



IMPLEMENTATION OF AN EFFECTIVE INTERNAL CONTROL FRAMEWORK (ICF)

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Presentation Agenda



- ❖ Introduction
- ❖ Components of an Internal Control Framework
- ❖ Implementing the COSO Internal Control Framework
- ❖ Conclusion



INTRODUCTION

Setting the Stage



“Risk is like fire:
If controlled it will help you;
if uncontrolled it will rise up
and destroy you.”

— Theodore Roosevelt

YOU MAY NOT
CONTROL ALL THE
EVENTS THAT
HAPPEN TO YOU,
BUT YOU CAN
DECIDE NOT TO BE
REDUCED BY THEM.

MAYA ANGELOU

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Why Internal Controls?



Internal controls are processes designed to help safeguard an organization and minimize risk to its objectives. (*auditboard.com*)



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Importance of Internal Controls



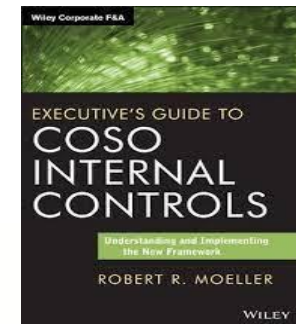
- Internal controls help **safeguard funds**, provide for efficient and effective **management of assets**, and permit **accurate financial accounting**.
- Sound internal controls help ensure that transactions are properly authorized, that supporting IT systems are well-managed, and that the information contained in financial reports is reliable.
- Internal controls are designed to protect an enterprise and its related business units from the loss or misuse of its assets.
- Internal controls cannot eliminate all errors and irregularities, but they can alert management to potential problems.

History of ICFs (1)



Robert R. Moeller in his book *Executives Guide to COSO Internal Controls* gives a history noting the following:

- Internal Control is a basic management concept that covers all aspects of enterprise operations
- In past years, it was one of those nice-sounding expressions where no one really had a consistent definition about what was meant by ***effective internal controls***
- Following a series of accounting scandals in the early 1990s, a group of professional accounting and finance organizations, including the American Institute of Certified Public Accountants (AICPA), formed what has become the Committee of Sponsoring Organizations (COSO) to **develop a consistent framework to define the concept of internal controls**



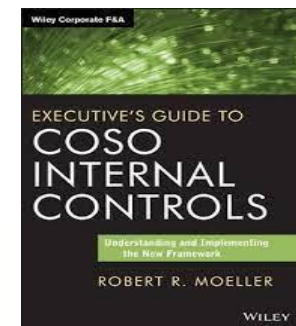
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History of ICFs (2)



- The initial COSO internal control framework was released in 1992
- It is **not a formal standard** or a set of governmental regulations but a framework outlining the characteristics and concepts of an effective system of internal control for enterprises of all types and sizes.
- It was soon adapted as a requirement for external auditors in their assessments of financial statement internal controls, and it became a key measure for assuring Sarbanes-Oxley Act (SOx) compliance.
- A revised COSO internal control framework was released in May 2013 to take into account changes in IT and business systems since 1992, as well as the more collaborative and international nature of business today and growing concerns for improved enterprise governance processes.

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Other Common ICFs



Other frameworks include the following:

- COBIT (Control Objectives for Information and Related Technologies), is a popular IT control framework designed by ISACA for IT governance and management to help businesses develop, organize and implement strategies around information management and governance.
- ISO Frameworks: the most commonly used control frameworks for internal auditors being ISO:9001 for quality auditing and ISO:27001 an IT control framework





COMPONENTS OF AN INTERNAL CONTROL FRAMEWORK (ICF)

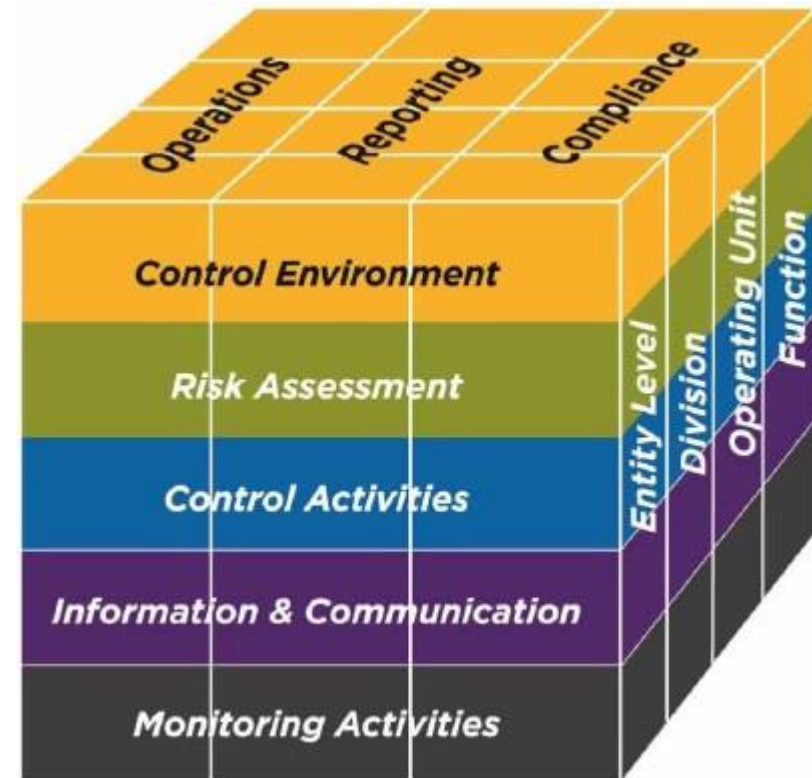
The COSO Framework



COSO is the most commonly used ICF.

The COSO model defines internal control as a process effected by an entity's board of directors, management and other personnel designed to provide reasonable assurance of the achievement of objectives in the following categories:

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



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COSO Cube



The “COSO cube” is a three-dimensional illustration of how the COSO internal control framework may be applied:

- The five components of the ICF;
- Three types of Internal control; and
- The areas of an entity to which COSO might be applied to achieve operational, financial, and compliance objectives



Five Components of the COSO ICF



The following five components work to support the achievement of an entity's mission, strategies and related business objectives in an effective internal control system:

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

There are 17 principles of internal control linked to the 5 components



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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.



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Risk Assessment



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



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Control Activities



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

Information and Communication



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



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Monitoring Activities



16. Conducts ongoing and/or separate evaluations

17. Evaluates and communicates deficiencies



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Three Types of Internal Control



They are linked to three types of risk management “objectives,” which is what a business hopes to achieve.

Operations objectives

Concerning the effectiveness and efficiency of entity operations including operational and financial performance goals and safeguarding assets against loss.

Reporting objectives

Concerning internal and external reporting, financial and non-financial. These controls may encompass reliability, timeliness, transparency, or other concepts set forth by regulators or the organization’s policies.

Compliance objectives

Concerning conformance to relevant laws and regulations.



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COSO Coverage Areas



Four areas of an entity to which COSO might be applied to achieve operational, financial, and compliance objectives:

- Entity Level
- Division
- Operating Unit
- Function



They establish that the COSO framework can be used to gauge the effectiveness of controls for an enterprise as a whole or at the division, operating unit, or function level—and that control activities should take place at all these levels.

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IMPLEMENTING THE COSO INTERNAL CONTROL FRAMEWORK

Implementation

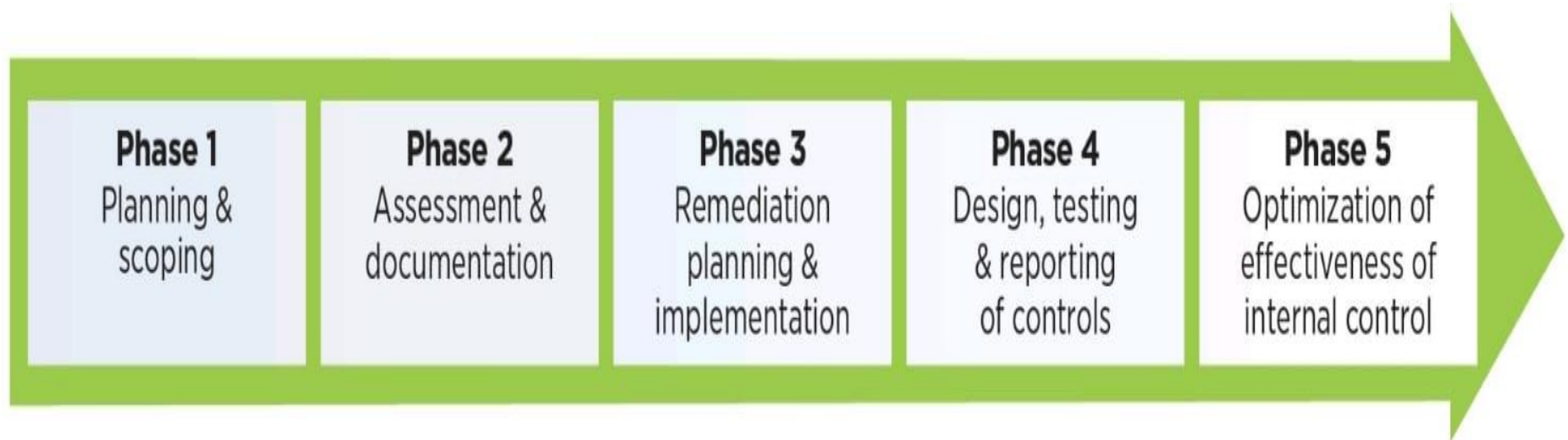


- Implementation of the COSO internal control framework requires assessing its five components and 17 principles against the organization's current internal control system, and making adjustments accordingly.
- The 17 principles of internal control can serve as a handy checklist for enterprises to use to evaluate and strengthen their internal control system
- To successfully apply COSO's internal control framework requires a methodical, step-by-step approach.



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Implementing the COSO Framework in Five Phases



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1. Plan and Scope



- Appoint an implementation team. The team should include people with a thorough knowledge of how work gets done in the organization.
- Develop an implementation plan that includes timing, resources needed, and roles and responsibilities of implementation team members.
- Determine the scope of the framework's implementation: Which activities will it measure, and over what period of time?
- Evaluate the five components of the COSO internal control framework to understand how the enterprise's internal control system is designed, and how well it functions.



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2. Assess and Document



The implementation team:

- Assesses the organization's control structure. Are its systems centralized or decentralized? How are entity-level controls structured? Is there a formal ERM process?
- Assesses fraud risk.
- Documents existing processes and controls.
- Performs gap assessments. This entails comparing the COSO internal control framework's components and principles to practices in the organization.



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3. Remediate



- Make a remediation plan. Prioritize the control deficiencies that pose the most serious vulnerabilities, and move down the list to the least serious. Include milestones and a schedule for completion.
- Implement your remediation plan



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4. Design, Test and Report



- Classify controls as critical or non-critical.
- Design procedures for testing each critical control. Each test should take into consideration the risk to be mitigated and the control description.
- Test controls, reporting to management on progress and obstacles.



5. Optimize Internal Controls' Effectiveness



- How do identified risks and controls mesh with your enterprise's goals, plans, and strategies? Is there need for realignment?
- When developing or redesigning controls, consider various control activities such as physical controls; whether controls are preventive, detective, or corrective; and whether controls are automated, partially automated or manual
- Once controls are in place, monitoring is key to ensuring that they remain effective.
- Should a control fail, study the incident carefully to determine its cause for the most effective remediation.



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REPORTING

Reporting on the Internal Control System (1)



Consider annual reporting to management and the Board on the internal control system. The report may cover the following:

1. Organizational Control

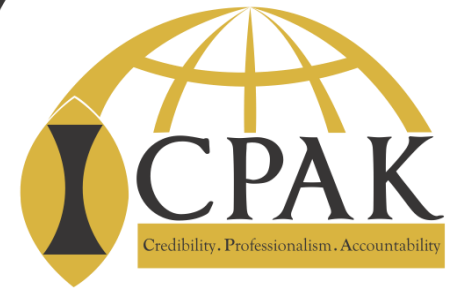
This establishes the framework within which the organization conducts its various activities. These consist of: purpose, authority, responsibility, organizational structure, decision authority, job descriptions and segregation of duties.

2. Operational Controls

This dictates the manner in which the organization performs its various activities and conducts its affairs. These consist of: planning, budgeting, accounting and information systems, documentation, authorization, policies and procedures and orderliness.

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Reporting on the Internal Control System (2)



3. Personnel Controls

These controls help ensure suitability of employees and their performance. These are: recruiting and selection of suitable personnel, orientation, training and development and supervision.

4. Facilities and Equipment

Suitable facilities help build effective and efficient operations while protecting the organization's assets.

5. Risk Management

Implementing a Risk Management Policy Framework is aimed at ensuring the element of surprise is eliminated.

Reporting on the Internal Control System (3)



6. Self-Assurance Process (Monitoring)

Self-assurance process is the mechanism for assessing whether adequate measures for managing risks that interfere with achievement of set objectives have been put in place.

7. Periodic Reviews

Reviews help organizations assess the progress and performance of their employees, operations, and programs. These include: review of individual employee performance, internal review of operations and programs and external reviews.



CONCLUSION

In Summary



- An internal control system is an important driver of business performance, which manages risk and enables the creation and preservation of enterprise value.
- The right kind of internal controls—which enable an enterprise to capitalize on opportunities, while offsetting threats—can actually save time and money and promote the creation and preservation of value.
- Effective internal controls also create a competitive advantage, because an enterprise with effective controls can take on additional risks.

Parting Shot



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Interactive Session



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