

Review Question #16

Internal controls is a process effected by people, designed to provide _____ assurance.

- a) Absolute
- b) Partial
- c) Reasonable
- d) Quality

Review Question #17

COSO is the internal control framework.

- a) True
- b) False

Review Question #18

An agency implements a new policy requiring that all management and employees to have purchases over \$500 be approved. This relates to:

- a) Information and Communication
- b) Monitoring Activities
- c) Control Activities
- d) Control Environment

Review Question #19

Policies and Procedures should match.

- a) True
- b) False

Review Question #20

Identifying information requirements is an ongoing process.

- a) True
- b) False

Contact Info

Ethan Draves
edraves@sco.idaho.gov

Roni Harlan
rharlan@sco.idaho.gov

Justin Powell
jpowell@sco.idaho.gov